

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3045

- The process often requires legislators to choose between proposals that are modestly beneficial to all citizens but can be devastatingly negative to specific interest groups; and,
- Other forms of providing oversight have become more popular.

States differ when it comes to implementing sunset legislation

States differ on the scope of sunset legislation, the standard period for review, the criteria against which entities are evaluated, the types of entities subject to sunset, and the type/extent of legislative participation in the process.²

According to 2002 *The Book of the States*, there are 26 states with active sunset programs. Exhibit 2 summarizes the scope of sunset legislation for the 26 states. In terms of agencies reviewed, eight of the states, including Alaska, Texas, and Colorado, have comprehensive sunset programs. These states periodically conduct sunset reviews on administrative agencies, regulatory agencies, and/or provisions of law. Another nine states, only conduct sunset reviews on regulatory agencies. The other states have more selective/discretionary sunset laws; choosing what programs to review based on factors such as legislative interest, risk, and available resources. An additional 11 states have not enacted sunset legislation in the same sense as these 26 states but have included sunset clauses in selected programs or legislation.

<u>Exhibit 2</u>	
Scope of Sunset Legislation	Number of States with Active Sunset Programs
Comprehensive	8
Regulatory	9
Selective	8
Discretionary	<u>1</u>
Total	26

<u>Exhibit 3</u>	
Standard Period between Sunset Reviews	Number of States with Active Sunset Programs
4 years	4
6 years	3
10 years	8
12 years	1
Varies	2
Not Specified	<u>8</u>
Total	26

The standard period of time between sunset reviews varies between states from a low of four years to a high of 12. Exhibit 3 summarizes the standard extension period for the 26 states with active sunset programs. Alaska shares the shortest standard sunset period of four years with three other states. Eight of the states have periods of ten years and ten states do not have specific periods for the review or the period varies.

Most states have, embodied in their sunset legislation, criteria used to evaluate the merits of an agency or provision of law. Sunset criteria differ in number, focus, and detail but share similar characteristics. Most importantly, criteria are used to determine whether there is a continued public need for the entity being reviewed. Additionally, states typically have criteria for determining whether the agency being reviewed has effectively incorporated

² According to 2002 *The Book of the States Volume 34*, published by the Council of State Governments.

public participation, responded in a timely manner to complaints, efficiently accomplished its objectives, and complied with specific requirements such as affirmative action.

States also differ on the responsibility for sunset reviews. In some states, such as Alaska, the responsibility for conducting sunset reviews rests with a legislative agency. Others have staff within the executive branch perform the reviews. Many states use a self-evaluation report that agency management must complete and submit to the evaluation agency.

Legislative intent of Alaska's sunset law

The sponsoring legislator made the following comments regarding intent of the sunset law:

The legislature finds that the substantial increase in the number of state agencies, boards and commissions, and the proliferation of rules and regulations which each has adopted have contributed to a public disenchantment with the operation of state government.

The sunset law was intended to ensure that government growth in boards, commissions, and other agency programs was necessary and productive. This sentiment was widely supported during the 1977 legislative session. As a result, the legislation received broad-based support. However, there were concerns over the resulting workload for legislative and agency staff.

The sponsor of the sunset bill wanted to include a variety of executive branch departments, agencies, and programs under its provisions. Other legislators were concerned about including such programs because of the unknown workload implications. Ultimately, the sunset bill that passed made other agencies subject to the sunset process (AS 44.66.020) but listed none specifically. Rather, it allowed for a process by which programs could be added. To date, this option has not been used. Alaska's sunset program covers only specific state agencies, boards, and regulatory agencies.

Exhibit 4

Automatic Termination without Sunset

The following are five examples of commissions and programs that contain termination clauses in their enabling legislation but are not subject to the sunset legislative oversight process. Automatic termination, without sunset, occurs when a bill authorizing an entity/program has a section that repeals the enabling statutes as of a certain date. These programs typically go through a lobbying phase to encourage legislation to extend their life.

The difference between the following entities, and those subject to sunset, is the level of legislative review of the extension process. The sunset statutes mandate a hearing be held to take testimony from the public and other parties. Further, sunset statutes require no more than one board or commission can be mentioned in the title of a bill for the reorganization or extension. Conversely, entities with automatic termination can be extended without formal hearings and may be part of other legislation.

Commissions/programs with automatic termination include:

- Navigable Water Commission of Alaska
- Alaska Minerals Commission
- Alaska regional economic assistance program
- Reemployed retirees program
- State training and employment program

Alaska's experience with the sunset process

While the total numbers of entities subject to sunset have not changed dramatically (27 in 1977 compared to 30 in 2004), the organizations that make up the total have significantly changed. During this time period, seven occupational boards were added, seven were terminated, and two were merged into one board. Additionally, 16 nonoccupational boards and regulatory agencies were added, 11 were terminated, and two were merged into one.

Appendix B provides a summary of occupational boards that were subject to sunset as of June 30, 2004, those that were terminated since the law was passed; and, those that were added. Appendix C provides the same information for nonoccupational boards and regulatory agencies subject to sunset.

Since inception of the sunset law, entities have been subject to the sunset process over 150 times. The report conclusion section of this report addresses the extent to which sunset audit recommendations have been implemented.

Common misconceptions about the sunset process

The sunset process is not clearly understood by all public policy participants. Two of the most common "misconceptions" are listed below:

1. When an occupational board terminates, the licensing of the related professions also terminates: This is not true. When an occupational board terminates, licensing of the professions it regulates does not terminate. Statutes still require professions to be regulated but do not specifically address whether the responsibility for regulation transfers to the Department of Commerce, Community, and Economic Development (DCCED) – the state department typically responsible for regulating occupations. This creates uncertainty for licensees and a legal quagmire for DCCED, who is expected to take over regulation but may not have the legal authority to do so.
2. All boards, commissions, and councils are subject to sunset: This, also, is not true. With the exception of occupational licensing boards, there are no unique characteristics that identify an agency for sunset. Nonoccupational boards that are subject to sunset, as well as those not subject to sunset, share similar characteristics. For example, the Council of Domestic Violence and Sexual Assault and the Commission on Aging are subject to sunset, but the Advisory Board on Alcoholism and Drug Abuse and the Homeless Council are not.

Further, there is no unique characteristic that identifies the need for an occupation to be regulated by a board rather than DCCED. Currently, there are 14 occupational licensing programs administered by DCEED without the use of an occupational licensing board. (See Appendix D to this report for the listing)

Regulation of occupations divided between occupational licensing boards and DCCED

Occupations are regulated by either an occupational licensing board or directly by DCCED. Alaska statutes designate 21 occupational licensing boards and 14 occupations that DCCED directly regulates (Appendix B identifies the 21 occupational boards and Appendix D identifies the 14 occupations regulated directly by DCCED). Occupational boards are generally responsible for establishing regulations for its occupations, granting licensure, and taking disciplinary action. DCCED provides administrative support to occupational boards including general administrative assistance (purchasing and scheduling); communicating with licensees (license information, exam information); and, proving inspection, enforcement, and investigative resources.

Role of board members and experts in the occupational licensing investigative process

According to statutes and regulations, an occupational licensing board can be involved in an investigation at three different points in the investigative timeline. The board can:

- issue a summary suspension of a license;
- approve, deny, or modify a Memorandum of Agreement (MOA);³ and,
- act as an adjudicative authority after reviewing a Hearing Officer's decision.

Exhibit 5

Investigative Authority

Sec. 08.01.087. Investigative and enforcement powers of department.

(a) The department may, upon its own motion, conduct investigations to

- (1) determine whether a person has violated a provision of this chapter or a regulation adopted under it, or a provision of AS 43.70, or a provision of this title or regulation adopted under this title dealing with an occupation or board listed in AS 08.01.010 ;

Individual board members are utilized by the investigative staff for technical assistance. However, board members that have reviewed evidence must recuse themselves in the event the full board is called upon to act in any of the three points mentioned previously.

The Department of Law has recommended that board members be prohibited from participating in the investigative process. This segregation is necessary, in order to maintain the boards' statutory role as impartial adjudicators.

When it is determined necessary by the Chief Investigator, the investigative unit will hire an expert. Experts are typically used when technical expertise is needed to help substantiate an alleged violation.

³ MOAs are agreements between the licensee and, either, DCCED (for occupations regulated without an occupational board) or a board. The terms of an MOA are negotiated by staff in the investigative unit and the respondent or the responder's attorney. Occupational licensing boards can modify terms of an agreement and request that the respondent agree to the new terms, or the board can accept the terms by signing the agreement.

Process for investigating occupational licensing complaints

DCCED's Division of Occupational Licensing (OccLic) has an investigative unit whose purpose is to investigate allegations of illegal or incompetent activity by licensees. The unit also investigates allegations of unlicensed occupational activity. The unit is composed of a chief investigator, 12 investigator IIIs, one investigator I, and an administrative clerk.

Each investigator is assigned to a primary occupation and serves as backup for other occupations. When the unit is contacted about a complainant, contact is routed to the assigned investigator. The investigator assigned to the pertinent occupation interacts with the complainant to gain an understanding of the alleged offense and determines whether the violation falls within OccLic's jurisdiction. If the complaint appears to be within OccLic's jurisdiction to investigate, the investigator will request a complaint form be completed and returned.

When complaints are filed with OccLic, they are forwarded to the primary investigator. It is each investigator's responsibility to officially open the case by entering the pertinent information into the investigative case management system.

OccLic does not hold complaints in a backlog until resources become available. Most investigators have more assigned cases than they can actively investigate. Investigators keep an inventory of assigned cases and make their own determination – subject to general priority guidance – as to which of their assigned cases to investigate.

The investigative unit does not use standard procedures when conducting investigations (except for a standard policy of assigning case priority levels). Investigators draw upon their previous investigative experience when conducting and documenting investigations. The extent and format of documentation reflects each investigator's previous training and experience. There is no standard means of informing a subject of an investigation that the investigation is being conducted. Further, there is no standard means of informing complainants of delays in the investigative process.

In addition to investigating complaints, investigators have the responsibility of monitoring compliance with disciplinary actions and/or memorandums of agreement. Typically, memorandums of agreements consist of fines, continuing education classes, and/or drug testing. However, occupational licensing boards and DCCED have imposed other requirements such as periodic psychological examinations.

Exhibit 6

Director Caseload Reduction Directive

During FY 03, OccLic's director instituted a caseload reduction project to reduce the inventory of cases. Investigators were directed to close cases that were over a year old and did not pose a serious threat to public safety. During FY 03 and FY 04, a total of 78 cases were closed under this project.

REPORT CONCLUSIONS

We conducted a review of Alaska's sunset process to assess the impact of Alaska's sunset laws and to make recommendations for improvement taking into consideration national trends and best practices.⁴ We also reviewed the investigative unit within the Department of Commerce, Community, and Economic Development (DCCED), Division of Occupational Licensing.

Operational, regulatory, and statutory improvements associated with over 25 years of sunset experience have been institutionalized by entities subject to sunset. Because of improvements, sunset reviews on a standard four-year cycle are no longer an efficient use of state resources. Detail conclusions regarding the sunset process are discussed in Section I below.

DCCED's investigation unit has increased protection of the general public and members of licensed professions by increasing the number of disciplinary actions taken. However, the unit's case management procedures are in need of significant improvement. Detailed conclusions regarding operations of DCCED's investigative unit are discussed in Section II beginning on page 17.

SECTION I – ANALYSIS OF ALASKA'S SUNSET PROCESS

Alaska's sunset process has been successful at identifying and correcting significant deficiencies. Consequently, sunset laws have evolved from a means of enacting change to the mechanism for monitoring continued operations. Entity operations have matured and warrant less frequent oversight.

The sunset review period should be lengthened to eight years to more efficiently use state resources. Sunset evaluation criteria can be improved by specifically requiring an analysis of effectiveness and efficiency and including a review for duplication of effort. Both recommended changes are consistent with national trends in sunset law.

Sunset laws in other states have changed significantly

Sunset laws in other states have changed significantly since first enacted nationally in the mid-1970s. The focus of sunset reviews during the early years was on eliminating government agencies. Many states were successful at eliminating unneeded agencies;

⁴ The Government Accountability Office defines best practices as "the processes, practices, and systems identified in public and private organizations that performed exceptionally well and are widely recognized as improving an organization's performance and efficiency in specific areas." We used best practices entitled *Carrying Out a State Regulatory Program* published by the National State Auditors Association in 2004 to help evaluate operations of DCCED's investigative unit.

Exhibit 7

Sunrise Laws Gain Popularity as Means of Limiting Growth of Government

Nationally, legislation called "sunrise law" has been adopted by many states. Sunrise is defined as the process by which an occupation or profession wishing to receive registration or licensure must propose the components of the legislation, along with cost and benefit estimates of the legislation. Sunrise attempts to limit the growth of government by requiring certain aspects of regulation be considered as part of the legislative decision-making process. Currently, there are 11 states with active sunrise programs.

Sunrise laws differ from sunset in that sunrise attempts to limit growth of government by preventing an unwarranted government agency or program. Conversely, sunset attempts to terminate unnecessary government agencies or programs. Proponents of sunrise law argue that it is less costly and more effective to increase the scrutiny at an agency's birth rather than try to enact its termination.

As with sunset programs, states have set up their respective sunrise programs differently and have experienced varying levels of success. States differ on what occupations are covered by sunrise law and to what degree interested parties must provide information. Some states have formal sunrise procedures that require questionnaires for applicant groups and a summary review of the questionnaire by an objective agency – both the questionnaire and the review must be considered by the legislature during the decision-making process. Other states have more informal procedures, while others make the process optional. A report on occupational licensing issued by the state of Minnesota's legislative auditor (Report # 99-05b Feb 3, 1997) concluded that state legislatures with formal procedures appear to be better informed during the occupational licensing process.

In this same report, Minnesota's legislative auditor highlighted Florida and Washington as two states with successful sunrise programs. Florida's sunrise statute covers proposals to regulate previously unregulated occupations but does not include increases in the scope of practice of occupations already licensed. Washington's law covers unregulated occupations and scope of practice proposals for health care professions. Additionally, Washington's sunrise law stipulates that when regulation is deemed necessary the legislature should enact the least restrictive form of regulation (for instance registration or certification rather than license).

