ALASKA LEGISLATURE COMMITTEE FILES 1983 - 1984 8672

2584 HLC HB 569 - HB 610

2584

HEALTH AND SAFETY CODE

DIVISION 7. DEAD BODIES

PART 1. GENERAL PROVISIONS

CHAPTER 1. DEFINITIONS

7000. The definitions in this chapter apply to this division and to visions 8 and 9 of this code.

7001. "Human remains" or "remains" means the body of a deceased rson, and includes the body in any stage of decomposition and cremated mains.

7002. "Cremated remains" means human remains after incineration d necessary processing under Section 7054.1 in a crematory.

7003. "Cemetery" means any one, or a combination of more than one, the following, in a place used, or intended to be used, and dedicated, cemetery purposes:

(a) A burial park, for earth interments.

(b) A mausoleum, for crypt or vault interments.

(c) A crematory, or a crematory and columbarium, for cinerary erments.

7004. "Burial park" means a tract of land for the burial of human mains in the ground, used or intended to be used, and dedicated, for metery purposes.

7005. Except in Part 5 of Division 8 of this code, "mausoleum" means tructure or building for the entombment of human remains in crypts vaults in a place used, or intended to be used, and dedicated, for metery purposes.

7006. "Crematory" means a building or structure containing one or ore furnaces for the reduction of bodies of deceased persons to cremated mains.

7007. Except in Part 5 of Division 8 of this code, "columbarium" means tructure, room, or other space in a building or structure containing hes for inurnment of cremated human remains in a place used, or ended to be used, and dedicated, for cemetery purposes.

7008. "Crematory and columbarium" means a building or structure ntaining both a crematory and columbarium.

7009. "Interment" means the disposition of human remains by rnment, entombment, or burial in a cemetery or, in the case of mated remains, by inurnment, entombment, burial, or burial at sea as ovided in Section 7117.

7010. "Cremation" means the reduction of the body of a deceased rson to cremated remains in a crematory and the placement of the mated remains in a grave, vault or niche or burial at sea as provided Section 7117 of this code.

7011. "Inurnment" means placing cremated remains in an urn and acing it in a niche.

7012. "Entombment" means the placement of human remains in a ypt or vault.

7013. "Burial" means the placement of human remains in a grave.

7014. "Grave" means a space of ground in a burial park, used, or tended to be used, for burial.

7015. "Crypt" or "vault" means a space in a mausoleum of sufficient ze, used or intended to be used, to entomb uncremated human remains.

7016. "Niche" means a space in a columbarium used, or intended to be used, for inurnment of cremated human remains.

7017. "Temporary receiving vault" means a vault used or intended to be used for the temporary placement of human remains.

7018. "Cemetery authority" includes cemetery association, corporation sole, or other person owning or controlling cemetery lands or property.

7019. "Cemetery corporation," "cemetery association," or "cemetery corporation or association" mean any corporation now or hereafter organized which is or may be authorized by its articles to conduct any one or more or all of the businesses of a cemetery, but do not mean or include a corporation sole.

7020. "Cemetery business," "cemetery businesses," and "cemetery purposes" are used interchangeably and mean any and all business and purposes requisite to, necessary for, or incident to, establishing, maintaining, operating, improving, or conducting a cemetery, interring human remains, and the care, preservation, and embellishment of cemetery property, including, but not limited to, any activity or business designed for the benefit, service, convenience, education, or spiritual uplift of property owners or persons visiting the cemetery.

7021. "Directors" or "governing body" means the board of directors, board of trustees, or other governing body of a cemetery association.

7022. "Lot," "plot," or "interment plot" means space in a cemetery, used or intended to be used for the interment of human remains. Such terms include and apply to one or more than one adjoining graves, one or more than one adjoining crypts or vaults, or one or more than one adjoining niches.

7023. "Plot owner," "owner," or "lot proprietor" means any person in whose name an interment plot stands of record as owner, in the office of a cemetery authority.

7024. "Permit for Disposition of Human Remains" includes "burial permit" and is a permit, issued pursuant to law, for the interment, disinterment, removal, reinterment or transportation of human remains.

DIVISION 8. CEMETERIES

PART 1. GENERAL PROVISIONS

CHAPTER 1. CEMETERY DEFINED

8100. Six or more human bodies being buried at one place constitute the place a cemetery.

CHAPTER 2. VANDALISM

8101. (a) Every person is guilty of a misdemeanor and punishable by a fine of not less than two hundred fifty dollars ($250) nor more than one thousand dollars ($1,000), or by imprisonment in the county jail for not exceeding one year, or by both, who maliciously does any of the following:

(1) Destroys, cuts, mutilates, effaces, or otherwise injures, tears down, or removes any tomb, monument, memorial, or marker in a cemetery, or any gate, door, fence, wall, post or railing, or any inclosure for the protection of a cemetery or any property in a cemetery.

(2) Obliterates any grave, vault, niche, or crypt.

(3) Destroys, cuts, breaks or injures any building, statuary, ornamentation, tree, shrub, or plant within the limits of a cemetery.

HB

589

STATE OF ALASKA

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3873

HOUSE LABOR AND COMMERCE COMMITTEE

March 2, 1984

FOR IMMEDIATE RELEASE
CONTACT: REP. JOHN COWDERY
465-4905

HOUSE LABOR AND COMMERCE COMMITTEE AMENDMENT KEEPS SUSITNA EQUITY CLAUSE INTACT

JUNEAU - The House Labor and Commerce Committee on Friday approved House Bill 589, but added an amendment to the legislation which would ensure funding and construction of the Watana Dam phase of the Susitna Hydroelectric Project.

HB 589, authored by the Sheffield administration, proposed to repeal the so-called "susitna equity clause" as part of an attempt to finance four ailing hydroelectric projects under the direction of the Alaska Power Authority.

Rep. John Cowdery, R-Anchorage, chairman of the committee, said the amendment would delay repeal of the equity clause until construction of the Watana Dam is ensured with the establishment of a proposed major projects fund. "This is a message to the administration that Susitna supporters will not stand by idlely while attempts are made to salvage the four dam pool" said Cowdery. The representative from south Anchorage noted "this is only the first step in the process of developing a comprehensive state-wide energy program. There is obviously a lot of negotiating to be done before the problems with hydropower in Alaska are resolved".

The Labor and Commerce Committee also approved a measure appropriating 35 million dollars to help stabilize power rates for the four dam pool. Both pieces of legislation now go to the Resources Committee where further work will be done on the states energy program and the proposed major projects fund.

MARCH 2, 1984

TO: JOHN

FROM: KEN

RE: HB 589

POINTS OF DEBATE FAVORING AMENDMENT TO HB 589

THE KEY WORD IN WENDTE'S OPPOSITION DEBATE WILL BE "IF". THERE ARE TOO MANY "IF'S" OR VARIABLES STILL TO BE RESOLVED BEFORE SUSITNA SUPPORTERS WILL ALLOW THE EQUITY CLAUSE TO BE REPEALED.