Both Washington and Florida have been successful at limiting licensure through their sunrise programs. No groups of professionals have been licensed in Florida since the law was passed in 1991. In Washington, only one health care profession has been licensed since the law was passed in 1983.

A well-designed sunrise program can provide complete information for better decision making, thereby limiting unnecessary growth of government. However, the improvement is not without a cost. Similar to the sunset program, administration of the program, review, and deliberation would be a costly process.

however, not to the extent envisioned. The most common outcome of sunset reviews has been administrative and structural changes.⁵

The commitment to improve government through sunset legislation led 36 states to adopt sunset laws between 1976 and 1981, but the use of sunset laws began to fade in the mid-1980s. By 1990, only two additional states had adopted sunset laws, six states had repealed their sunset laws, and another six had suspended their programs. Some discontinued the sunset process due to funding shortages, while other states discontinued their programs because they were ineffective. As of 2002, 26 states continue to have active sunset review programs.

For those states that continue to utilize the sunset process, attention has shifted away from determining whether there is a continued public need for an agency, program, or law. Instead, reviews are becoming more focused on efficiency and effectiveness. Recommendations tend to reflect needed operational and regulatory improvements.

States have found it difficult to terminate agencies or provisions of law under the sunset process. Once established, agencies/programs/laws tend to have a number of people with a strong vested interest in maintaining the status quo. Terminations often result in a marginal benefit to the public but can have significant, negative consequences for a specific group. Political forces make it difficult to objectively terminate. As a result of the difficulty in terminating a program, sunrise laws have gained popularity as a means of limiting the growth of government. Sunrise laws are explained in Exhibit 7 on the opposite page.

The sunset process has contributed to operational improvements

Sunset review recommendations have resulted in significant operational, regulatory, and statutory changes to boards and regulatory agencies covered by the sunset law. The changes have improved and enhanced operations of Alaska's boards and regulatory agencies. We reviewed the degree to which sunset audit recommendations made by our division, during the years 1993 through 2003, were implemented. We limited our review to recommendations that could be implemented by a board/regulatory agency (operational and regulatory types of recommended changes) or by the legislature (statutory changes).

During the 11-year time period (FY 93 to FY 04), Legislative Audit made 176 statutory, operational, or regulatory recommendations in sunset audits, that could be implemented by either a board/regulatory agency or the legislature. Seventy-three percent of recommendations for nonoccupational boards and regulatory agencies were implemented or partially implemented. For occupational boards, eighty-three percent of recommendations were implemented or partially implemented. Exhibit 8 on the next page summarizes the degree of implementation by type of recommendation.

⁵ Information taken from *Sunset, Sunrise, and Agency Audits* published by the Council on Licensure, Enforcement and Regulation (CLEAR) 2004.

In summary, operational procedures, regulations, and statutes have been improved as a direct result of the sunset process. Consequently, the boards and regulatory agencies subject to sunset, are less at risk of operating in a manner contrary to the public's best interest.

Standard sunset extension period of four years is not an efficient use of state resources

Since the 1977 initiation of Alaska's sunset law, government accountability has become a more central part of public policy. Occupational boards submit annual reports which include: licensing statistics, goals and objectives of the next year, investigative unit summaries, progress made on sunset audit recommendations, and recommendations for statutory or regulatory changes. The legislature has instituted an accountability program for state agencies that require reporting measures of accomplishments. These non-sunset mechanisms of oversight provide alternative ways for the legislature to review operations.

Resources devoted to the sunset process are not commensurate with the need for continued legislative oversight. As discussed earlier, improvements have been institutionalized by entities subject to sunset and alternative means of oversight were instituted. Monitoring of operations accomplished through the sunset process would become more efficient, if the standard period of review was lengthened. We recommend increasing the standard period for review to eight years.

This recommendation is supported by national trends. Alaska, along with three other states, has the shortest standard extension period of four years. Three states have a six-year standard and eight have a ten-year standard. The Background Information section of this report identifies the standard sunset review periods for other states with active programs.

Alaska's existing sunset criteria are similar to other states but could be improved

The sunset law includes nine criteria to be considered during the legislative oversight process. These nine criteria are used by Legislative Audit as evaluation criteria for every sunset audit. No changes to sunset criteria statutes have been made since first enacted in 1977. The nine criteria are listed in Appendix A of this report.

Exhibit 8

**Implementation of Audit Recommendations
1993 through 2003**

Nonoccupational Board/Regulatory Agency				
Type of Recommendation	Yes	Partial	No	Total
Statutory	6	1	10	17
Operational	37	5	8	50
Regulatory	1		1	2
Total	44	6	19	69

Occupational Board				
Type of Recommendation	Yes	Partial	No	Total
Statutory	27	3	10	40
Operational	53		8	61
Regulatory	5		1	6
Total	85	3	19	107

We compared Alaska's sunset criteria to five other states with similar comprehensive sunset programs.⁶ Sunset criteria used by Alaska are similar to the criteria used in other states. Our comparison also concluded that several states use criteria that Alaska does not have but may benefit from including in its laws. As discussed in Recommendation No. 1, the legislature should consider amending the sunset statutes to include the following criteria:

- *The extent to which the board, commission, or agency has effectively obtained its objectives and purposes and the efficiency with which it has operated.* This criterion reflects the national trend towards focusing sunset reviews on efficiency and effectiveness. This focus is consistent with efforts by the legislature to make government more accountable.
- *The extent to which the entity duplicates the activities of other government agencies or of the private sector.* This criterion gives legislators a means of evaluating whether government is duplicating government or is providing a service already available through the public sector. This criterion could serve as a basis for recommending sunset of existing agencies in the event that duplication is unjustified.

Schedule for sunset reviews should be restructured to make workload more manageable

The 24th Alaska Legislature will be considering legislation that extends 12 boards and commissions set to terminate under the sunset statutes. Typically, four to seven boards and/or commissions are due to terminate each year. The spike in this number of entities set to terminate is a result of extensions made over the previous years. The resulting 2005 workload will require additional commitment of staff resources and committee time.

Legislative Audit will be considering the impact on legislative resources when making recommendations for extension. It is our intent to recommend extension dates that smooth the workload. Such action will make the impact more manageable for future legislatures (See Appendix E).

SECTION II – ANALYSIS OF DCCED'S INVESTIGATIVE UNIT OPERATIONS

DCCED's investigative unit has difficulty in efficiently addressing its caseload. Case management is hampered by poor supervision of open caseloads, a lack of standards for completing critical aspects of the investigative process, and a prioritization policy that does not ensure cases are consistently addressed in a fair and equitable manner.⁷ Most findings

⁶ As discussed in the Background Information section of this report, there are currently 26 states with active sunset programs. Eight of the 26 are comprehensive in scope, including Alaska. By comparing Alaska's sunset criteria to five other comprehensive sunset programs, our review covered 75 percent of states with similar sunset programs.

⁷ Individuals that file a complaint with the investigative unit most likely assume their complaint will be addressed in the order in which it was received. Investigators manage their own inventory of cases under broad guidance to first address cases concerning public safety. When it comes to cases with the same priority level, investigators are not required to investigate cases on a first-in first-out basis.

noted during our review can be attributed to the need for improving case management procedures.

Inability to reduce the inventory of open investigative cases has been an ongoing problem

A large inventory of open cases has been a continual problem for the investigative unit. The unit had 586 open cases at the end of FY 93, compared to 530 open cases at the end of FY 04. The unit's inventory of open cases dipped to a low of approximately 450 in 1999 but increased to over 600 at the end of each year between FY 01 and FY 03. The large inventory of open cases slows down the unit's ability to address new complaints in a timely fashion.

The investigative unit has been unable to address the case inventory (thereby improving the timeliness of the investigative process) even though their staff has doubled since FY 93.⁸ Staff increased during the 11-year period, yet the inventory of cases did not significantly decrease. Increase in staff positions did lead to an increase in disciplinary actions,⁹ the number of cases opened, and the number of cases closed.

Investigators are limited in their ability to actively work cases. The number of cases an investigator can actively work varies based on the nature of complaints, complexity of the investigations, and priority set on other cases in an investigator's assigned caseload. Most investigators have a much larger caseload than they can investigate. The longer a case is open, the more difficult it is for investigators to find respondents, witnesses, and other forms of evidence. Further, older cases are more likely to be closed due to lack of investigative resources and lack of evidence.

Poor case management noted during review of investigative case files

While the investigative unit does a good job of monitoring compliance with ongoing disciplinary actions, we observed several deficiencies in the processing and management of the investigative unit's caseload. The operational deficiencies involve:

- inconsistent assignment of case priority levels,
- inappropriate delays in entering a case in the investigative computerized tracking system,
- extended periods of investigative inactivity,
- inadequate documentation to justify closure action,
- investigator reassignment, and
- instances of keeping cases open after an investigation is completed.

⁸ In FY 93 there were seven full-time equivalent investigator positions. This number increased to a high of 16 positions in FY 03. In FY 04, the unit had one investigator IV position, 12 investigator III positions, and one investigator I position for a total of 14 investigator positions.

⁹ Disciplinary actions usually involve one or more of the following: license suspension, license revocation, memorandum of agreement, or fines.

Most findings can be attributed to poor case management procedures. Poor case management procedures include inadequate supervision of investigators' inventory of assigned cases and a general lack of standards for critical aspects of the investigative process. Without adequate supervision of investigators' caseloads, periods of inactivity go undetected and older cases go unaddressed. The organizational structure and reporting relationships of the investigative unit contributes to the Chief Investigator's inability to adequately supervise his staff's open caseload. This is discussed in further detail below.

Critical aspects of the investigative process include complaint intake and assignment, investigation and documentation, drafting of closure documents, and enforcement. The investigative unit lacks standards for most of these areas. Investigators claim that prescribed standards would not be effective, because each investigation is unique. We acknowledge the unique circumstances involved in each investigation, however, general standards could be effective in ensuring investigations conform to predetermined expectations with regards to documentation and timeliness. For example, we noted in several instances, a delay between the conclusion of an investigation and the drafting of closure documents. Standard timelines would be helpful to clarify management's expectation regarding a reasonable timeframe for completing and submitting closure documents.

Organization of the investigative unit impedes productivity and restricts improvements

The investigative unit's organization and workload assignment procedures make it difficult to address the operational deficiencies through policy and procedure changes. The unit's organizational structure would limit the impact of improved procedures.

The Chief Investigator has the difficult task of supervising 14 positions (13 investigators and one clerical staff) and fulfilling the position's other time-intensive responsibilities. The unit has no midlevel supervisors.

Under this organizational structure, the Chief Investigator prioritizes his workday, working on the tasks that must get done such as; drafting accusations, editing closure documents, assisting with negotiations, working with the Department of Law, and interacting with the press, board members, and the general public. Less time-sensitive supervisory duties such as monitoring the status of investigators' open cases, evaluating the quality of investigative work (including level of documentation), and providing training receive little of the Chief Investigator's attention.

In summary, organization of the investigative unit impedes the ability to make procedural improvements. Recommendation No. 2, in the Findings and Recommendation section, addresses the need to make organizational changes as the first step to implementing improvements.

Investigative staff positions do not reflect complexity of investigative tasks

Almost all of the investigator positions (12 out of 14) are Investigator IIIs, yet the complexity of investigative tasks range from simple to complex. Consequently, the investigative unit has upper-level investigative positions doing tasks that would be more efficiently performed by a lower-level position or a paralegal. Productivity would be efficiently maximized in an organizational structure where duties being performed were commensurate with the experience and education of the position performing the task. This is further discussed as a basis for restructuring the investigative unit in Recommendation No. 2.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The legislature should consider amending sunset statutes.

From our review of Alaska's more than 25 years of experience with the sunset review process, we have developed three overarching recommendations for improving the sunset statutes. The legislature should consider amending the sunset statutes to:

1. Lengthen the standard sunset extension period from four to eight years: The need for legislative oversight no longer warrants sunset reviews on a standard four-year cycle. Most boards and regulatory agencies have been through the sunset process several times and have implemented many of the recommended improvements. As a result, the risk that boards/regulatory agencies are acting in a manner inconsistent with the public's best interest has decreased substantially.

Alaska Statute 08.03.020 provides procedures governing termination, transition, and continuation of occupational boards. Subsection (c) states:

A board scheduled for termination under this chapter may be continued or reestablished by the legislature for a period not to exceed four years unless the board is continued or reestablished for a longer period under AS 08.03.010.

This statute does not preclude a longer extension period. However, because of this statute, it has been standard practice for the legislature to authorize an extension period of four years.

Alaska Statute 44.66.010 sets the maximum extension period for nonoccupational boards and regulatory agencies. Subsection (c) states:

A Commission scheduled for termination under this chapter may be continued or reestablished by the legislature for a period not to exceed four years.

We recommend amending AS 08.03.020(c) and AS 44.66.010(c), making the standard period for reestablishment no longer than eight years, while giving the legislature discretion to make extensions for a shorter/longer period. An eight-year period reflects our central findings that boards/regulatory agencies warrant less-frequent legislative oversight. Lengthening the standard extension period to eight years will free up legislative committee time for consideration of other priorities and make the sunset process less time consuming for board/regulatory agencies and legislative staff.

2. Expand sunset evaluation criteria: Sunset evaluation criteria in state law do not explicitly include an overall assessment of: (1) efficiency and/or effectiveness of an agency; or, (2) duplication of effort with other state entities or the private sector. Efficiency is mentioned in Alaska statutes only in terms of the boards' ability to process complaints. Past actions by the legislature indicate that this is an important area for evaluation.

Additionally, the degree to which an agency's activities are duplicated by other state agencies, or the private sector, is a valid basis for recommending termination. State law at AS 44.66.050(d) indicates that duplication should be considered but sunset evaluation criteria do not specifically address this performance area.

Adding these criteria will make the sunset process more effective and enhance legislative oversight. States with similar sunset programs have sunset criteria that addressed these areas.

We recommend the legislature consider amending the sunset criteria statutes, AS 44.66.050(c), by adding the following criteria:

- The extent to which the board, commission, or agency has effectively obtained its objectives and purposes and the efficiency with which it has operated.
- The extent to which an entity duplicates the activities of other government agencies or of the private sector.

While efficiency and effectiveness are often part of sunset reviews, inclusion in statutory evaluation criteria would make sure these factors were consistently considered during the sunset process. Likewise, addressing the possibility of duplication of services would assist the legislature in making government more efficient overall.

3. Clarify responsibility for regulation, in the event an occupational licensing board terminates. Statutes do not specifically define how the regulating responsibility for professions will shift to another state agency, in the event an occupational licensing board terminates under the sunset provisions. Traditionally, the Department of Commerce, Community and Economic Development (DCCED) has assumed the responsibility for administering the regulated occupation after a board has terminated. However, the statutes do not clearly give DCCED the authority to do so.

We recommend the legislature consider amending central licensing statutes to address this uncertainty.

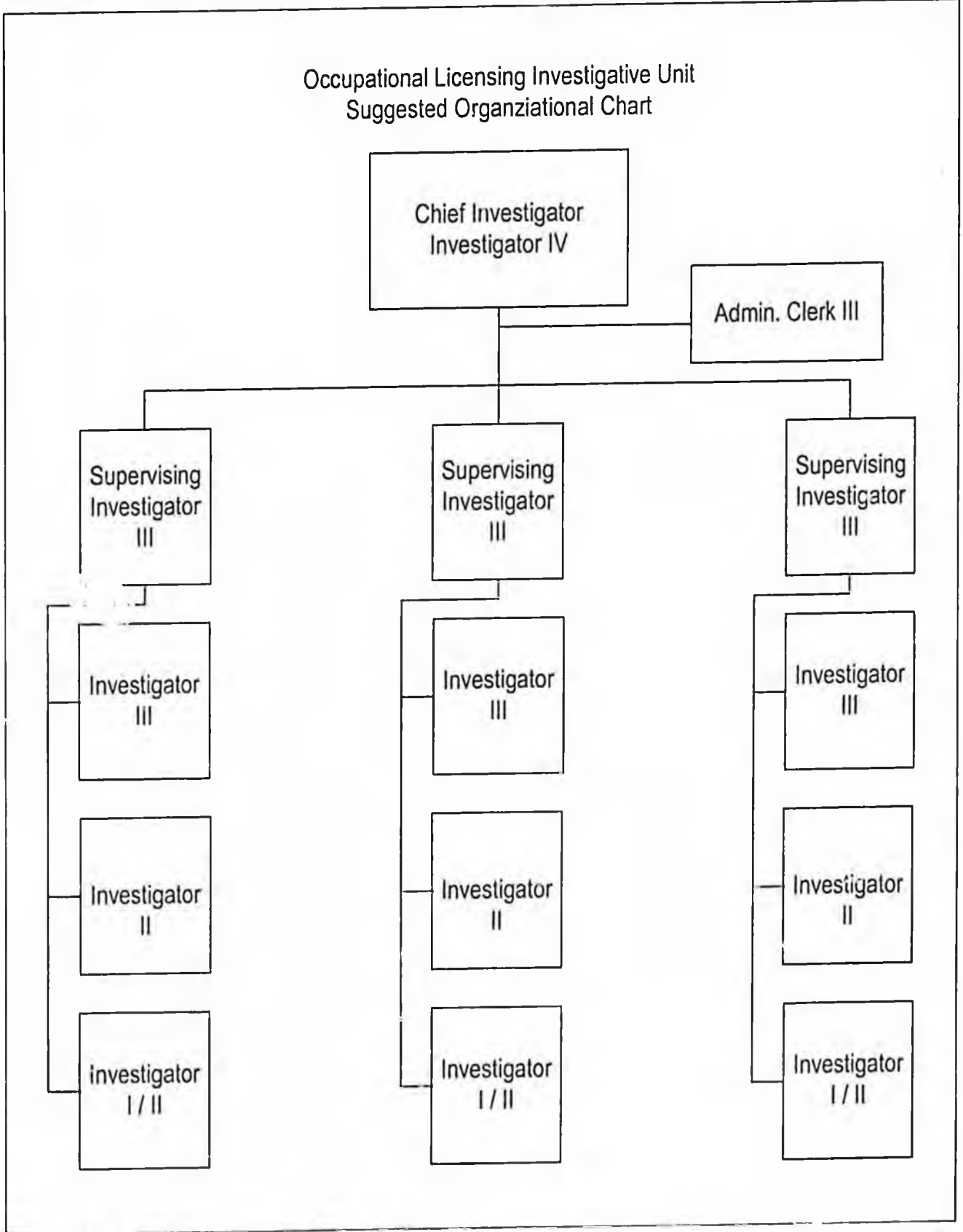
Recommendation No. 2

The director of the Division of Occupational Licensing (OccLic) should implement changes to address investigative inefficiencies and case management procedures.

Investigative inefficiencies and poor case management procedures have hampered the performance of the investigative unit, thereby reflecting poorly on occupational boards', and DCCED's, effectiveness at regulating their respective professions. Review of 59 investigative cases identified the following:

- The priority code for 12 of 59 cases (20% of tested cases) was not assigned in a manner consistent with the unit's policy and procedure.
- In 11 of 59 cases (19% of tested cases), the investigator started working the case at least 14 days before it was opened in the case management system. Delays range from 15 to 679 days.
- There were 37 periods of inactivity exceeding 90 days in 24 cases (41% of tested cases). This excludes the periods of inactivity that were outside the control of an investigator (waiting for documents, cases at the Attorney General's office, and cases awaiting hearing).
- In the six cases using an expert witness (10 % of tested cases), three cases were delayed over 100 days awaiting receipt of the expert's opinion.
- In the nine cases that involved the Attorney General's office (15% of tested cases), five cases experienced delays of over 239 days awaiting action by the Department of Law. Two of the five cases were delayed over 360 days.
- There were four of 40 closed cases that lacked adequate documentation in the investigative file to justify the closure action.
- There was one delay of 179 days between the respondent requesting a hearing and the investigative unit notifying the hearing officer.
- There were 14 instances in nine cases (15% of tested cases) that had the investigator reassigned. One of the cases was reassigned four times during the course of the investigation.
- Five of the 59 cases (8% of tested cases) were left open even though the investigation had concluded. Investigators stated that cases remained open as a means of monitoring.
- One case selected for testing could not be located by OccLic's investigative unit.

Exhibit 9



The duty to investigate occupational licensing complaints is statutorily assigned to DCCED. The efficiency to which complaints are investigated is one of the evaluation criteria used in the sunset legislative oversight process. AS 44.66.050(c) requires the determination as to whether a board or commission has demonstrated a public need for its continued existence by taking into consideration a number of factors, including the following, as specified in AS 44.66.050(c)(6):

the efficiency with which public inquiries or complaints regarding the activities of the board, commission, or agency filed with it, with the department to which a board or commission is administratively assigned, or with the office of victims' rights or the office of the ombudsman have been processed and resolved;

The ineffective, organizational structure of the investigative unit and poor case management procedures contributed to the findings noted above. Recommendations addressing the findings are twofold: (1) restructure the investigative unit's staff positions and reporting relationships; and, (2) based on the restructured organization, implement a number of procedural improvements.

1. Restructure the organization of the investigative unit

We recommend OccLic's director take action to reorganize the investigative unit. The Chief of Investigations cannot, both, effectively supervise 14 staff positions and carry out his other required duties. Without correcting this problem, the impact of any changes to policies and procedures will be limited.

OccLic's director should consider the addition of midlevel supervisors and the reclassification of several Investigator III positions to create a more hierarchical organizational structure. The organizational chart in Exhibit 9, on the opposite page, demonstrates how the investigative unit could be reorganized.

Such reorganization will alleviate much of the Chief Investigator's routine, daily supervisory responsibilities. It will allow for the successful implementation of procedural improvements such as detailed assessment and assignment of cases that maximizes the use of staff resources. These improvements are necessary to address the findings noted during our review of investigative case files.

Further, a hierarchical organizational structure is more capable of effectively dealing with turnover of investigator positions. Midlevel supervisors will be in a position to facilitate training and mentoring of new staff positions. Large scale turnover is imminent since many of the current investigators are at or nearing retirement age. The new structure should help mitigate the cost and disruption caused by staff turnover.

2. Change case assessment and assignment procedures

Once an improved hierarchical organizational structure is in place, the unit would benefit from a case assessment process whereby cases are assigned to investigative positions, based on expected complexity of the case and availability of investigative resources. Under this type of system, less-complex cases would be assigned to less-experienced entry-level investigators and more-complex cases would be assigned to more-experienced upper-level investigators. The assessment and assignment process would also consider the assignment of higher priority cases (those that could pose a public harm) to investigators with resources available to immediately address the case.

Most cases (70% of those opened during the past five fiscal years) are considered lower-level priority cases – priority three or four. Currently, lower-level cases are more prone to extended periods of inactivity and generally take longer to get through the investigative process. Assessing and assigning cases based on complexity and priority would help ensure that all cases move through the investigative process in a more timely fashion.

Assigning cases based on complexity does a much better job of matching the skills and experience of investigators to the tasks they are asked to perform. Less-complex tasks are performed by less-costly investigative positions, which is a more efficient use of state resources. Further, because cases are assigned based on available resources, the investigative process should endure fewer periods of inactivity, making the overall process more efficient and effective.

3. Implement improvements to case management procedures

Reorganization of the investigative staff positions, and implementation of a new case assessment and assignment process, are essential to the successful implementation of procedural improvements. We also recommend the following improvements to address investigative findings:

- a) ***Improve the monitoring of open investigations:*** Midlevel supervisors should conduct routine evaluations of investigator caseloads including the development of action plans to address effective closure of older cases.
- b) ***Timelines for completion should be made a part of contracts for expert services:*** To address the problem of untimely submission of expert analyses, mutually agreed upon timelines for completing the project should be made a part of contracts with experts.
- c) ***Develop and enforce standards for case file documentation:*** Standards are needed to ensure that case files provide comprehensive support for investigative outcomes.

Documentation should include all contacts made related to the investigation. Ensuring cases are well documented will help alleviate the inefficiencies associated with reassigning cases. Further, improved documentation will facilitate case file review.

- d) ***Develop and enforce expected timelines for completing aspects of the investigation:*** Timelines are necessary to clarify management expectations for opening cases, investigating cases, drafting closure documents, and if necessary, presenting closing documents for board consideration. Further, using standards for completion as a performance measure will help gauge productivity.

4. Implement other changes to increase efficiency and effectiveness

Other improvements should also be implemented to improve the investigative function including the following:

- a) ***Improve website to better filter complaints:*** Industry best practices¹⁰ recommend websites that encourage valid complaints and discourage invalid complaints. DCCED's current Occupational Licensing website does not provide enough information about the division's jurisdiction by occupation to effectively filter out nonjurisdictional complaints. Investigators often spend time communicating information to potential complainants that could, more economically, be communicated through the agency's website. We also recommend providing a detailed description of the investigative process and answers to frequently asked questions via the website to further reduce the need for investigators to communicate this information, thereby freeing up more time to focus on investigating open cases.
- b) ***Extend work schedule:*** Industry best practices allow for investigators to meet with people outside the standard business day. Prior to FY 04, several investigators worked four days a week coming in early and/or staying late. According to investigators, this schedule provided them with time before and/or after the standard work day for scheduling interviews. We recommend, reestablishing some form of a flexible schedule to provide for interaction with the public before/after the standard business day.
- c) ***Establish preset schedules for inspections:*** Industry best practices also identify a predetermined schedule for conducting inspections. Currently, the timing and frequency of inspections are left up to investigators. The investigative unit would benefit from a management approved schedule for conducting inspections that reflects a strategic use of available resources.

¹⁰ We compared industry best practices for carrying out a state regulatory program published by the National State Auditors Association in 2004 to DCCED's investigative unit operations.

We recognize the organizational changes suggested may be difficult to accomplish within the context of Alaska's personnel system and collective bargaining structure. As stated however, such a restructuring is central to the effectiveness of other recommended changes.

Recommendation No. 3

The director of the Division of Occupational Licensing should consider drafting a policy to guide investigators' use of board members during the investigative process.

Our review of case files found that consultation with board members was poorly documented and the degree they are involved in the investigative process was unclear. While most investigators seek out board member guidance in a significant number of cases, the unit does not have clear guidance on how to utilize board members in a manner that is consistent with legal guidance.

Most investigators routinely consult members of various occupational licensing boards for technical assistance including advice on case closures. Further, for all professions regulated by the State Medical Board, it is standard practice for case closures to be reviewed by a designated board member. We question whether the use of board members, in this type of advisory capacity, is consistent with legal guidance.

Statutes assign the responsibility for investigating occupational licensing complaints to DCCED. Most occupational licensing boards are subject to the state's Administrative Procedures Act (APA). Under APA, licensing boards are the ultimate arbitrator of administrative hearings, held in conjunction with sanctions against licensees, and are required to be impartial in that capacity. As such, the Department of Law has directed that board members not become involved with the investigative process – lest it compromise the impartiality of their adjudicative function.

Using board members to direct investigative activities of a case is an inadequate separation of duties. The risk of improperly using board members is heightened by the lack of an approved policy guiding the investigators. We recommend a standard policy and procedure be drafted and approved by the Attorney General's office to ensure the boards do not jeopardize their position in occupational licensing legal proceedings.