1. IF POWER SALES AGREEMENTS ARE SIGNED.

2. IF PETERSBURG DOES NOT SIGN THE AGREEMENT SOON, ALTERNATIVE POWER SALES CONTRACTS WILL HAVE TO BE DRAWN UP AND THERE IS NO ASSURANCE THE FOUR OTHER COMMUNITIES INVOLVED IN THE NEGOTIATIONS WILL AGREE TO THE NEW TERMS BECAUSE:

A. THE ENTRY RATE INTO THE INITIAL PROJECT FOR THE FOUR COMMUNITIES WILL BE HIGHER.

B. THE WHOLESALE POWER RATE MIGHT ALSO BE HIGHER BECAUSE OF LESS UTILIZATION AT LAKE TYEE.

3. IF THE LEGISLATURE APPROVES A MAJOR PROJECTS FUND WHICH PRIORITIZES WATANA CONSTRUCTION. IF THE LEGISLATURE APPROVES THE COMMITTEE SUBSTITUTE FOR HB 589. IF THE LEGISLATURE PASSES HB 684 APPROPRIATING FUNDS FOR RATE STABILIZATION. IF ALL THESE PIECES OF LEGISLATION ARE PACKAGED AND APPROVED IT WILL SOLIDIFY ALASKA'S COMMITMENT TO A COMPREHENSIVE STATEWIDE ENERGY PROGRAM.

4. IF THESE STEPS ARE TAKEN I WOULD PROJECT THE "BONDING APPEAL" FOR ALASKA'S HYDROELECTRIC PROJECTS WILL ESCALATE AND THERE WILL BE NO DEFAULT ON ANY OF THE SHORT DEBTS NOW FACING THE STATE.

AS CHAIRMAN, IT IS MY INTENTION TO PASS FROM THE LABOR AND COMMERCE COMMITTEE TO THE NEXT COMMITTEE OF REFERRAL, THE COMMITTEE SUBSTITUTE FOR HB 589 ALONG WITH HB 684 APPROVING A 35 MILLION DOLLAR APPROPRIATION FOR RATE STABILIZATION.

STATE OF ALASKA

POUCH V
JUNEAU, ALASKA 99811
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March 2, 1984

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Department of Commerce & Economic Development / POSITION PAPER

HB 589: "An act relating to the Alaska Power Authority; and providing for an effective date."

My name is George Matz. I am Special Assistant to Commissioner Richard A. Lyon for the Department of Commerce and Economic Development. I am representing Commissioner Lyon who regrets that he is not able to attend this hearing because of previous commitments in Washington, D.C.

There are four points that I want to make in my testimony:

- First, HB 589 is essential to the power sales agreements and the long-term financing of the "Four Dam Pool."
- Second, the long-term financing of the "Four Dam Pool" is essential to the Energy Program for Alaska.
- Third, the power sales agreements now being negotiated by the Alaska Power Authority (APA) should be financable.
- Fourth, the Department of Commerce and Economic Development supports the terms and conditions of the power sales agreements being negotiated by the APA.

To elaborate on these points, the Energy Program for Alaska was conceived by the Legislature in 1981 when it enacted Chapter 118, SLA 1981 (SB 25). After nearly three years of gestation, we are about to witness its birth as an operating power supply system. However, nearly $200 million of interim financing must first be converted to long-term financing. How the financing occurs will determine the long-term health of the Energy Program for Alaska.

If revenue bonds are used for long-term financing, the Energy Program for Alaska will have overcome some prenatal illness and can look forward to a healthy life with ever more attractive power rates. Also, these initial projects can expect to be the parents of a family of power projects that serve the electrical needs of Alaska. Hopefully, with our improved diagnostic skills, we will prevent a recurrence of the problems previously experienced.

If long-term financing is based on additional State appropriations, the Energy Program for Alaska will draw nourishment from other State needs. Also, the program will not have demonstrated the ability to exist without 100% financial support from the State. This is not a good precedent for propagating additional power projects.

If the Energy Program for Alaska has neither revenue bond financing nor State appropriation, it will be stillborn. In financial terms that means the State would default on repayments of the interim financing.

As we approach the term of this gestation, we know that some assistance is needed to assure completion of long-term financing. Our bond counsel and underwriters warned us of some statutory problems that could impede the sale of revenue bonds. Also, the respective communities and utilities have stated that their participation is contingent on certain statutory changes.

As a result of this advice, the Governor has introduced HB 589 which includes the statutory changes required to meet the demands of both the bond buyer and the wholesale power buyer. The Administration considers each section of this bill to be essential.

The highlights of HB 589 are as follows:

1. Section 1 repeals the existing statutory requirement that industrial retail power rates can be no less than retail power rates to residential customers. This allows utilities to offer, if they wish, lower rates to large volume customers.

2. Section 1 and 2 allows the four projects that are part of the "Four Dam Pool" (Solomon Gulch, Swan Lake, Lake Tyee and Terror Lake) to be considered as one project. The significance of this is that the debt service portion of the wholesale power rate for each project will be unified rather than project-specific as currently required by the statutes. Project-specific allocation of debt service results in higher wholesale power rates for projects which are more costly and/or have unused capacity relative to other projects in the pool. However, new projects added to the Energy Program for Alaska will have project-specific rates.

3. Section 2 deletes the "Susitna clause" which otherwise would trigger substantial wholesale power rate increases for projects included in the Energy Program for Alaska. The possibility of this rate increase and the reduction that could occur in demand and revenues will have a decidedly negative effect on the ratings and interest rates of revenue bonds used for long-term financing of the "Four Dam Pool."

4. Section 2 includes a technical amendments which deletes "at the bus-bar" in order to remove ambiguity.

5. Section 3 protects the "Four Dam Pool" from the addition of new projects to the Energy Program for Alaska which could substantially increase their wholesale power rate.

6. Section 4 removes reference to the "Susitna clause" from definitions that apply to the Energy Program for Alaska.

7. Section 5, similiar to Section 1, allows utilities to establish retail industrial rates that are less than residential rates.

8. Section 6 provides an immediate effective date.

HB 589 represents a tremendous amount of analysis and negotiating. All communities or utilities that are part of the "Four Dam Pool" have had extensive opportunity to partake in drafting the concept and the language of this bill. The Administration firmly believes that HB 589 represents the best resolution to a difficult problem and the best approach for leveraging futher development of power projects in Alaska.

FEBRUARY 29, 1984

TO: JOHN
FROM: KEN
RE: HB 589

HB 589 WOULD AMEND STATE STATUTES GOVERNING THE ALASKA POWER AUTHORITY. IT WOULD COMBINE FOUR HYDROELECTRIC PROJECTS, LAKE TYEE, SWAN LAKE, SOLOMON GULCH, AND TERROR LAKE, INTO ONE POWER PROJECT WHICH WOULD BE REFERED TO AS THE INITIAL PROJECT. THE LEGISLATION WOULD ALSO REPEAL THE HIGHLY CONTROVERSIAL "SUSITNA CLAUSE", A STATUTE APPROVED BY THE LEGISLATURE TO ASSURE THE CONSTRUCTION OF THE SUSITNA HYDROELECTRIC PROJECT.