APPENDICES

(Intentionally left blank)

APPENDIX A

Alaska's Sunset Criteria

Alaska's criteria for reviewing boards and commissions, subject to sunset, are defined by AS 44.66.050(c) as noted below:

- (1) the extent to which the board, commission, or program has operated in the public interest;
- (2) the extent to which the operation of the board, commission, or agency program has been impeded or enhanced by existing statutes, procedures, and practices that it has adopted, and any other matter, including budgetary, resource, and personnel matters;
- (3) the extent to which the board, commission, or agency has recommended statutory changes that are generally of benefit to the public interest;
- (4) the extent to which the board, commission, or agency has encouraged interested persons to report to it concerning the effect of its regulations and decisions on the effectiveness of service, economy of service, and availability of service that it has provided;
- (5) the extent to which the board, commission, or agency has encouraged public participation in the making of its regulations and decisions;
- (6) the efficiency with which public inquiries or complaints regarding the activities of the board, commission, or agency filed with it, with the department to which a board or commission is administratively assigned, or with the office of victims' rights or the office of the ombudsman have been processed and resolved;
- (7) the extent to which a board or commission that regulates entry into an occupation or profession has presented qualified applicants to serve the public;
- (8) the extent to which state personnel practices, including affirmative action requirements, have been complied with by the board, commission, or agency to its own activities and the area of activity or interest; and
- (9) the extent to which statutory, regulatory, budgeting, or other changes are necessary to enable the agency, board, or commission to better serve the interests of the public and to comply with the factors enumerated in this subsection.

APPENDIX B

Changes in Occupational Boards Subject to Sunset per AS 08.03.010

Terminated Boards	July 1, 1980 through June 30, 2004
Big Game Commercial Services Collection Agency Electrical Examiners Guide Licensing and Control Mechanical Examiners Nursing Home Administrators Welding Examiners	

Added Boards	July 1, 1977 through June 30, 2004
* Big Game Commercial Services Certified Direct-Entry Midwives Certified Real Estate Appraisers Marital and Family Therapy * Mechanical Examiners Professional Counselors Social Work Examiners	

Occupational Boards Subject to Sunset	As of June 30, 2004
Barbers and Hairdressers	Pharmacy
Certified Direct-Entry Midwives	Physical Therapy and Occupational Therapy
Certified Real Estate Appraisers	Professional Counselors
Chiropractic Examiners	Psychologists and Psychological Associate Examiners
Dental Examiners	Public Accountancy
Dispensing Opticians	Real Estate Commission
Governors of the Alaska Bar Association	Registration for Architects, Engineers, and Land Surveyors
Marine Pilots	Social Work Examiners
Marital and Family Therapy	Veterinary Examiners
Medical	
Nursing	
Optometry, Examiners in	

* Board has also been terminated.

APPENDIX C

**Changes in Nonoccupational Boards and Regulatory Agencies
Subject to Sunset per AS 44.66.010**

Terminated, Merged, or Renamed	July 1, 1980 through June 30, 2004
<p><u>Terminated:</u> Alaska Code Revision Commission Alaska Council on Science and Technology Alaska Renewable Resources Corporation Alaska State Fire Commission Alaska Tourism Marketing Council Alaska Transportation Commission Alaska Women's Commission Citizen's Foster Care Review Board Hazardous Substance Spill Technology Review Rural Development Council Tourism Coordinating Committee</p>	<p><u>Merged:</u> Alaska Public Utilities Commission <i>merged with the Alaska Pipeline Commission and renamed</i> Regulatory Commission of Alaska</p> <p><u>Renamed:</u> Older Alaskan Commission <i>renamed to</i> Alaska Commission on the Aging</p> <p>Citizens Review Panel for Permanency Planning <i>renamed to</i> Citizen's Foster Care Review Board</p>

Added	July 1, 1977 through June 30, 2004
<p>* Alaska Code Revision Commission * Alaska Council on Science and Technology * Alaska Renewable Resources Corporation Alaska Seismic Hazards Safety Commission * Alaska State Fire Commission * Alaska Tourism Marketing Council * Alaska Women's Commission Board of Storage Tank Assistance Citizen's Review Panel for Permanency Planning</p>	<p>Council on Domestic Violence and Sexual Assault * Hazardous Substance Spill Technology Review Older Alaskans Commission * Rural Development Council Special Education Service Agency Statewide Suicide Prevention Council * Tourism Coordinating Committee</p>

Nonoccupational Boards and Regulatory Agencies Subject to Sunset – As of June 30, 2004	
<p>Alaska Commission on Aging Alaska Seismic Hazards Safety Commission Alcoholic Beverage Control Board Board of Storage Tank Assistance Council on Domestic Violence and Sexual Assault</p>	<p>Regulatory Commission of Alaska Special Education Service Agency State Board of Parole Statewide Suicide Prevention Council</p>

* Agency has also been terminated.

APPENDIX D

DCCED-Regulated Occupations without a Board

<u>Name of Occupation</u>	<u>Statutory Reference</u>
Regulation of acupuncturists	AS 08.06
Regulation of audiologist and speech-language pathologists	AS 08.11
Regulation of big game guides and transporters	AS 08.54
Regulation of collection agencies	AS 08.24
Regulation of concert promoters	AS 08.92
Regulation of construction contractors	AS 08.18
Regulation of dietitians and nutritionists	AS 08.38
Regulation of electrical and mechanical administrators	AS 08.40
Regulation of agencies that perform euthanasia services (animals)	AS 08.02.050
Regulation of professional geologists	AS 08.02.011
Regulation of hearing aid dealers	AS 08.55
Regulation of morticians	AS 08.42
Regulation of the practice of naturopathy	AS 08.45
Regulation of nursing home administrators	AS 08.70

APPENDIX E

Schedule of Actual and Proposed Termination Dates

June 30, 2006

Board of Governors of the Alaska Bar Association
Board of Chiropractic Examiners
Board of Examiners in Optometry
State Physical Therapy and Occupational Therapy Board
Council on Domestic Violence and Sexual Assault

June 30, 2007

Board of Certified Direct-Entry Midwives
Board of Marine Pilots
State Medical Board
Alcoholic Beverage Control Board
Regulatory Commission of Alaska
Board of Storage Tank Assistance

June 30, 2008

Board of Parole
Real Estate Commission
Alaska Commission on Aging

June 30, 2009

Board of Public Accountancy *
State Board of Registration for Architects, Engineers, and Land Surveyors *
Board of Veterinary Examiners *
Statewide Suicide Prevention Council *

June 30, 2010

Board of Pharmacy *
Board of Social Work Examiners *
Board of Marital and Family Therapy *
Board of Professional Counselors *
Board of Psychologist and Psychological Associate Examiners *
Board of Certified Real Estate Appraisers *

June 30, 2011

Board of Nursing
Board of Dental Examiners *
Board of Barbers and Hairdressers *

June 30, 2013

Special Education Service Agency

Recommended for Termination

Board of Dispensing Opticians
Alaska Seismic Hazards Safety Commission

- * These are proposed sunset dates.

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OFFICE OF THE COMMISSIONER

Frank H. Murkowski, Governor

December 30, 2004

Pat Davidson
Legislative Auditor
Legislative Budget and Audit Committee
Division of Legislative Audit
P.O. Box 113300
Juneau, AK 99811

RECEIVED
DEC 30 2004
LEGISLATIVE AUDIT

RE: Sunset Process and Selected Investigative Issues

Dear Ms. Davidson:

Thank you for the opportunity to review and comment on the findings in your recent audit of the Sunset Process and the Investigative Unit for the Division of Occupational Licensing. Both of these audits were overdue and we greatly appreciate your initiative and thoughtful efforts. Our comments are as follows:

Recommendation No. 1

The legislature should consider amending sunset statutes.

The Department sees merit in many of your suggestions for statute changes and will work with you during the next legislative session to gain the desired results.

Recommendation No. 2

The Director of the Division of Occupational Licensing should implement changes to address investigative inefficiencies and case management procedures.

The Department basically agrees with your specific recommendations as follows:

1. Restructure the organization of the investigative unit
2. Change case assessment and assignment procedures
3. Implement improvements to case management procedures
4. Implement other changes to increase efficiency and effectiveness

We agree that various actions are necessary if we are to achieve our ultimate goal of a timely, efficient and fair investigative process. However, any changes will not come easily or quickly.

Through the director of the division, changes have been implemented over the past two years specific to structure and management with the investigations unit. The director will evaluate the success of these changes and make additional changes and modifications as necessary to continue to evolve the effectiveness of the investigation unit. These changes may include reinstating the investigators' flexible schedule under close management supervision to assure accurate and timely work accomplishments.

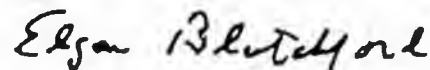
Recommendation No. 3

The director of the Division of Occupational Licensing should consider drafting a policy to guide investigators' use of board members during the investigative process.

The Department agrees there should be a policy regarding board members involvement in the investigative process, but we are unsure of what that policy should be. Several boards have asked about being exempt from the Administrative Procedures Act (APA) so that they could be more involved in the investigations. These board members are willing to give up their duties as adjudicators to better use their expertise in resolving complaints against others in their professions. They feel that their involvement would help eliminate unnecessary investigations, shorten the time required for closure and decrease the costs associated with investigations. While the APA has removed board members from the investigative process because of the potential problems with impartiality, it is a rather small percentage of the cases where board members actually become the adjudicators. This may be more of a "turf" battle than a legal issue. The division will make additional efforts in an attempt to resolve these conflicting issues and develop sound policy concerning board member involvement in investigative actions.

Again we appreciate the opportunity to comment and we especially appreciate your assistance in improving our services to the public.

Sincerely,



Edgar Blatchford
Commissioner

cc: Rick Urion, Director
Division of Occupational Licensing

SB

1888

HFIN

FILE

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: CSSB 188(FIN)
(S) Publish Date: 4/20/06

Revision Date/Time (Note if correction): _____ Dept. Affected: Commerce
Title Bulk Fuel Revolving RDU Alaska Energy Authority (453)
Loan Fund Cap Component AEA Rural Energy Operations
Sponsor Olson
Requester Senate Finance Component No. 2600

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

FUND SOURCE	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill increases the maximum amount for a single borrower to \$400,000, and allows a cooperative corporation or electric cooperative to borrow the lesser of \$400,000 multiplied by the number of communities, or \$1,500,000.

This bill has no impact on the cost of AEA operations.

Prepared by: Sara Fisher-Boad, Financial Analyst Phone: 907 269 4629
Division: Alaska Energy Authority Date/Time: 2/6/06 2:00 PM
Approved by: William C. Noll, Commissioner Date: 2/6 2006
Agency: Commerce, Community, and Economic Development

Alaska State Legislature



Out of Session:
PO Box 531
Golovin, Alaska 99762
(907) 443-5599

In Session:
State Capitol, Suite 510
Juneau, Alaska 99801-1182
(800) 597-3707
(907) 465-3707
(907) 465-4821 Fax

SENATOR DONALD C. OLSON

DISTRICT T

SPONSOR STATEMENT

Alakanuk
Ambler
Anaktuvuk Pass
Atkasuk
Barrow
Brevig Mission
Browerville
Buckland
Chevak
Deering
Diomedes
Elim
Emmonak
Gambell
Golovin
Hooper Bay
Kaktovik
Kiana
Kivalina
Kobuk
Kotlik
Kotzebue
Koyuk
Mountain Village
Noatak
Nome
Noorvik
Nuqsut
Nunam Iqua
Pilot Station
Pitka's Point
Point Hope
Point Lay
 Savoonga
Scanlon Bay
Selawik
Shaktulik
Shishmaref
Shungnak
St. Mary's
St. Michael
Stebbins
Teller
Unalakleet
Wainwright
Wales
White Mountain

SB 188, Bulk Fuel Loan Fund Cap

I introduced SB 188 at the urging of members of the Governor's Rural Energy Action Council. The council's April 15 report has many recommendations to help rural communities contend with rapidly escalating energy costs.

SB 188 is one of their recommendations for the bulk fuel loan program, a program that allows communities to minimize fuel costs through large purchase economies. This is an important program for those communities that are ice bound during the winter and depend on just one or two large shipments to supply their fuel needs for the entire year.

Currently, the bulk fuel loan program has a maximum loan of \$300,000 that any one borrower may take in a fiscal year. The effect of this cap during times of dramatically increasing fuel costs is to reduce the maximum amount of fuel that may be purchased. The proposed finance committee CS will counteract this effect by increasing the loan limit to \$400,000 for a single borrower. For cooperative organizations that are purchasing bulk fuel for more than one community, the loan limit is further increased to \$400,000 multiplied by the number of communities or \$1,500,000, whichever is lesser. This latter measure is to encourage larger purchases for multiple communities in order to attain additional economies of scale for the benefit of all energy consumers.

The senate finance committee substitute for SB 188 retains the most essential recommendations of the Alaska Energy Authority and is endorsed by the administration. Its enactment will directly assist in lowering energy costs to small communities in Alaska. The bill is timely and needed.

THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

AIDEA/AEA

Alaska Energy Authority

January 26, 2006

The Honorable Donny Olson
Alaska State Senate
State Capitol, MS 3100
Juneau, Alaska 99801-1182

RE: CS SB 188 (CRA) Loans from the Bulk Fuel Revolving Loan Fund

Dear Senator Olson:

We respectfully request your support of the attached amendment to CS SB 188(CRA).

The Bulk Fuel Revolving Loan Fund (BFRLF) was created to provide short-term financing for bulk fuel purchases in communities with populations less than 2,000. On February 7, 2005, Governor Murkowski commissioned the Rural Energy Action Council (REAC) to provide him with recommendations to address the high cost of energy in Rural Alaska. REAC's report was published on April 15, 2005 and included proposal changes to the BFRLF program. Your prompt and early response to the Governor Murkowski's REAC recommendations by introducing SB 188 was greatly appreciated.

During the interim between legislative sessions, Governor Murkowski requested the Alaska Energy Authority (AEA) review the statutes regarding the BFRLF program. Our review considered current existing statutes, changes proposed by SB 188, and the changes recommended by REAC.

With the support of Governor Murkowski and based on the REAC recommendations, AEA proposes changes to the program to increase the loan limit and to assist entities responsible for maintaining community infrastructure.