WHILE I BELIEVE THIS BILL HAS CONSIDERABLE MERIT, I AM OPPOSED TO THE REPEAL OF THE SUSITNA CLAUSE WITHOUT SOME SUBSTITUTE ASSURANCE THAT THE WATANA PHASE OF SUSITNA WILL BE CONSTRUCTED. IT MY INTENTION, AS CHAIRMAN, TO TAKE TESTIMONY TODAY ON HB 589, AND, I WOULD ASK THE MEMBERS OF THIS COMMITTEE TO CONSIDER THAT TESTIMONY AND PERHAPS A COMMITTEE SUBSTITUTE.

LEGISLATIVE BRIEFING
LABOR AND COMMERCE COMMITTEES
ENERGY PROGRAM FOR ALASKA

The Energy Program for Alaska, adopted by the Legislature in 1981, provides for State construction, ownership, and operation of power generating projects throughout the State. Program objectives are achieved by providing financing through the Power Authority for the development of new power projects and the acquisition of existing projects. The Energy Program includes a check and balance system for project development and approval, through which a project's feasibility must be approved by the Legislature before expenditures for design and construction can begin. Following legislative approval and funding, the Power Authority designs and constructs the project, which is then owned by the State.

Under the Energy Program for Alaska, the Power Authority acquired the Solomon Gulch project, then being constructed by Copper Valley Electric Association. This project serves Valdez and Glennallen. The Swan Lake project, then being developed by Ketchikan Public Utilities, was also acquired under this program. In addition, the Power Authority assumed responsibility for developing and constructing the Tyee Lake project for Wrangell and Petersburg, and the Terror Lake project near Kodiak.

These hydroelectric projects are known as the Four Project Pool, which has become the cornerstone of the Energy Program for Alaska. The Solomon Gulch project is in commercial operation; the Tyee project will soon be providing test power to Wrangell and Petersburg; Swan Lake is providing test power to Ketchikan; and the Terror Lake project is about 95 percent complete with power projected to be on-line in September 1984. With the completion of these projects, the role of the Power Authority in power generation, transmission, and the wholesale marketing of electrical energy is significantly expanding.

When the Legislature began appropriating funds in 1979 for the construction of hydroelectric projects, it was intended that these projects were to be fully financed by the State. However, declining State revenues resulting from a drop in international oil prices has forced the abandonment, at least for the foreseeable future, of full State funding of these projects. Lower oil prices have also made the short term cost of hydropower from new projects less advantageous, when compared to the cost of diesel generated electricity, than it once was expected to be. Power Authority economic and financial analyses have necessarily assumed conservative long term oil price increases although experts consider the possibility of world oil supply interruptions could dramatically revise current Power Authority projections.

In the face of the financial reality of declining State revenue, the Legislature amended the Energy Program for Alaska with House Bill 9 (HB 9) in 1982. The original legislation had established a single wholesale power rate for all Power Authority projects in the State. HB 9 changed this by establishing a new rate setting mechanism based on pooling the debt service of the projects and providing that each project carry its own operation and maintenance costs.

To meet the requirements of HB 9 and the needs of consumers in the communities served by the Four Project Pool as equitably as possible, the Power Authority has

proposed new power sales agreements with those communities served by the Four Project Pool. These agreements are the result of several months of negotiation and extensive coordination between the Power Authority, the utilities to be served by the projects, financial institutions, the Governor's Office, and the legislative leadership. Under the agreements, initial consumer rates for the four hydroelectric projects are designed so as not to exceed the cost of diesel-generated power, and in the long-run, provide more favorable rates. They should provide significant benefits to the communities served by the projects as well as communities to be served by future projects that will be included in the program.

In order to implement the proposed power sales agreements, new legislation is necessary. These legislative changes are:

- Elimination of the energy fund requirement (commonly referred to as the Susitna Clause) to reduce the potential future risk to the Four Project Pool communities
- A limitation on the impact of new projects coming into the system on the debt requirement of the first four projects
- Authorization of the sale of power to industrial users at a separate rate
- Classification of the first four projects as one project in order to issue revenue bonds as a single system
- Approval and financing of a Rate Stabilization Fund (with a total State appropriation of approximately $35 million) to off-set the difference between the costs of hydropower and diesel generated electricity during the early years of the projects.

Negotiations are still in progress with the Five communities involved in the Four Project Pool. The Power Authority plans to present its final offer to the Board of Directors for action on March 9, 1984. The communities have indicated that it will take thirty to forty-five days longer for them to ratify any agreement due to local ordinance requirements. Petersburg has indicated that they will conduct a local election on the matter on April 17, 1984.

ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES
RESEARCH AGENCY

Pouch Y, State Capitol
Juneau, Alaska 99811
(907) 465-3991

March 10, 1983

MEMORANDUM

TO: Representative Jack McBride

FROM: Jack Kreinheder
Research Staff

RE: History of Hydro Projects in Election District 1
Research Request 83-54

You requested that we summarize the development of hydro projects in Election District 1, focusing on the Swan Lake, Lake Grace and Tyee Lake sites. As you know, the Swan Lake and Tyee Lake projects are under construction by the Alaska Power Authority, while Lake Grace was considered as an alternative to the Swan Lake site.

Existing Hydro Projects in Ketchikan and Petersburg

The City of Ketchikan's electric utility generates about 45 percent of its annual power production from three existing hydro facilities at Ketchikan, Beaver Falls, and Lake Silvis. The generation capacity of these hydro units is 4,200, 5,000, and 2,100 kilowatts, respectively. The first generating unit at the Ketchikan site was installed in 1938, with another unit added in 1957. The first Beaver Falls unit was installed in 1946, with two more generators added in 1954. The Lake Silvis plant was installed in 1968.

Ketchikan's remaining power demand is met by diesel generators with a total capacity of about 18,300 kilowatts. These diesel units will be retired except for standby generation purposes when the Swan Lake project is completed.

Petersburg generates about 50 percent of its current power requirements from the Crystal Lake hydro project. This project was originally developed in 1929, with a major expansion in 1955. The current generation capacity of the Crystal Lake plant is about 2,000 kilowatts.

The City of Wrangell presently generates all of its electricity from diesel plants.

Lake Grace

Lake Grace is located about 15 miles east of Swan Lake on the west side of Behm Canal. The proposed hydro plant at Lake Grace would have been substantially larger than Swan Lake in terms of power output and cost. The Lake Grace project would provide 25,000 kilowatts (KW) of capacity and 102 million kilowatt hours (KWH) of average annual energy, in comparison to 18,000 KW of capacity and 85.4 million KWH of energy for the Swan Lake project.

You expressed an interest in how the decision was made by Ketchikan to proceed with development of the Swan Lake hydro site, rather than the Lake Grace site. The principal basis for this decision was an appraisal report prepared by R.W. Beck and Associates in June 1977 for Ketchikan Public Utilities. This report evaluated the technical and economic feasibility and compared the cost of power for hydro developments at Swan Lake, Lake Grace, and Mahoney Lake, which is a smaller site.