The amendment proposes the following changes to the Bulk Fuel Revolving Loan Fund Program:

- Raises the loan limit to \$400,000 from \$300,000 for a single borrower. [CSSB 188(CRA) does not change the loan limit; REAC recommended a loan limit increase to \$650,000]
- Allows a cooperative corporation or electric cooperative servicing more than one community to borrow the lesser of \$400,000 multiplied by the number of communities, or \$1,500,000. [CSSB 188(CRA) limited cooperatives to \$300,000 multiplied by number of communities or \$1,000,000 maximum; both versions are the result of a REAC recommendation]
- Expands the definition of eligible borrower to a person maintaining community facilities or infrastructure. AEA has been approached by a subsidiary of Yukon Kuskokwim Health

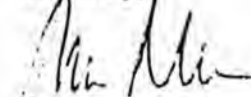
The Honorable Donny Olson
January 26, 2006
Page 2

Corporation that is operating community water and sewer systems. This change will assist entities that operate village infrastructure. [Not addressed in CSSB 188 (CRA)]

- Allows AEA to adopt regulations to establish standards for the allocation of loan funds to eligible borrowers. [Not addressed in CSSB 188 (CRA)]
- Clarifies that fees and collection charges be deposited in the BFRLF not the general fund. The Department of Law has recommended this change to correct an ambiguous subsection in the statutes. No impact on the general fund since the GF is not currently receiving any monies generated from this program. [Not addressed in CSSB 188 (CRA)]

We are ready to meet with you and your staff to provide any other information you may require. Thank you for considering our request.

Sincerely,



Ron Miller
Executive Director

Findings and *Action* Recommendations for Governor Frank Murkowski

April 15, 2005

Prepared for:

Rural Energy Action Council (REAC)
Created by Governor Frank H. Murkowski
February 7, 2005

Prepared by:

AIDEA / Alaska Energy Authority
813 W. Northern Lights Boulevard
Anchorage, Alaska 99503
(907) 269-3000
(907) 269-3044 FAX
Toll free in Alaska (888) 300-8534

For an online version of this publication, go to
www.aidea.org/RuralEnergyActionCouncil.htm

At O'Leary : 2 PM Gov Conference Room

Issue: High Cost of Bulk Fuel in Rural Alaska

Recommendation #6: Under Alaska Energy Authority's (AEA) Bulk Fuel Revolving Loan Fund (AS 42.45.250), allow the maximum amount borrowed by cooperatives formed under AS 10.15 to be based on the number of eligible communities that belong to the cooperative, and increase the loan limit above \$300,000.

Rationale: Increased bulk fuel storage capacity and rising fuel costs has resulted in communities needing more financial resources to purchase bulk fuel; the formation of cooperatives may allow volume discounts for bulk fuel purchases.

Action: Amend AS 42.45.250 (e) to allow the maximum loan amount to cooperatives formed under AS 10.15 to be based on the number of eligible communities belonging to the cooperative. Amend AS 42.45.250 (e) (1) to increase the maximum loan amount above \$300,000.

Funding Required: Amending AS 42.45.250 (e) will not have a fiscal impact on the Bulk Fuel Revolving Loan Fund. Amending AS 42.45.250 (e)(1) may have a fiscal impact and require additional capitalization of the Bulk Fuel Revolving Loan Fund, but to determine the fiscal impact will require additional information that is not available at this time.

Background: Rising costs of bulk fuel for delivery to rural communities combined with increased bulk fuel storage capacity in some communities, has created a situation where the ability to pay for bulk fuel deliveries is becoming increasingly difficult, especially the decrease in revenues being experienced by rural communities (See Appendix D for Sample of the Price of Fuel and Appendix E for AEA Energy Fuel Survey). One potential method to lower the cost of bulk fuel is the formation of cooperatives that are comprised of multiple communities. Consolidation of bulk fuel purchases and the resulting increase in the volume of fuel purchased may lead to a lower delivered cost.

In addition, the increase in fuel costs, even with a volume discount, coupled with increased storage capacity in some communities has lead to the bulk fuel "invoice" amount being an amount such that the current maximum loan amount under AS 42.45.250 (e)(1) requires the borrower to have a larger down payment when cash resources are more scarce.

AEA's Bulk Fuel Revolving Loan Fund currently provides communities with a population of 2,000 or less the opportunity to finance bulk fuel purchases in accordance with AS 42.45.250 and 3 AAC 106.300 – 106.365. Under AS 42.45.250 (e)(1), a borrower is currently limited to a maximum loan of \$300,000.

The maximum loan amount of \$300,000 to a single borrower precludes a cooperative that may for example be comprised of ten (10) eligible communities, each with a need to purchase \$300,000 in fuel, from obtaining a bulk fuel loan of

sufficient size to cover the cost of the bulk fuel purchase. Increasing the loan maximum amount to \$650,000 for each applicant under the current eligibility criteria will help alleviate some of the financial challenges faced by the applicants. A higher loan amount means communities needing reduced cash resources to consummate a bulk fuel purchase.

With regard to the increased loan amount of \$650,000, AEA expressed reservations as to whether this is the appropriate loan amount and the impact any increased loan amount would have on the Bulk Fuel Revolving Loan Fund without further capitalization of the Fund.

See Appendix F for Financing Bulk Fuel, which provides a list of known existing loan programs for fuel in Alaska.

SB

1888

SFIN

FILE

SENATE FINANCE COMMITTEE REPORT

REPORTED OUT
 APR 20 2006
 SENATE FINANCE COMMITTEE

DATE: 4/28/05

FURTHER:

DATE TURNED
 IN TO OFFICE: 4/20/06

Finance Committee considered

SENATE BILL NO. 188

SB 188 BULK FUEL REVOLVING LOAN FUND CAP

"An Act increasing the maximum amount of loans from the bulk fuel revolving loan fund to one borrower."

and recommends:

- be replaced with _____ CS SB 188 (FIN)
- adopt previous _____ CS CS FORTHCOMING (_____)
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to _____ Committee

CS Senate Bill:

- Same Title
- New Title

SCS House Bill:

- Same Title
- Technical Title Change
- New Title w/ SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Ind.	Zero	FN#
CCED	2/8/06			✓	

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Ind.	Zero	FN#

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	DO PASS	DO NOT PASS	NO REC	AMEND
<i>[Signature]</i>	✓			
<i>[Signature]</i>	✓			
<i>[Signature]</i>	✓			
<i>[Signature]</i>	✓			
COCHAIR: <i>[Signature]</i>			✓	
COCHAIR: <i>[Signature]</i>			✓	

FISCAL NOTE

REPORTED OUT
APR 20 2006
SENATE FINANCE COMMITTEE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: CSSB 188(FIN)
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Commerce
Title Bulk Fuel Revolving RDU Alaska Energy Authority (453)
Loan Fund Cap Component AEA Rural Energy Operations
Sponsor Olson
Requester Senate Finance Component No. 2600

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill increases the maximum amount for a single borrower to \$400,000, and allows a cooperative corporation or electric cooperative to borrow the lesser of \$400,000 multiplied by the number of communities, or \$1,500,000.

This bill has no impact on the cost of AEA operations.

Prepared by: Sara Fisher-Goad, Financial Analyst Phone 907 269 4623
Division Alaska Energy Authority Date/Time 2/8/06 3 06 PM
Approved by: William C. Noll, Commissioner Date 2/8/2006
Agency Commerce, Community, and Economic Development

ADOPTED

WORK DRAFT

WORK DRAFT

WORK DRAFT

24-LS0952\S
Cook
1/30/06

CS FOR SENATE BILL NO. 188()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FOURTH LEGISLATURE - SECOND SESSION

BY

Offered:
Referred:

Sponsor(s): SENATOR OLSON

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the maximum amount of loans from the bulk fuel revolving loan
2 fund to one borrower in a fiscal year."

3 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 * Section 1. AS 42.45.250(e) is amended to read:

5 (e) Loans made from the bulk fuel revolving loan fund to one borrower in any
6 fiscal year

7 (1) may not exceed \$400,000, or, if the borrower is a cooperative
8 corporation organized under AS 10.15 or an electric cooperative organized under
9 AS 10.25 and uses the loan to purchase bulk fuel on behalf of more than one
10 community, may not exceed the lesser of \$400,000 multiplied by the number of
11 communities on whose behalf the bulk fuel is to be purchased, or \$1,500,000
12 [\$300,000];

13 (2) shall be repaid in one year or less; and

14 (3) may not exceed 90 percent of the wholesale price of the fuel

1

purchased.

SENATE FINANCE COMMITTEE
2/13/2006 COMMITTEE ACTION

Bill Number	SB 188		
Amendment			
Motion	to adopt CS "S"		
<u>Motion by</u>	Olson		
<u>Objection by</u>	Green		
Removed	✓		
<u>Second Objection by</u>			
<u>Committee Member</u>	Y	<u>Vote</u>	N
Senator Olson			
Senator Stedman			
Senator Bunde			
Senator Dyson			
Senator Hoffman			
Co-Chair Wilken			
Co-Chair Green			
<u>Tally</u>			
Yea			
Nay			
Absent			
MOTION	ADOP T E D		



Official Business

Alaska State Senate

Senate Finance Committee

Mail Stop 400
State Capitol
Juneau, Alaska 99801-0400

FAX COVER SHEET

DATE: 4/20/06 TIME: 10:00 AM

TO: LEGAL

NUMBER OF PAGES, INCLUDING COVER SHEET: 1

FROM: ROBIN PAUL
SENATE FINANCE CMTE. ASST. SECRETARY
PHONE: 465-2618
FAX: 465-2187

NOTES: Need Final Pls: CS SB 188 (FIN)

Version 24-LS0952/S
No changes

Thank You!
Robin

SENATE FINANCE
COMMITTEE #1
Amendment #
To Bill Number: SB188
Sponsor: Olson
Date: 2/8/06 Logged by: Mindy

24-LS0952\S.1
Cook
2/6/06

FAILED

AMENDMENT

OFFERED IN THE SENATE

BY SENATOR OLSON

TO: CSSB 188(), Draft Version "S"

1 Page 1, line 2, following "year":

2 Insert "; and authorizing regulations to establish standards for the allocation of
3 money in that fund to eligible borrowers"

4
5 Page 2, following line 1:

6 Insert a new bill section to read:

7 "* Sec. 2. AS 42.45.250(j) is amended to read:

8 (j) The authority may adopt regulations necessary to carry out the provisions
9 of this section, including regulations to establish

10 (1) reasonable fees for services provided and charges for collecting the
11 fees; and

12 (2) standards for the allocation of bulk fuel revolving loan fund
13 money to eligible borrowers."

SENATE FINANCE COMMITTEE
2 / 13 / 2006 COMMITTEE ACTION

Bill Number	SB 188		
Amendment	# 1		
Motion	to adopt		
<u>Motion by</u>	Olson		
<u>Objection by</u>	Green		
<u>Removed</u>			
<u>Second Objection by</u>			
<u>Committee Member</u>	<u>Y</u>	<u>Vote</u>	<u>N</u>
Senator Hoffman	✓		
Senator Olson	✓		
Senator Stedman			✓
Senator Bunde	-		-
Senator Dyson	✓		
Co-Chair Wilken			✓
Co-Chair Green			✓
<u>Tally</u>			
Yea	3		
Nay	3		
Absent	1		
MOTION	FAILED		

AMENDMENT

OFFERED IN THE SENATE

BY SENATOR OLSON

TO: CSSB 188(), Draft Version "S"

1 Page 1, line 1, following "An Act":

2 Insert "relating to the purposes of and eligibility for loans from the bulk fuel
3 revolving loan fund; and"

4

5 Page 1, following line 3:

6 Insert a new bill section to read:

7 **"* Section 1.** AS 42.45.250(a) is amended to read:

8 (a) The bulk fuel revolving loan fund is established in the authority to assist
9 communities, utilities providing power in communities, and fuel retailers in
10 communities in purchasing bulk fuel to maintain community facilities or to generate
11 power or supply the public with fuel for use in communities. A community, or a
12 person generating power or selling fuel in a community or maintaining a community
13 facility who has written endorsement from the governing body of each community for
14 which a loan from the fund is sought, is eligible for a loan from the bulk fuel revolving
15 loan fund for a purchase of an emergency supply or a semiannual or annual supply of
16 bulk fuel to be used in the community."

17

18 Page 1, line 4:

19 Delete "Section 1"

20 Insert "Sec. 2"

21

22 Page 2, following line 1:

23 Insert a new bill section to read:

1 ** Sec. 3. AS 42.45.250(l) is amended by adding a new paragraph to read:

2 (3) "community facility" means a public building or public work open
3 to, or used by or for the benefit of, the public and owned by a community, a
4 governmental entity, or a nonprofit organization; in this paragraph, "public building or
5 public work" includes educational and health facilities, water and sewer facilities,
6 roads, and docks."

SENATE FINANCE COMMITTEE
2 / 13 / 2006 COMMITTEE ACTION

Bill Number	SB 188		
Amendment	# 2		
Motion	Olson to adopt		
<u>Motion by</u>	Olson		
<u>Objection by</u>	Green		
<u>Removed</u>			
<u>Second Objection by</u>			
<u>Committee Member</u>	Y	<u>Vote</u>	N
Senator Dyson			
Senator Hoffman			
Senator Olson			
Senator Stedman			
Senator Bunde			
Co-Chair Wilken			
Co-Chair Green			
<u>Tally</u>			
Yea			
Nay			
Absent			
MOTION	WITHDRAWN		

Alaska State Legislature

Out of Session:
PO Box 531
Golovin, Alaska 99762
(907) 443 5599

In Session:
State Capitol, Suite 510
Juneau, Alaska 99801-1182
(800) 597-3707
(907) 465-3707
(907) 465-4821 Fax

SENATOR DONALD C. OLSON

DISTRICT T

SPONSOR STATEMENT

SB 188, Bulk Fuel Loan Fund Cap

Alakanuk
Ambler
Anaktuvuk Pass
Atkasuk
Barrow
Brevig Mission
Browerville
Buckland
Chevak
Deering
Diomedea
Elim
Emmonak
Gambell
Golovin
Hooper Bay
Kaktovik
Kiana
Kivalina
Kobuk
Kolik
Kolzebue
Koyuk
Mountain Village
Neotak
Nemo
Noorvik
Nuiqsut
Nunam Iqoa
Pilot Station
Pitka's Point
Point Hope
Point Lay
Savoonga
Scammon Bay
Solawik
Shaktolik
Shehtutot
Shungnak
St. Mary's
St. Michael
Stebbins
Teller
Unalakleet
Wainwright
Wales
White Mountain

I introduced SB 188 at the urging of members of the Governor's Rural Energy Action Council. The council's April 15 report has many recommendations to help rural communities contend with rapidly escalating energy costs.