The R.W. Beck report found that although hydro development was feasible at each of the three sites, Swan Lake was the most economic hydro alternative which would eliminate Ketchikan's reliance on diesel fuel. The average 10-year cost of power for the Swan Lake project was estimated at 6.7 cents per KWH, compared to 7.8 cents per KWH for the Lake Grace alternative. The Mahoney Lake alternative was competitive with Swan Lake with a power cost of 6.7 cents per KWH, but the Mahoney Lake site would not generate enough power to replace all of Ketchikan's diesel generation. A summary comparison of the three projects is included in Appendix A, taken from the R.W. Beck report.

You also indicated an interest in whether the U.S. Borax mineral development at Quartz Hill was considered in the evaluation of alternative hydro projects for Ketchikan. It appears that the power requirements of the Borax development were not given significant consideration, for at least two reasons. When the Borax molybdenum discovery was first announced in 1977, Borax planned to meet its power needs by constructing its own hydro project at Wilson Lake (this plan was later dropped because of strong local opposition, due in large part to the high sport fishing value of Wilson Lake). In addition, the City of Ketchikan was primarily concerned with meeting the power needs of its residents, not of mining or other industries outside of the city.

R.W. Beck recommended that Lake Grace and Mahoney Lake be reevaluated as additional hydroelectric developments when the power output from Swan Lake nears full utilization. Lake Grace is now within the Misty Fjords National Monument, which may make future development of this site more difficult. The Lake Grace area was withdrawn under federal land classification at one time as a power project site, but is unclear whether this withdrawal was superceded by the National Monument designation.

Swan Lake

The Alaska Power Authority prepared the following brief history of the Swan Lake project, which is expected to begin producing power by January or February of 1984.

> The City of Ketchikan, having made the decision to discontinue its reliance on the use of diesel electric generation to meet rising energy demands, authorized the engineering firm of R.W. Beck in September of 1977 to investigate the feasibility of developing, as a major hydroelectric generating resource, the Swan Lake Project which is located approximately 22 miles northeast of Ketchikan near the northern end of Carroll Inlet in the central portion of Revillagigedo Island.
>
> In June of 1978, R.W. Beck issued a feasibility report indicating that a hydroelectric project which would demonstrate a benefit/cost ratio of 1.25 could be constructed at Swan Lake at a total investment cost of $80,924,000. Subsequently, the City of Ketchikan, Ketchikan Public Utilities (KPU) authorized R.W. Beck to proceed with preparation of final design of the project.
>
> The 1980 Legislature through joint resolution authorized the Alaska Power Authority to issue bonds up to the maximum amount of $120,000,000 for financing the construction of the Swan Lake Project.
>
> Construction was initiated by KPU in November of 1980. Funding for project design and initial construction was secured primarily through the proceeds or loans from the Power Authority's Power Project Revolving Loan Fund.
>
> On May 28, 1981, the Power Authority loaned KPU $35,000,000 for construction from funds which had been raised through the sale of General Obligation Bonds.
>
> On May 21, 1982, the Power Authority and KPU executed an acquisition agreement under which, in return for providing funds to complete project construction, the Power Authority will receive title to the project and as operation of the project [begins] will provide sufficient power for the City of Ketchikan's needs via a Power Sales Agreement.

The total construction cost for the Swan Lake project is now estimated at $93.5 million in nominal dollars. The target completion date is April 1984; however, the construction work is ahead of

schedule and the project may be completed as early as January 1984. Swan Lake will have an installed generation capacity of 22.5 megawatts and an annual firm energy production of about 70 million KWH. The project is expected to have about 50 percent utilization in its first years of operation; that is, about 35 million KWH of the 70 million KWH available will be used by Ketchikan Public Utilities. The year in which the full capacity of Swan Lake will be consumed depends largely on the rate of increase in future power demand, which is uncertain. However, current Power Authority projections show the project being fully utilized in about 2002.

Lake Tyee

I believe that you have seen a copy of my memo on the Tyee project to Representative Clocksin, dated February 11. Attached to that memo was a Tyee chronology prepared by the Power Authority which focused mainly on cost estimates. This chronology is also attached here as Appendix 2.

The Tyee project was originally proposed by the Thomas Bay Power Authority, a local Petersburg and Wrangell group. This group was first interested in the development of the Thomas Bay hydro site, but a reconnaissance study by the Corps of Engineers indicated that the smaller Tyee project was more feasible and cost-effective. Based on the Corps study, the Thomas Bay Power Authority dropped the Thomas Bay site in favor of the Tyee project. When the Alaska Power Authority became operational in 1978, an agreement was reached for the Authority to take over the development of the project and proceed with design and licensing work.

The Alaska Power Authority prepared the following brief history of the Tyee project.

> On December 19, 1979, the Alaska Power Authority submitted an application to the Federal Energy Regulatory Commission (FERC) for the construction of the Tyee Hydroelectric Project in the vicinity of Wrangell and Petersburg, Alaska. Our engineers, R.W. Retherford Associates/International Engineering Company (IECO), estimated the cost of the project at that time at $53,333,000, including an allowance for inflation at the rate of seven percent per year during the construction period. Procurement of long-lead-time turbines began in July 1981, in anticipation of a FERC license. FERC issued a license August 5, 1981, and the award of several additional procurement and one construction contract followed almost immediately thereafter.

The power-on-line date is scheduled for January 1984. The current estimate of the total project cost is $124 million. Available funds include $82 million in State grants and $50 million in interim financing.

The powerhouse is located in the Tongass National Forest, approximately 40 miles east-southeast of Wrangell, Alaska. The project is designed to develop the energy potential of Tyee Lake--a natural lake at Elevation 1396--convert it to electricity, and transmit the energy to the communities of Wrangell and Petersburg for distribution.

Tyee will have an initial generating capacity of 20 megawatts, expandable to 30 megawatts with the addition of a third generating unit. The project will be able to produce about 110 million KWH per year, of which about 34 million KW (31 percent) is expected by the Power Authority to be sold to Petersburg and Wrangell in the first year of operation. Based on the Power Authority's estimate of 2.5 percent annual increase in power demand, the power output from the Tyee project will not be fully utilized until the year 2033.

I have also attached as Appendix C a memorandum by George Matz of the Office of Management and Budget which outlines the history of the Tyee project from the perspective of studies and approvals.

If you have any questions or would like more specific information on any of these hydroelectric projects, please do not hesitate to contact me. Also, I plan to complete a response to your research request on Swan Lake power rates (#83-89) by March 25. This analysis will compare projected power rates for the Swan Lake project with current power generation costs in Ketchikan and discuss alternatives for reducing Swan Lake rates, if necessary.

ALTERNATIVE HYDRO PROJECTS
SUMMARY OF CHARACTERISTICS

	Swan Lake Project	Lake Grace Project	Mahoney Lake Project
BASIN HYDROLOGY			
Drainage Area Above Dam, Sq. Mi.	36.5	29.2	2.05
Avg. Drainage Area Elevation	1,800	1,500	2,500
Avg. Annual Runoff at Dam Site, A.F. ...	335,000	279,000	33,500
Avg. Annual Runoff per Sq. Mi., cfsm ...	12.7	13.2	22.4
Max. Annual Runoff at Dam Site, A.F. ...	426,360	350,900	43,050
PROJECT POWER DATA			
Avg. Annual Energy Generated, GWh	88.0	105.2	49.7
Avg. Annual Energy at Load Center, GWh .	85.4	102.0	48.2
Annual Firm Energy Generated, GWh	68.0	93.3	29.5
Annual Firm Energy at Load Center, GWh .	66.0	90.5	28.6
Dependable Capacity at Load Center, kW .	18,000	25,000	9,000
RESERVOIR			
Normal Maximum Pool Elevation	330	500	1,956
Minimum Reservoir Elevation	269	458	1,776
Reservoir Area at Normal Maximum Pool ..	1,500	2,580	68
Active Storage Capacity, A.F.	86,000	150,600	7,150
DAM			
Type	Conc. Arch	Conc. Arch	None
Crest Elevation	344	509	-
Height Above Foundation, Feet	190	150	-

TABLE W-7

	Project SWAN LAKE	Project LAKE GRACE	Project MAHONEY LAKE
SPILLWAY			
Length, Ft.	100	200	90
Crest Elevation	330	500	1,956
POWER INTAKE	Single Level on Dam	Multi-Level on Abutment	Lake Tap and Valve Chamber
POWER CONDUIT			
Tunnel:			
Diameter, Ft.	10	9	-
Length, Ft.	2,250	3,400	-
Q Maximum, cfs	1,160	920	-
V Maximum, fps	14.8	14.5	-
Penstock (Steel):			
Diameter, Ft.	9	6.5	3
Length, Ft.	70	875	6,200
Q Maximum, cfs	1,160	920	86
V Maximum, fps	18.2	27.8	12.2
POWERHOUSE			
Turbines (Type)	2-Vertical Shaft Francis	2-Vertical Shaft Francis	2-Impulse
Speed, rpm	450	600	900
Net Design Head, Ft.	291	429	1,709
Rated Capacity, Best Gate, kW Total	22,680	26,700	10,600
Discharge at Avg. Head, cfs	1,014	855	78
Avg. Tailwater Elevation	8	27	88

(Continued)

	SWAN LAKE Project	Lake Grace Project	Mahoney Lake Project
TRANSMISSION LINE			
Voltage, kV	115	115	34.5
Length, Mi. (for New Line)	25	40	4
Type	Wood-Pole	Wood-Pole	Wood-Pole
ACCESS ROADS			
New Roads, Miles	1.0	3.6	7.0

ALASKA POWER AUTHORITY

334 WEST 5th AVENUE - ANCHORAGE, ALASKA 99501

Phone: (907) 277-7641
(907) 276-0001

February 9, 1983

Mr. Jack Kreinheder
House Research Agency
Pouch Y
Juneau, Alaska 99811

Subject: Tyee Hydroelectric Project-Summary of Estimated Total Costs

Dear Jack:

As per your request, following is a brief summary on the sequence of events on the Tyee hydropower project primarily relating to cost. The summary of Board actions was extracted from our corporate minutes. Most of the actions taken by the Board were based on advice from myself and my staff.

On December 19, 1979, the Alaska Power Authority submitted a revised application to the Federal Energy Regulatory Commission (FERC) for the construction of the Tyee Hydroelectric Project in the vicinity of Wrangell and Petersburg, Alaska. Our engineers, R.W. Retherford Associates/International Engineering Company (IECO) estimated the total cost of the project at that time at $39,590,000 (1980$'s). With an allowance for inflation and interest during construction the estimated total capital investment at that time came to $53,333,000.

In September 1980, IECO submitted a revised cost estimate of $50,976,000 (August 1980$'s).

Early in 1981, the Power Authority retained EBASCO Services, Inc., to prepare an independent cost estimate. EBASCO subsequently estimated the total project cost at $96,693,000 (May 1981$'s). Escalated to the midpoint of construction, this would represent a completed cost of approximately $110 million. After reviewing the EBASCO estimate, IECO conceded that its previous estimates were low and IECO raised its estimate to $81,069,000 (June 1981$'s). EBASCO refuted this revised estimate.

Procurement of long-lead-time turbines began in July 1981 in anticipation of a FERC license. The Board of Directors was realigned by Statute in the latter part of July 1981. The FERC issued a license on August 5, 1981 and the award of several additional procurement and one construction contract followed almost immediately thereafter.

IECO continued to make monthly reports on the status of the project, including estimated total project costs. It is important to note that by the end of March 1982, IECO had increased its project estimate to $97,072,000,

including engineering costs prior to construction. In the March report the overhead transmission line was estimated to cost $12,840,000 plus a $6,000,000 contingency. Less than two months later, during the bid opening for that contract, IECO provided an engineer's estimate of $23,280,887.00--an estimate that is 24 percent above any previous estimate, including contingency funds. The actual low bid was even higher at $24,901,466.

Starting with the IECO estimate from the March 1982, report, adjusting for the actual low bid on the transmission line, and adding the estimated cost for a proposed separate substation construction contract, the estimated total project cost was increased by IECO to $110,133,000 (May 1982). This did not include approximately $5 million for owner provided insurance. During the months that followed, the total project cost has decreased and increased, slightly, as adjustments have been made for actual bids on relatively small procurement contracts..

In December 1982, and again in January 1983, senior staff of IECO and IECO's parent company, Morrison Knudson (M-K), met with representatives of the Power Authority to discuss construction management of the project, including total project costs. The latest information from IECO is that the total project cost will not exceed $124,886,100. The Power Authority has asked the parent company, M-K, to completely review this estimate. A report from the M-K staff is anticipated the second week of March 1983.

A summary of Board actions, as extracted from our corporate minutes, is as follows:

October 4, 1978 Board receives report on Tyee Project indicating that, according to the reconnaissance study by Robert W. Retherford Associates, (RWR) the Project looks favorable and that Thomas Bay Power Commission (TBPC) will soon enter into contract with RWR for Federal Energy Regulatory Commission (FERC) work and that TBPC may request the Alaska Power Authority to take over the project.

November 18, 1978 APA Board voted to make $120,000 loan to TBPC for Tyee FERC work and this would supplement the $300,000 available from the Water Resources Revolving Loan Fund (WRRLF) in order to cover the $475,000 contract with RWR.

June 21, 1979 Board makes a loan to TBPC of $60,000 for Tyee Project. TBPC and Representative E.J. Haugen request the APA take over Tyee. The Board directed staff to bring information back at next Board meeting for Project take-over.

September 27, 1979 Tyee Letter of Understanding with TBPC adopted by Board.

November 2, 1979 Board authorized Executive Director to submit FERC license application. Also passed "stop-the-clock" resolution needed for bonding.

February 7, 1980 Board agreed to extend contract for advanced Engineering

and Design to IECO for Tyee but it was later decided with legal council to seek competitive proposals.

April 18, 1980 Board selects IECO for the Engineering and Design from among three proposals.

October 23, 1980 Board informed that costs have increased from $39,000,000 to $51,000,000 and has IECO explain to Board.

April 20, 1981 Board selects consultant panel as required by FERC.

May 14, 1981 Board awards Bids for Turbines.

July 6, 1981 Board considered awarding contract for Steel Towers and Conductors but defers "notice to proceed" until after opening of major Civil Contract so that the Board could get a better fix on the true cost of the Project.