SB 188 is one of their recommendations for the bulk fuel loan program, a program that allows communities to minimize fuel costs through large purchase economies. This is an important program for those communities that are ice bound during the winter and depend on just one or two large shipments to supply their fuel needs for the entire year.

Currently, the bulk fuel loan program has a maximum loan of \$300,000 that any one borrower may take in a fiscal year. The effect of this cap during times of dramatically increasing fuel costs is to reduce the maximum amount of fuel that may be purchased. The proposed finance committee CS will counteract this effect by increasing the loan limit to \$400,000 for a single borrower. For cooperative organizations that are purchasing bulk fuel for more than one community, the loan limit is further increased to \$400,000 multiplied by the number of communities or \$1,500,000, whichever is lesser. This latter measure is to encourage larger purchases for multiple communities in order to attain additional economies of scale for the benefit of all energy consumers.

The proposed CS for SB 188 incorporates all the recommendations of the Alaska Energy Authority and is endorsed by the administration. Its enactment will directly assist in lowering energy costs to small communities in Alaska. The bill is timely and needed.

BULK FUEL REVOLVING LOAN FUND

HISTORY, STATUS, PROJECTIONS

Prepared For:

Alaska Energy Authority

Prepared By:

*Richard Emerman
Emerman Consulting LLC*

August 25, 2005

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3 Demand Projections for BFRLF Loans Assuming No Changes In the Program	42
4 Bulk Fuel Financing Alternatives	58
5 Creating Bulk Fuel Purchasing Cooperatives and Projected Impact on Fuel Price and BFRLF Demand	61
6 Proposals to Raise the BFRLF Annual Borrowing Limit and the Projected Impact on BFRLF Demand	69

Attachment 1: Original statute establishing the Bulk Fuel Revolving Loan Fund, current BFRLF statute, and current BFRLF regulations.

Attachment 2: Excerpts on Consolidation of Fuel Purchases from "Screening Report for Alaska Rural Energy Plan," Northern Economics, Inc., April 2001.

Attachment 3: Handbook entitled "Cooperative Purchasing: A Way to Save When Buying Fuel for Rural Communities," Alaska Department of Community and Regional Affairs, September 1989.

EXECUTIVE SUMMARY

- I. The Bulk Fuel Revolving Loan Fund (BFRLF) was created in 1980 to provide short-term financing for bulk fuel purchases in communities with less than 2,000 population. Eligible borrowers, who purchase bulk fuel to generate power or supply the public with fuel for use in communities, include but are not limited to corporations, cooperatives, governmental entities, electric utilities, and other organizations that may serve one or more communities. By 1993 the original borrower limit of \$50,000 per year had been raised to \$100,000. It was raised again to \$200,000 for FY03 and then to \$300,000 for FY04 and beyond.

Loans from the Fund must be used to obtain at least a 6-month supply of fuel or to obtain emergency fuel supplies. The interest rate on loans is set by statute to equal the 12 month average of the long-term municipal revenue bond rate unless the administering agency determines that a rate reduction is needed based on the community's ability to pay. Program regulations establish a presumption that zero interest will apply to a borrower's first loan from the program, 5% interest on the second loan, and the municipal revenue bond rate for the third and subsequent loans. However, the regulations do not remove the agency's discretion to set the rates in any manner that is consistent with statute.

Loans must typically be repaid within 9 months of the initial disbursement. By long-standing policy, additional loans are not available to borrowers until prior loans have been fully repaid.

At the end of FY05, the net assets of the BFRLF amounted to approximately \$8.2 million. Fund earnings from loan fees, interest income, and investment income have substantially exceeded potential losses from uncollectible loans since the inception of the program. A significant proportion of borrowers become past due in their payments at some point during the year but the record shows that nearly all loans are ultimately repaid in full despite problems with late payments.

The record of BFRLF loan requests and loan disbursements (i.e. actual loans issued from the fund) over the last 5 years is as follows:

(\$ Millions)

<u>Fiscal Year</u>	<u>Loan Requests</u>	<u>Loan Disbursements</u>
2001	\$3.0	\$2.0
2002	2.6	2.3
2003	4.4	2.5
2004	6.1	3.5
2005	9.0	5.3

The number of borrowers and the average amount loaned per borrower over the last 5 years is as follows:

<u>Fiscal Year</u>	<u>Number of Borrowers</u>	<u>Average Amount Loaned Per Borrower (\$ Thousands)</u>
2001	37	\$55.2
2002	34	68.4
2003	39	65.0
2004	46	76.3
2005	53	99.7

Among the factors contributing to the recent increases in loan demand are (i) increase in fuel prices, (ii) increase in volumes of fuel financed by individual borrowers, and (iii) increase in the BFRLF annual borrower limit.

The delivered price of diesel fuel was essentially flat from FY01 through FY04 before increasing sharply during the past year. Statistics acquired for the Power Cost Equalization program show the following history of population-weighted average prices for Alaska communities with less than 2,000 population. Prices for FY01 through FY04 are annual averages for PCE utilities, while the FY05 price is based only on the most recent fuel delivery which, for a number of utilities, occurred in fall 2004. The FY05 price used in this report is therefore lower than fuel prices encountered today:

<u>Fiscal Year</u>	<u>Weighted Average Diesel Price per Gallon</u>
2001	\$1.45
2002	1.45
2003	1.37
2004	1.54
2005	2.01

These diesel fuel prices closely track historical crude oil prices. Both the Alaska Department of Revenue and the Energy Information Administration of the U.S. Department of Energy recently published forecasts that anticipate fuel prices returning to FY03 levels over the next 3 years. For projections developed in this report, this fuel price expectation is considered "Scenario #1." "Scenario 2" is based on the assumption that prices in FY06 will be 20% higher than those most recently reported to the PCE program in FY05, and will remain constant in nominal dollar terms over the 10-year projection period.

The number of gallons financed per BFRLF borrower over the last 5 fiscal years is estimated as follows:

<u>Fiscal Year</u>	<u>Gallons Financed Per BFRLF Borrower (Thousands)</u>
2001	37.3
2002	44.3
2003	43.6
2004	49.2
2005	50.7

There has been a lagged response to the increases in statutory borrowing limits for the BFRLF, including a sizeable increase in loans exceeding \$100,000 that occurred during FY05. Although the annual borrower limit was increased to \$300,000 for FY04 and FY05, very few borrowers have yet to exceed the previous limit of \$200,000 per year.

- II. Assuming no annual limit in the amount that bulk fuel purchasers could borrow from the BFRLF, the total potential market for BFRLF loans in communities with less than 2,000 population is estimated at approximately 50 million gallons per year, at an FY05 weighted average cost of roughly \$100 million. Given that FY05 loans issued from the BFRLF amounted to \$5.3 million, it appears that the BFRLF finances about 5% of its potential market. Potential borrowers pay for or finance the remaining 95% by other means.

One of the constraints that limits use of the BFRLF is the existing \$300,000 annual limit per borrower. Much of the potential market for BFRLF loans consists of bulk fuel purchasers whose annual cost of fuel is well above that limit. This report adopts the assumption that 25 million gallons (valued during FY05 at approximately \$50 million) constitutes the potential market for BFRLF financing under current law that limits individual borrowers to \$300,000 or less each year.

- III. Among communities of eligible size, the number for which a BFRLF loan has been issued over the last 5 years is less than the number for which no BFRLF loan has been issued. These "non-BFRLF" communities are spread throughout the state and throughout the eligible size distribution. This further suggests that there is considerable room for growth in the demand for BFRLF financing. Another factor contributing to such growth potential is the fact that, based on the record of increasing electricity usage among PCE communities, there appears to be a continuing, gradual trend of increased energy demand in rural Alaska.

Assuming no change in the program statute or regulations, this report develops the following projections of BFRLF demand for the two different fuel price scenarios defined above. These are projections of actual loans assuming the Fund were sufficiently capitalized to issue them. These are not projections of loan requests, which would presumably be higher.

	(Millions of Dollars)		
	<u>FY08</u>	<u>FY11</u>	<u>FY14</u>
Scenario #1 (declining fuel prices)	\$4.5	\$6.9	\$10.2
Scenario #2 (current fuel prices)	9.2	12.6	16.9

IV. Alternative methods of paying for or financing bulk fuel purchases include the following:

- Cash in advance or upon delivery.
- Credit from fuel distributors.
- Credit from commercial lenders.
- Credit through the "Alaska Resupply" program operated by the Bureau of Indian Affairs.
- Acquisition of fuel through the Alaska Native Industries Cooperative Association (ANICA).
- Credit through the Bulk Fuel Bridge Loan program.

V. There is an extensive history of efforts to consolidate bulk fuel purchasing in rural Alaska with the goal of achieving price savings. Attempts to create and maintain formal bulk fuel purchasing cooperatives have been unsuccessful although some efforts at informal consolidation have worked out and have been sustained over a period of years. Interviews suggest that, while volume discounts might be achieved for consolidated purchasers within a certain size range, more significant savings are likely to be achieved through strategies that assure fuel distributors of full and timely payment.

Hypothetical savings through consolidation strategies may be significant for individual purchasers based on a typical volume discount program reported in an earlier study, but aggregate savings from this strategy are likely to be small compared with the size and range of BFRLF demand projections or with the cost of fuel in rural Alaska overall.

- VI. The Rural Energy Action Council created by Governor Murkowski suggested that the annual limit for borrowers from the BFRLF be increased for cooperatives serving more than one community – possibly to \$300,000 times the number of communities served. Its report also discusses the possible benefit of increasing the limit for individual borrowers to \$650,000 per year.

A bill introduced during the 2005 legislative session would increase the BFRLF borrower limit for the following two types of organizations:

- A "cooperative corporation organized under AS 10.15"
- An "electric cooperative organized under AS 10.25."

For these organizations, the current language of the bill would raise the annual limit to "\$300,000 multiplied by the number of communities on whose behalf the bulk fuel is to be purchased, or \$1,000,000, whichever is greater." This language means that, for an electric cooperative such as AVEC that serves 50 communities, the annual borrowing limit would be \$15 million. However, if the intent was to set the annual borrowing limit at "whichever is less" of the two alternatives, then AVEC's borrowing limit under an amended bill would be \$1.0 million rather than \$15 million.

Only 5 existing organizations were identified that would be directly affected by the proposed legislation. None of these are currently BFRLF borrowers and none expect to become BFRLF borrowers in the foreseeable future whether or not the legislation is enacted. However, it is possible that one or more may access the BFRLF regardless of current expectations. Naknek Electric Association reported that it needed supplemental financing this past year from the Cooperative Finance Corporation (CFC) in an amount exceeding \$300,000 to help finance its bulk fuel acquisition because the utility's cash reserves were inadequate to pay the entire bill. Should this happen again and if the BFRLF borrower limit were raised, Naknek Electric could find it preferable to obtain supplemental financing from the BFRLF rather than CFC.

This report develops the following projections of BFRLF demand assuming the annual limit for individual borrowers is raised to \$400,000 or to \$600,000, again under the two different fuel price scenarios. As before, these are projections of actual loans assuming the Fund were sufficiently capitalized to issue them. These are not projections of loan requests, which would presumably be higher.

BFRLF Demand Projections for Two Fuel Price Scenarios
No Change in Borrower Limit vs. Increase to \$400,000 or to \$600,000

(Millions of Dollars)

	<u>FY08</u>	<u>FY11</u>	<u>FY14</u>
Scenario #1 (declining fuel prices)			
No Change in Borrower Limit	\$4.5	\$6.9	\$10.2
Increase to \$400,000	4.9	7.7	11.8
Increase to \$600,000	5.1	8.1	12.6
Scenario #2 (current fuel prices)			
No Change in Borrower Limit	\$9.2	\$12.6	\$16.9
Increase to \$400,000	10.0	14.6	20.1
Increase to \$600,000	10.4	15.6	21.7

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AIDEA/AEA

Alaska Energy Authority

January 26, 2006

The Honorable Donny Olson
Alaska State Senate
State Capitol, MS 3100
Juneau, Alaska 99801-1182

RE: CS SB 188 (CRA) Loans from the Bulk Fuel Revolving Loan Fund

Dear Senator Olson:

We respectfully request your support of the attached amendment to CS SB 188(CRA).

The Bulk Fuel Revolving Loan Fund (BFRLF) was created to provide short-term financing for bulk fuel purchases in communities with populations less than 2,000. On February 7, 2005, Governor Murkowski commissioned the Rural Energy Action Council (REAC) to provide him with recommendations to address the high cost of energy in Rural Alaska. REAC's report was published on April 15, 2005 and included proposal changes to the BFRLF program. Your prompt and early response to the Governor Murkowski's REAC recommendations by introducing SB 188 was greatly appreciated.

During the interim between legislative sessions, Governor Murkowski requested the Alaska Energy Authority (AEA) review the statutes regarding the BFRLF program. Our review considered current existing statutes, changes proposed by SB 188, and the changes recommended by REAC.

With the support of Governor Murkowski and based on the REAC recommendations, AEA proposes changes to the program to increase the loan limit and to assist entities responsible for maintaining community infrastructure.