August 18, 1981 FERC license has been received. Bids for Civil construction were reviewed as were the economics of the Project based on new cost estimates. Notice-to-proceed was given on Towers and Conductors. The Board was informed that existing funds were insufficient and that interim financing would be necessary. Board deferred action until the next meeting.

September 10, 1981 Board awards Civil Works contract to Southeast Harrison Western (SEHW) after lengthy debate.

October 2, 1981 Board informed on legal actions against Tyee construction contracts. Need for interim financing was discussed and indicated a proposal would be presented to the Board in December, 1981. Risk Management's desire to use "Wrap-up Insurance" on Tyee Project was discussed and actions that would be taken to effectuate such a program.

December 15, 1981 A Finance Plan was presented to the Board. It was recommended that the Board appoint a subcommittee to review the feasibility of the Tyee Project based on present knowledge of the costs. Commissioners Ward and Mueller and Dr. Weeden were appointed to the subcommittee. The Board moved that final financing documents for financing be prepared. The economics of the Project was reviewed.

January 22, 1982 Senator Dankworth and Representative Haugen addressed the Board and recommended proceeding with interim financing. Board authorized securing of $50,000,000 in interim financing. Board awarded a contract for Underwater Cables.

May 25, 1982 The Board awarded the Overhead Transmission Line contingent upon the Legislature not passing a piece of legislation that was being considered but that subsequently was not passed. Thus on June 3, 1982 the Executive Director informed the Board of his intent to issue the award for Transmission Tower construction.

October 22, 1982 The Board awarded contract for Transformers.

I trust this information is of assistance to you. If there is any further information you need, please call on me.

Sincerely,

Eric P. Yould
Executive Director

CC:
C. Conway
Comm. D. Lyon

MEMORANDUM State of Alaska

TO Gordon Harrison
Associate Director
Office of Management and Budget
Division of Strategic Planning

DATE February 23, 1983

FILE NO

TELEPHONE NO 465-3573

FROM George Matz GM
Division of Strategic Planning
Office of Management and Budget

SUBJECT Tyee Lake Project

There has been controversy recently regarding the Tyee Lake Project. The City of Petersburg has stated that the cost of power from the project is too expensive and they may not want to sign a power sales contract under the terms initially proposed by the Alaska Power Authority (APA). This situation has lead to an examination of other questions including the projects economic feasibility and the process by which this is determined. The purpose of this memo is to provide an historical perspective on the question of economic feasibility. The information in this memo should supplement rather than duplicate information in a February 9, 1983 memo from Eric Yould to Jack Kreinheder and a February 11, 1983 memo from Jack Kreinheder to Representative Don Hocksin.

The feasibility study for the Tyee Lake Project was completed for the APA in December of 1979. The statute at this time (AS 44.56.180) required the Office of the Governor to evaluate APA feasibility studies. Since the APA was in its infancy and the Tyee Lake Project was its first project to have completed a feasibility study, no formal review was undertaken.

In 1980, the Legislature passed an omnibus energy bill (Ch 83, SLA 1980) which amended requirements for APA reconnaissance and feasibility studies. This bill also requires the Division of Budget and Management (now Office of Management and Budget) to review these studies for statutory compliance and provide a recommendation to the Governor and the Legislature for feasibility studies. However, certain projects, including the Tyee Lake Project, had been previously approved by the Legislature and were exempted from review by the Division of Budget and Management. House Joint Resolution No. 62, which had been approved by the Legislature earlier in the 1980 session, stated that the general design of the Tyee Lake Project was approved and that the APA could incur $70,000,000 in revenue bond indebtedness to finance the project.

In 1981, the Legislature once again made significant amendments to the APA statutes (Ch 118, SLA 1981). One of the more significant amendments established a Power Development Fund to be used primarily for financing construction of State owned power projects. Restrictions were placed on the use of this fund. One of these restrictions (AS 44.83.394) states that "the authority may not use money in the fund for a power project except in compliance with AS 44.83.177-44.83.187 and unless the authority determines that the project is economically feasible."

Ch 90, SLA 1981 (which was the appropriation bill which accompanied Ch 118, SLA 1981) made appropriations to begin construction on three power projects. These projects, and the amount of their respective appropriations are Tyee Lake Project - $48,000,000, Swan Lake Project - $53,000,000, and the Terror Lake Project $81,500,000. Additional appropriations in the form of a loan, had previously been made to each of these projects. These loans were converted to grants by another bill Ch 91, SLA 1981.

Although each of these projects had completed feasibility studies and received legislative approval, AS 44.83.394 required a final review of the economic feasibilty of each project before the APA could make expenditures from the Power Development Fund. The statutes are not specific as to how the economic feasibility should be determined. The APA assumed that the feasibility assessment should be treated as an updated supplement to previous feasibility studies rather than repeat the entire process.

Apparently, the APA's first attempt at complying with AS 44.83.394 was an August 13, 1981 memo from Robert Mohn, Director of Engineering to the Record (see Attachment A). The information in this memo was presented to the August 18, 1981 meeting of the APA Board of Directors to demonstrate that even with more recent and higher construction cost estimates, the Tyee Lake Project was economically feasible at the "most likely" load growth rates. Following this presentation, the Board was asked to approve the award of construction contracts which would obligate funds in the Power Development Fund. It should be noted that this was the first meeting of a newly appointed Board of Directors and not all of the Board members were familiar with statutory requirements for power projects.

Ron Lehr, a Board member and Director of Budget and Management at that time, questioned some of the points used in the presentation and requested backup information. This information was sent to Budget and Mangement where staff found the information inadequate to make a determination regarding the economic feasibility of the Tyee Lake Project. APA staff was informed of this and responded in a September 10, 1981 letter with copies of the calculations used for the August 13, 1981 memo.

Budget and Management staff reviewed these calculations, found some technical errors, and requested that corrections be made in the analysis. Apparently, the request led to a decision by the APA to provide a more complete and adequate explanation of the economic feasibility of the project. The product of this effort was a "Findings and Recommendations" report that was completed on December 2, 1981 and distributed to the Board at its December meeting. This report fully explained the assumptions that were being used and provided enough details to review the economic feasibility of the project.

Although a review by Budget and Management of the "Findings and Recommendations" report was not required by statute, a review was undertaken for the benefit of Ron Lehr who's interest was both as a Board member and State Budget Director. Ron Lehr distributed this review to the Board at its January, 1982 meeting.

The Budget and Management review (Attachment B) questioned several assumptions and calculations used in the "Findings and Recommendations" report. The conclusion of the review is that the Tyee Lake Project may not be economically feasible based on the "most likely" load forecast but should be economically feasible if the actual load should exceed the "most likely" load forecast. Some of the more significant points brought out in the review are given below.

1) If and When - The economic feasibility analysis of a power project, particularly projects having a long life such as hydro power, should not only determine "if" the project is feasible but "when" is the most economic time to begin construction. A timing exercise of this nature was not done for the Tyee Lake Project even though such an exercise is most applicable to projects which have initial overcapacity, such as the Tyee Lake Project.

2) Reserve Capacity - Neither this economic analysis or cost of power calculation considered the cost of reserve capacity.