The amendment proposes the following changes to the Bulk Fuel Revolving Loan Fund Program:

- Raises the loan limit to \$400,000 from \$300,000 for a single borrower. [CSSB 188(CRA) does not change the loan limit; REAC recommended a loan limit increase to \$650,000]
- Allows a cooperative corporation or electric cooperative servicing more than one community to borrow the lesser of \$400,000 multiplied by the number of communities, or \$1,500,000. [CSSB 188(CRA) limited cooperatives to \$300,000 multiplied by number of communities or \$1,000,000 maximum; both versions are the result of a REAC recommendation]
- Expands the definition of eligible borrower to a person maintaining community facilities or infrastructure. AEA has been approached by a subsidiary of Yukon Kuskokwim Health

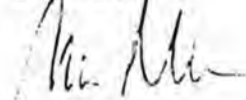
The Honorable Donny Olson
January 26, 2006
Page 2

Corporation that is operating community water and sewer systems. This change will assist entities that operate village infrastructure. [Not addressed in CSSB 188 (CRA)]

- Allows AEA to adopt regulations to establish standards for the allocation of loan funds to eligible borrowers. [Not addressed in CSSB 188 (CRA)]
- Clarifies that fees and collection charges be deposited in the BFRLF not the general fund. The Department of Law has recommended this change to correct an ambiguous subsection in the statutes. No impact on the general fund since the GF is not currently receiving any monies generated from this program. [Not addressed in CSSB 188 (CRA)]

We are ready to meet with you and your staff to provide any other information you may require. Thank you for considering our request.

Sincerely,



Ron Miller
Executive Director

BULK FUEL REVOLVING LOAN FUND

HISTORY, STATUS, PROJECTIONS

Prepared For:

Alaska Energy Authority

Prepared By:

*Richard Emerman
Emerman Consulting LLC*

August 25, 2005

BULK FUEL REVOLVING LOAN FUND

HISTORY, STATUS, PROJECTIONS

Prepared For:

Alaska Energy Authority

Prepared By:

*Richard Emerman
Emerman Consulting LLC*

August 25, 2005

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Loans must typically be repaid within 9 months of the initial disbursement. By long-standing policy, additional loans are not available to borrowers until prior loans have been fully repaid.

At the end of FY05, the net assets of the BFRLF amounted to approximately \$0.2 million. Fund earnings from loan fees, interest income, and investment income have substantially exceeded potential losses from uncollectible loans since the inception of the program. A significant proportion of borrowers become past due in their payments at some point during the year but the record shows that nearly all loans are ultimately repaid in full despite problems with late payments.

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(\$ Millions)

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2004	6.1	3.5
2005	9.0	5.3

The number of borrowers and the average amount loaned per borrower over the last 5 years is as follows:

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Among the factors contributing to the recent increases in loan demand are (i) increase in fuel prices, (ii) increase in volumes of fuel financed by individual borrowers, and (iii) increase in the BFRLF annual borrower limit.

The delivered price of diesel fuel was essentially flat from FY01 through FY04 before increasing sharply during the past year. Statistics acquired for the Power Cost Equalization program : how the following history of population-weighted average prices for Alaska communities with less than 2,000 population. Prices for FY01 through FY04 are annual averages for PCE utilities, while the FY05 price is based only on the most recent fuel delivery which, for a number of utilities, occurred in fall 2004. The FY05 price used in this report is therefore lower than fuel prices encountered today:

<u>Fiscal Year</u>	<u>Weighted Average Diesel Price per Gallon</u>
2001	\$1.45
2002	1.45
2003	1.37
2004	1.54
2005	2.01

These diesel fuel prices closely track historical crude oil prices. Both the Alaska Department of Revenue and the Energy Information Administration of the U.S. Department of Energy recently published forecasts that anticipate fuel prices returning to FY03 levels over the next 3 years. For projections developed in this report, this fuel price expectation is considered "Scenario #1." "Scenario 2" is based on the assumption that prices in FY06 will be 20% higher than those most recently reported to the PCE program in FY05, and will remain constant in nominal dollar terms over the 10-year projection period.

The number of gallons financed per BFRLF borrower over the last 5 fiscal years is estimated as follows:

<u>Fiscal Year</u>	<u>Gallons Financed Per BFRLF Borrower (Thousands)</u>
2001	37.3
2002	44.3
2003	43.6
2004	49.2
2005	50.7

There has been a lagged response to the increases in statutory borrowing limits for the BFRLF, including a sizeable increase in loans exceeding \$100,000 that occurred during FY05. Although the annual borrower limit was increased to \$300,000 for FY04 and FY05, very few borrowers have yet to exceed the previous limit of \$200,000 per year.

- II. Assuming no annual limit in the amount that bulk fuel purchasers could borrow from the BFRLF, the total potential market for BFRLF loans in communities with less than 2,000 population is estimated at approximately 50 million gallons per year, at an FY05 weighted average cost of roughly \$100 million. Given that FY05 loans issued from the BFRLF amounted to \$5.3 million, it appears that the BFRLF finances about 5% of its potential market. Potential borrowers pay for or finance the remaining 95% by other means.

One of the constraints that limits use of the BFRLF is the existing \$300,000 annual limit per borrower. Much of the potential market for BFRLF loans consists of bulk fuel purchasers whose annual cost of fuel is well above that limit. This report adopts the assumption that 25 million gallons (valued during FY05 at approximately \$50 million) constitutes the potential market for BFRLF financing under current law that limits individual borrowers to \$300,000 or less each year.

- III. Among communities of eligible size, the number for which a BFRLF loan has been issued over the last 5 years is less than the number for which no BFRLF loan has been issued. These "non-BFRLF" communities are spread throughout the state and throughout the eligible size distribution. This further suggests that there is considerable room for growth in the demand for BFRLF financing. Another factor contributing to such growth potential is the fact that, based on the record of increasing electricity usage among PCE communities there appears to be a continuing, gradual trend of increased energy demand in rural Alaska.

Assuming no change in the program statute or regulations, this report develops the following projections of BFRLF demand for the two different fuel price scenarios defined above. These are projections of actual loans assuming the Fund were sufficiently capitalized to issue them. These are not projections of loan requests, which would presumably be higher.

(Millions of Dollars)

	<u>FY06</u>	<u>FY11</u>	<u>FY14</u>
Scenario #1 (declining fuel prices)	\$4.5	\$6.9	\$10.2
Scenario #2 (current fuel prices)	9.2	12.6	16.9

IV. Alternative methods of paying for or financing bulk fuel purchases include the following:

- Cash in advance or upon delivery.
- Credit from fuel distributors.
- Credit from commercial lenders.
- Credit through the "Alaska Resupply" program operated by the Bureau of Indian Affairs.
- Acquisition of fuel through the Alaska Native Industries Cooperative Association (ANICA).
- Credit through the Bulk Fuel Bridge Loan program.

V. There is an extensive history of efforts to consolidate bulk fuel purchasing in rural Alaska with the goal of achieving price savings. Attempts to create and maintain formal bulk fuel purchasing cooperatives have been unsuccessful although some efforts at informal consolidation have worked out and have been sustained over a period of years. Interviews suggest that, while volume discounts might be achieved for consolidated purchasers within a certain size range, more significant savings are likely to be achieved through strategies that assure fuel distributors of full and timely payment.

Hypothetical savings through consolidation strategies may be significant for individual purchasers based on a typical volume discount program reported in an earlier study, but aggregate savings from this strategy are likely to be small compared with the size and range of BFRLF demand projections or with the cost of fuel in rural Alaska overall.

- VI. The Rural Energy Action Council created by Governor Murkowski suggested that the annual limit for borrowers from the BFRLF be increased for cooperatives serving more than one community – possibly to \$300,000 times the number of communities served. Its report also discusses the possible benefit of increasing the limit for individual borrowers to \$650,000 per year.

A bill introduced during the 2005 legislative session would increase the BFRLF borrower limit for the following two types of organizations:

- A “cooperative corporation organized under AS 10.15”
- An “electric cooperative organized under AS 10.25.”

For these organizations, the current language of the bill would raise the annual limit to “\$300,000 multiplied by the number of communities on whose behalf the bulk fuel is to be purchased, or \$1,000,000, whichever is greater.” This language means that, for an electric cooperative such as AVEC that serves 50 communities, the annual borrowing limit would be \$15 million. However, if the intent was to set the annual borrowing limit at “whichever is *less*” of the two alternatives, then AVEC’s borrowing limit under an amended bill would be \$1.0 million rather than \$15 million.

Only 5 existing organizations were identified that would be directly affected by the proposed legislation. None of these are currently BFRLF borrowers and none expect to become BFRLF borrowers in the foreseeable future whether or not the legislation is enacted. However, it is possible that one or more may access the BFRLF regardless of current expectations. Naknek Electric Association reported that it needed supplemental financing this past year from the Cooperative Finance Corporation (CFC) in an amount exceeding \$300,000 to help finance its bulk fuel acquisition because the utility’s cash reserves were inadequate to pay the entire bill. Should this happen again and if the BFRLF borrower limit were raised, Naknek Electric could find it preferable to obtain supplemental financing from the BFRLF rather than CFC.

This report develops the following projections of BFRLF demand assuming the annual limit for individual borrowers is raised to \$400,000 or to \$600,000, again under the two different fuel price scenarios. As before, these are projections of actual loans assuming the Fund were sufficiently capitalized to issue them. These are not projections of loan requests, which would presumably be higher.

BFRLF Demand Projections for Two Fuel Price Scenarios
No Change in Borrower Limit vs. Increase to \$400,000 or to \$600,000

(Millions of Dollars)

	<u>FY08</u>	<u>FY11</u>	<u>FY14</u>
Scenario #1 (declining fuel prices)			
No Change in Borrower Limit	\$4.5	\$6.9	\$10.2
Increase to \$400,000	4.9	7.7	11.8
Increase to \$600,000	5.1	8.1	12.6
Scenario #2 (current fuel prices)			
No Change in Borrower Limit	\$9.2	\$12.6	\$16.9
Increase to \$400,000	10.0	14.6	20.1
Increase to \$600,000	10.4	15.6	21.7

SECTION 1

HISTORY AND STATUS OF THE BULK FUEL REVOLVING LOAN FUND

A. Program inception and subsequent changes.

The Bulk Fuel Revolving Loan Fund (BFRLF) was created in 1980 in the Department of Commerce and Economic Development.¹ Subsequent organizational changes affecting program administration occurred as follows:

- In 1989, the program was transferred to the Alaska Energy Authority (AEA).
- In 1993, when AEA's rural programs were transferred to the Department of Community and Regional Affairs (DCRA), administration of the BFRLF was transferred to DCRA as well.
- In 1999, when DCRA was abolished and its rural energy programs reintegrated with AEA, administration of the BFRLF returned to AEA where it remains today.

Most of the basic program structure remained unchanged despite these organizational changes over the last 25 years. For example, throughout this period loans have been limited by statute to communities, or borrowers serving communities, that have less than 2,000 population. Other key provisions that have remained unchanged include:

- Loans must be repaid in one year or less.
- Loans may not exceed 90% of the wholesale price of the fuel purchased.
- The interest rate is tied to the 12 month average of the municipal bond rate for 30-year revenue bonds. However, the agency administering the program may reduce or eliminate the interest rate in view of a community's ability to pay.

There have been a number of changes in the program, however, including the following:

¹ A copy of the original legislation, excerpted from SLA 1980, Chapter 83, is provided in Attachment 1. Also included in Attachment 1 are the current statutes and regulations pertaining to the Bulk Fuel Revolving Loan Fund - AS 42.45.250 and 3 AAC 106.300.

- In the 1980 legislation that established the program, the maximum amount that could be loaned to a single borrower in a single fiscal year was set at \$50,000.

By 1993, this limit had been raised to \$100,000.

In 2002 (affecting loans issued in FY03), the limit was raised from \$100,000 to \$200,000.

In 2003 (affecting loans issued in FY04 and later), the limit was raised from \$200,000 to \$300,000.

- The current statute specifies that loans are available for the purchase of "emergency, semi-annual, or annual bulk fuel supplies." In other words, BFRLF loans are not available for less than a 6-month supply of fuel unless the fuel acquisition is considered an emergency. This has the effect of excluding many, though not all, potential borrowers who are located on roads or waterways that allow year-round access for bulk fuel delivery. Some communities with year-round access still choose to purchase a 6-month supply, or more, depending on such factors as fuel storage capability and possible cost savings from higher volumes and fewer deliveries.

This statutory provision, essentially defining a "bulk fuel" purchase to be at least a 6-month supply, was not included in the original legislation.

- The current statute specifies that BFRLF loans may be issued to finance "bulk fuel to generate power or supply the public with fuel for use in communities." This means that BFRLF loans are available for diesel fuel and gasoline for power generation, heat, and transportation within communities. However, loans are not available for the wholesale purchase of aviation fuel as air travel is not considered to be a use within a community.

This language, and its implications for financing the purchase of aviation fuel, was not included in the original legislation.

- Although most BFRLF loans have been and continue to be issued as unsecured loans, the current program statute allows for the imposition of collateral requirements and program regulations allow for the denial of loan applications based on the applicant's financial condition and credit history. A key example of these credit requirements is the long-standing policy of declaring an applicant ineligible for further BFRLF loans if any prior loans under the program remain unpaid.

The original statute made no reference to the State's security interest or to collateral requirements.

Current statutes explicitly provide that the following are eligible borrowers:

"A community, or a person generating power or selling fuel in a community who has written endorsement from the governing body of each community for which a loan from the fund is sought..."

The term "person" is defined by statute to include the following: a corporation, company, partnership, firm, association, organization, cooperative, joint venture, governmental entity, business trust, or society, as well as a natural person.

In the original 1980 legislation, only "communities" and "private individuals" were named as eligible borrowers.

Current law allows individual loans to finance bulk fuel acquisition for use in multiple communities, provided that the governing body of each community issues its written endorsement. For example, an electric cooperative with membership extending to more than one community can obtain a single BFRLF loan to finance its bulk fuel purchase as long as each participating community has less than 2,000 population and provides AEA with its written endorsement. Under current law, however, the cooperative in this example can borrow no more than \$300,000 in a single fiscal year – the same as any other borrower.

B. Net Assets of the BFRLF – Funds Available to Lend

AEA has provided the following information describing the growth in net assets of the BFRLF from the end of FY99 to the end of FY05:

TABLE 1

Fiscal Year	Net Operating Income (Loss)					Additions to Fund Capitalization	End of Fiscal Year	
	Loan Fees and Interest Income	Investment Income	Write-Downs and Recoveries	Loan Admin and Other Costs	Net Income (Loss) for Fiscal Year		Net Assets	Cash Component of Net Assets**
1999							2,209,765	1,696,835
2000	33,859	33,715	(422,900)	(53,820)	(409,146)		1,800,619	1,119,484
2001	37,631	65,741			103,372		1,903,991	1,527,437
2002	53,349	37,748		(42,311)	48,786	5,000,000	6,952,777	6,122,522
2003	76,013	79,395		(37,969)	117,439	471,351	7,541,567	6,804,343
2004	94,270	55,687	139,914	(7,751)	282,120	38,805	7,862,492	7,227,531
2005	147,550	120,652	82,938		351,140		8,213,332	7,022,184
TOTALS	442,672	392,938	(200,048)	(141,851)		5,510,156		

** A portion of the cash component at fiscal year end has already been committed (that is, "encumbered") for approved loans that are scheduled for disbursement in the following fiscal year. For example, of the \$7.0 million cash component existing at the end of FY05, approximately \$3.0 million was already committed for approved loans that had not yet been disbursed, while the remaining \$4.0 million was uncommitted at that point in time.

The following notes explain the structure and main entries in the chart:

- Net Assets at the end of the fiscal year include both receivables from outstanding loans and cash held in the BFRLF that is available for loan disbursements. As shown in the last two columns of the chart, by June 30 most of the Net Assets have consisted of cash although significant loan balances – \$1.2 million at the end of FY05 – have been outstanding at that time as well.
- At the end of FY99, Net Assets of the BFRLF amounted to \$2,209,765, which reflects all income, expenses, and appropriations to the BFRLF from its inception until June 30, 1999.
- Each year, the BFRLF gains income from loan fees, interest on loans, and investment of cash held in the Fund. These gains are shown in the first two columns under "net operating income (loss)," and serve to increase the Fund's "net assets."
- Periodically, AEA reviews its outstanding loans and determines how much is very unlikely ever to be repaid. In FY2000 this resulted in "writing down," for book purposes, loans in the amount of \$422,900. These acknowledged write-downs serve to reduce the net assets of the Fund. This entry in FY2000 was apparently the first time that potential loan losses were recorded for the BFRLF and deducted from the Fund's net assets. The write-down of \$422,900 consists of

loan balances that were considered uncollectible from loans issued prior to the 1999 transfer of the BFRLF to AEA.

- "Administrative and other costs" of \$53,820 were incurred during FY2000. These cash expenses also serve to reduce net assets.
- "Net Income (Loss) for the Fiscal Year" can now be calculated. This consists of income (from loan fees, loan interest, and investment of Fund cash) minus any write-downs (net of recoveries) and administrative costs. "Net Income (Loss)" for FY2000 consisted of a loss of \$409,146, which reduced the Fund's "Net Assets" from \$2,209,765 to \$1,800,619.
- The biggest change in Net Assets occurred in FY02 with the infusion of \$5.0 million (shown in the chart as an "Addition to Fund Capitalization"). This infusion came in the form of a grant from the federal Rural Utilities Service and was intended to increase the amount available to lend from the BFRLF.
- The other additions to Fund Capitalization – \$471,351 in FY03 and \$38,805 in FY04 – came from the Alaska Division of Emergency Services in response to a particularly poor fish harvest in certain parts of the state that left a number of villages short of cash needed to procure winter fuel supplies. The emergency funds were used to issue bulk fuel loans under the BFRLF program, and the loan repayments and other proceeds from the emergency funds stayed with the BFRLF and added to its Net Assets.
- Two more entries may need an explanation. In FY04, in the "Write-Downs and Recoveries" column, a positive \$139,914 was added back in to Fund income and assets, and in FY05 another \$82,938 was similarly added back in. These represented repayments on loans that had previously been considered uncollectible and which were previously included in the FY2000 write-down of \$422,900.

The result of all this is that the Net Assets of the BFRLF stood at approximately \$8.2 million at the end of FY05. As explained in the footnote to Table 1, approximately \$4.0 million of that amount was available for commitment to new loans at that point in time.

C. Loan Delinquency and Loan Write-Downs

As of June 30, 2005, the potential loss to the BFRLF from loans that are very likely to remain unpaid stood at approximately \$0.2 million. This is simply the net result from the "Write-Downs and Recoveries" column in Table 1 described above. Since these write-downs were included in the

\$422,900 "Write-Downs and Recoveries" entered in FY2000, they represent uncollectible loans that were made prior to FY2000.²

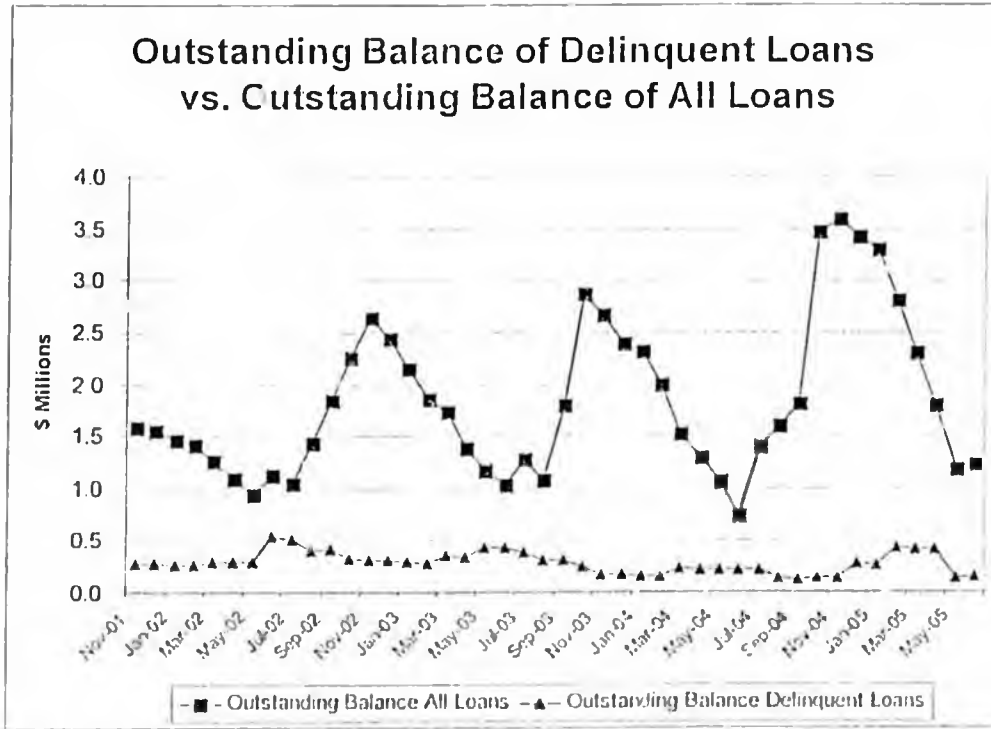
Without going back in the records to determine exactly which loans were included in the \$422,900 and when each loan was issued, it is difficult to estimate the percentage of loan funds that have been issued but are now considered uncollectible. However, the following illustrations help put the potential loss in context:

- Records provided by AEA show \$8.4 million in loan disbursements for the 5-year period from FY95 through FY99. The \$0.2 million in potentially uncollectible loans amounts to 2.4% of loan disbursements during that period.
- There have been no additional write-downs since FY2000 although annual loan disbursements have increased substantially. This means that, with the possible minor exception noted in footnote 2, no loans that were issued over the last 5 years and that currently have outstanding balances are judged by AEA to be uncollectible.
- As shown in Table 1, the sum of loan fees, loan interest income, and investment income over the last 6 years – \$0.8 million – more than compensates for the potential loss of \$0.2 million that has been estimated to date.

A loan is considered past due if the borrower is more than 30 days, but less than 90 days, behind in scheduled payments. The loan is considered delinquent if the borrower is behind by 90 days or more. To track the repayment delays that are of particular concern, each month AEA determines the outstanding balance of delinquent loans and compares it with the outstanding balance of all loans. This comparison is shown in Graph 1 below:

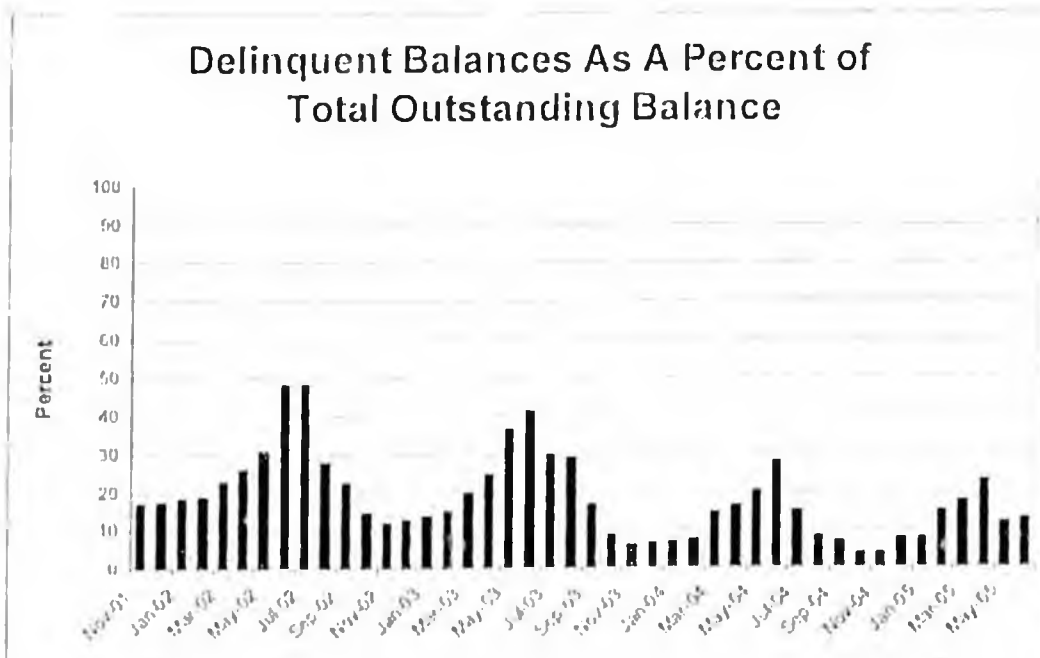
² AEA program management states that there is one additional loan with an outstanding balance of \$42,500 that was committed in FY99 and that is most likely uncollectible but has not yet been written down on the books.

GRAPH 1



Graph 2 shows the outstanding balance of delinquent loans as a percent of the outstanding balance of all loans:

GRAPH 2



These graphs together give rise to several observations:

- The incidence of borrower delinquency in relation to all borrowing activity has been steadily declining over the last 4 years.
- Graph 2 shows that the percentage of delinquent balances has been highest each year in late spring and summer. However, as shown in Graph 1, the dollar value of delinquent balances has varied only slightly within a narrow range. Since the total outstanding balance of loans varies dramatically by season and is lowest in the summer, it follows that the percent of delinquent balances will be highest in the summer as well.
- The percent of the total outstanding loan balance that is in delinquent status remains significant: approximately 15% at the end of February 2005, 18% at the end of March, and 23% at the end of April before declining sharply in May in both percentage and absolute dollar terms. Despite these significant percentages in February through April, the delinquent balances at the end of May and June 2005 in absolute dollar terms are about as low as they have ever been as shown in Graph 1.

As stated before, potential losses for the program as of June 30, 2005 are low – much lower than program income. The low level of loan write-downs suggests that almost all borrowers who fall into delinquent status eventually work their way out of it. The relatively low amount of loan write-downs has not impaired the program's capacity to supply loans.

D. Current and Historical Program Demand

For this study, data was acquired from AEA on BFRLF borrowers, loan requests, loan commitments, and loan disbursements for the 5-year period from FY 2001 through FY 2005. With regard to these terms:

- A "loan commitment" is the maximum amount that AEA agrees to lend in response to a loan request. Sometimes the loan commitment equals the loan request, sometimes it is a portion of the request, and sometimes a loan request is denied. There are a number of possible reasons why AEA's loan commitment may be less than the full request or why a request may be denied, including but not limited to:
 - i. The applicant has not fully repaid a prior BFRLF loan
 - ii. The applicant is under a tax lien.

- iii. The applicant has an unsatisfactory credit record and may not be able to pledge enough collateral to overcome it.
- iv. The request may be larger than necessary for the amount of fuel that the applicant orders or requires.
- v. There is insufficient cash available in the BFRLF. (Such funding constraints leading to delays and rejections were encountered before the \$5 million infusion of funds in FY02, but have not been encountered since that time.)

- A "loan disbursement" is the actual amount loaned from the Fund and may be equal to or less than the corresponding "loan commitment" depending on the amount and cost of fuel that is ultimately delivered to the borrower. Throughout this study, all references to "loans" will mean actual "loan disbursements." Further, it will be assumed that the fiscal year in which the loan occurs is determined by the date of disbursement, not by the date of the request or commitment.

- The data on requests, commitments and disbursements comes from two different sources:

- i. Program staff maintain a data base in which are recorded the loan requests and loan commitments by borrower, community, and fiscal year.
- ii. Loan disbursement data, again by borrower, community, and fiscal year, is not available in the program data base but is available instead in AEA's financial records.

It is difficult to precisely match up these two data sources so that any individual loan request and commitment can be readily followed through to a corresponding disbursement. The main problem is that, in a significant number of cases, a loan request comes in during the final months of a given fiscal year although the loan itself is not disbursed until the following fiscal year. As a result, the program data base records the loan request in "Year A" while the financial records show the loan disbursement in "Year B." Especially since loan requests and (lagging behind them) loan disbursements have recently been growing, this mismatch distorts the comparison of requests, commitments, and disbursements within a given fiscal year.

Having stated this qualification, Table 2 and Graph 3 are presented below with the aggregate data from these two sources. When reviewing them,