3) Load Forecast - The base year for the load forecast was higher than actual data. Also, the load forecast assumed an increase in electric space heating even though fuel oil appears to be a less expensive alternative.

4) Alternative - A number of smaller and less remote hydroelectric alternatives were not given detailed consideration. U.S. Army Corps of Engineers data indicates that some of these projects could have lower power costs than the Tyee Lake Project. Also, since all of the projects were smaller, overcapacity would not be a significant problem.

The load forecast in the most significant and perhaps the most uncertain parameter which applies to the economic feasibility of the Tyee Lake Project. Since the load forecasts were made a few years ago, we now have the benefit of hindsight to assess the accuracy of the first few years of the forecast. This information is presented below based on the "most likely" forecast for the "Findings and Recommendations" report and the "expected" forecast for the Feasibility Study. The Feasibility Study used 1978 as the last year of actual data. Neither of these forecasts, as presented, subtract out approximately 11,700 MWh of annual generation from an existing hydroelectric facility near Petersburg.

Energy Sales (MWh) for Wrangell and Petersburg

Year	Actual	Findings and Recommendations Report	Feasibility Study
1978	29,981	---	29,981
1979	29,087	---	31,445
1980	29,788	30,535	32,990
1981	29,222	31,726	35,275
1982	30,989	32,963	37,710

In summary, commitments to the Tyee Lake Project have been slightly ahead of establishing a more rigorous process for assessing the economic feasibility of proposed APA projects. Specifically:

1) the feasibility study for the project was completed before an independent review process was firmly established by the Legislature;

2) the Legislature approved the project without benefit of an independent cost analysis as now required by statute; and

3) construction contracts had been awarded before the "Findings and Recommendations" report had been completed and before the provisions of AS 44.83.394 has been met.

HB584

BILL SHEFFIELD
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

February 8 1984

The Honorable Jalmar Kerttula
Alaska State Senate
Pouch V
Juneau, AK 99811

Dear Senator Kerttula:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to the sale of power by the Alaska Power Authority. The bill amends portions of AS 44.83.398, which governs sale of power from projects in the energy program for Alaska. The amendments are necessary before power sales agreements can be signed and long-term financing can be put in place for the Lake Tyee, Swan Lake, Solomon Gulch, and Terror Lake hydroelectric projects -- the "four dam pool."

A section-by-section analysis follows.

Sections 1 (by amending AS 44.83.398(a)) and 5 (by repealing AS 44.83.398(d)) of the bill eliminate restrictions on industrial power rates that may be charged by utilities purchasing power from projects in the energy program for Alaska. The statute currently prohibits utilities from charging a retail power rate to industrial consumers that is less than the rate charged to residential consumers. The change allows utilities to offer a lower rate to large-volume consumers, or consumers who currently use their own generation sources, which should reduce the overall rate to all consumers. The authority has discussed with the utilities the use of fixed-term supply contracts with industrial users with the length of the contract limited so that, when usage of power from the hydroelectric facilities approaches capacity, more power will be available to residential consumers and they will not end up subsidizing industrial power rates.

Section 1 also provides for the combination of the Lake Tyee, Swan Lake, Solomon Gulch, and Terror Lake hydroelectric projects into one power project for the purposes of the wholesale power rate calculation in AS 44.83.398-(b)(1). This power project is referred to as the "initial project."

Section 2 deletes the "Susitna clause" in AS 44.83.398-(b)(2). Repeal of this provision is desired by both the authority and the purchasing utilities because of the potential effect on rates. It is also viewed as crucial to the long-term financing of the initial project and future projects in the energy program for Alaska. The rating services are reluctant to give a favorable rating to revenue bonds issued with this provision in place because of the possibility that ratepayers' rates could increase substantially in 1991. The rates could be high enough to reduce demand and revenues, thus jeopardizing the ability of the utilities to meet their payment obligations under the power sales contracts.

Section 2 also describes the method for determining the amounts to be allocated to each hydroelectric facility in the initial project. Under this combined system the facilities share the debt service for the entire project and there is a single cents-per-kilowatt-hour rate for debt service applicable to all four hydroelectric facilities in the initial project. The rate for costs of operations, maintenance, equipment replacement, safety inspections, and investigations is determined separately for each facility. The result is a different wholesale rate for each facility in the initial project, but a sharing of debt service which substantially reduces the wholesale rate for projects such as Lake Tyee.

Section 3 adds a sentence to AS 44.83.398(e) to allow the power authority to contractually limit the amount of debt service payable by power purchasers as a consequence of the later addition of new projects to the energy program for Alaska.

Section 4 removes the reference to the "Susitna clause" from AS 44.83.398(g).

Section 6 provides for an immediate effective date.

Sincerely,

Bill Sheffield
Governor

607
589

Alaska Power Authority
Commissioner: D Lyon
Executive Director: Lary Crawford

Board meeting, 22 February 1984

Power Sales agreements;

1. Copper Valley: close to an agreement. Jim Billingame, manager of utilitiesstates that he shows some concern of confronting his public with a cost not seen before. Presently Glennallen diesel generation is .06 PKH and proposed APA power will be .07 PKW. This constitutes a 40% increase to some. Valdez is an emphatic NO! Average monthly consumption in Glennallen is 340 KWH and translates to $90 per month, while Valdez is running an average monthly bill of 550 KWH or $151. per month. A 40% increase can be devastating.

2. Wrangell: Matt Cole (position unknown) will be taking power sales agreement to city council Thursday night (Feb 23rd) for consideration. He says discussion (informal) with council members appears good and contract may be forthcoming.

3. Kodiak: David Neese, Mgr of Muni-power. Municipality has agreed to purchase power from APA. Two suggestions: possible loans to consumers and the establishment of an advisory board.

4. Ketchikan: Rick -?--. mgr of utilities says it looks very good, contract in the making with questions as to wording of legal documents.

5. Petersburg: NO!

Management study (status report) presented by Roger McMannus of Mead consultants for FY 84, FY 85, FY 86.

Presently APA employes 69 persons

Executive Dept----------4
Planning ---------- 9
Projects ----------18
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People People

APA is asking for an immediate increase of 16, 17 more FY 85, and an additional 9 for FY 86 to total 111 persons.

1984 Susitna contingency fund: 3.18 Million dollars
Drilling request (wantana dam) 1.9 million. if approved this will leave in the contingency fund 1.28 million.

Competitive bidding on Watana Dam drilling will be let 27 Feb 84 with awarding of contract sometime in mid April 84.

STATE OF ALASKA 1984 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date:

REQUEST
Bill/Resolution No.: HB 589
Title: Relating to the Alaska Power Authority
Sponsor: Governor
Requestor:
Date of Request:

FISCAL DETAIL
Agency Affected: Commerce & Economic Development
Program Category Affected: Development
BRU, Program or Subprogram(s) Affected: Alaska Power Authority

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 84	FY 85	FY 86	FY 87	FY 88	FY 89
OPERATING						
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 SUPPLIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS						
800 MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

ANALYSIS: Attach a separate page for analysis

Prepared By: George Matz
Phone: 465-2079
Division: Dept. of Commerce & Economic Development
Date: 1/6/84

Approved by Commissioner: Richard A. Lyon
Date: 2/6/84
Agency: Dept. of Commerce & Economic Development

Distribution (by Agency preparing fiscal note):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

12/1/83

Repeal of the "Susitna Clause" will remove the obligation that the State must appropriate $5 billion to the Power Development Fund by 1991 in order to prevent triggering of a requirement that there be a 10 percent rate of return on power project investments.

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667
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HB584

BILL SHEFFIELD
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
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Pouch V
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Sincerely,

Bill Sheffield

Bill Sheffield
Governor

HB

610

MARCH 28, 1984

TO: JOHN

FROM: KEN

RE: HB 610 "RELATING TO CONSTRUCTION CONTRACTORS"

HOUSE BILL 610 HAS BEEN CHANGED CONSIDERABLY IN THE DRAFTING OF THIS COMMITTEE SUBSTITUTE. MOST OF THE SUBSTANCE OF THE ORIGINAL BILL 610 DEALT WITH THE CREATION OF A BOARD OF BUILDERS. IN THE COMMITTEE SUBSTITUTE, THE REFERENCE TO A BOARD OF BUILDERS HAS BEEN DELETED AND THE FOCUS HAS TURNED TO ENFORCEMENT OF CURRENT REGULATION. UNDER THIS COMMITTEE SUBSTITUTE, THE DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT WOULD BE GRANTED THE AUTHORITY TO HIRE INVESTIGATORS TO POLICE CONSTRUCTION JOB CITES TO INSURE ALL CONTRACTORS ON THE JOB ARE LICENSED AND ARE COMPLYING TO THE LAW. THE INVESTIGATORS WOULD BE GIVEN THE AUTHORITY TO WRITE CITATIONS FOR VIOLATIONS WHICH THEY DISCOVER DURING THEIR INVESTIGATIONS. THIS IS COVERED IN SECTION FIVE ON PAGE TWO. A SECTIONAL ANALYSIS OF THE COMMITTEE SUBSTITUTE HAS BEEN PREPARED AND PROVIDED BY THE LEGAL SERVICES DIVISION.

MARCH 28, 1984

TO: JOHN

FROM: KEN

RE: HB 610 "RELATING TO CONSTRUCTION CONTRACTORS"

THE COMMITTEE SUBSTITUTE FOR HOUSE BILL 610 IS BASICALLY A REWRITE OF THE ORIGINAL BILL. MOST OF THE SUBSTANCE OF THE ORIGINAL BILL DEALT WITH THE CREATION OF A BOARD OF BUILDERS. IN THE COMMITTEE SUBSTITUTE, THE REFERENCE TO A BOARD OF BUILDERS HAS BEEN DELETED AND THE FOCUS HAS TURNED TO ENFORCEMENT OF CURRENT REGULATION. UNDER THIS COMMITTEE SUBSTITUTE, THE DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT WOULD BE GRANTED THE AUTHORITY TO HIRE INVESTIGATORS TO POLICE CONSTRUCTION JOB CITES TO INSURE ALL CONTRACTORS ON THE JOB ARE LICENSED AND ARE COMPLYING TO THE LAW. THE INVESTIGATORS WOULD BE GIVEN THE AUTHORITY TO WRITE CITATIONS FOR VIOLATIONS WHICH THEY DISCOVER DURING THEIR INVESTIGATIONS. THIS IS COVERED IN SECTION FIVE ON PAGE TWO. A SECTIONAL ANALYSIS OF THE COMMITTEE SUBSTITUTE HAS BEEN PREPARED AND PROVIDED BY THE LEGAL SERVICES DIVISION.

MARCH 8, 1984

TO: JOHN

FROM: KEN

RE: HB 610

HB 610 WAS WRITTEN IN LATE NOVEMBER AFTER A NUMBER OF HEARINGS CONDUCTED BY REP. FURNACE ON PROBLEMS RELATING TO SMALL CONTRACTORS IN ALASKA. THE PURPOSE OF THIS LEGISLATION IS TO REDUCE THE NUMBER OF CONTRACTORS WHO OPERATE IN ALASKA WITHOUT HOLDING A STATE CONTRACTORS LICENSE. DURING THE HEAVY CONSTRUCTION SEASON A LARGE NUMBER OF CONTRACTORS FROM OUT OF STATE COME TO ALASKA AND BECAUSE MANY ARE NOT LICENSED OR BONDED AND DON'T HAVE EXPENSES SUCH AS WORKMANS COMPENSATION, THEY CAN EASILY UNDER BID THOSE CONTRACTORS WHO COMPLY WITH LICENSE REQUIREMENTS. THIS BILL WOULD MAKE CHANGES IN STATUTES DESIGNED TO HELP THOSE CONTRACTORS WHO HAVE COMPLIED WITH THE LAWS OF THIS STATE.

QUESTIONS:

1. WHAT IS THE ADVANTAGE TO SMALL CONTRACTORS OF HAVING A BOARD OF BUILDERS ?

2. WHAT IS THE NEED TO INCREASE A GENERAL AND SPECIALTY CONTRACTORS BOND ?

3. HOW CAN LANGUAGE BE ADDED OR CHANGED IN THIS BILL THAT WOULD GO EVEN FURTHER IN HELPING THE SPECIALTY CONTRACTORS ?

4. WHEN HEARINGS WERE BEING HELD IN ANCHORAGE ON THIS ISSUE, A SUGGESTION WAS MADE TO REQUIRE A CONTRACTOR INCLUDE HIS LICENSE NUMBER IN ALL ADVERTISEMENTS. WAS THAT SUGGESTION ADOPTED INTO THIS BILL ?

5. HOW MANY NONE LICENSED CONTRACTORS DUE YOU ESTIMATE ARE OPERATING IN ALASKA ?

6. HOW MANY OF THOSE ARE STATE RESIDENTS THAT ARE SIMPLY NOT LICENSED ?

MARCH 23, 1984

TO: JOHN

FROM: KEN

RE: WORK SESSION ON HB 610 "RELATING TO CONSTRUCTION CONTRACTORS AND ESTABLISHING A BOARD OF BUILDERS"

THE HOUSE LABOR AND COMMERCE COMMITTEE HAS SPENT MANY HOURS WORKING TO RESOLVE THE PROBLEMS WHICH PLAGUE THE CONSTRUCTION INDUSTRY. DURING THE INTERIM, SEVERAL HEARINGS WERE HELD WITH MEMBERS OF THE INDUSTRY IN AN EFFORT TO HAMMER OUT A LEGISLATIVE SOLUTION. THE RESULT WAS HOUSE BILL 610, WHICH WE NOW HAVE BEFORE US. DURING RECENT PUBLIC HEARINGS HELD HERE IN JUNEAU AND IN ANCHORAGE, THE COMMITTEE RECOGNIZED THAT HB 610 DID NOT SOLVE ALL THE PROBLEMS WE HAD SOUGHT TO SOLVE. IN THIS WORK SESSION TODAY, I WOULD ASK THE COMMITTEE TO CONSIDER THE CONCERNS BROUGHT OUT IN PUBLIC TESTIMONY, AS WE WORK TO CONSTRUCT A BILL WHICH IS ADVANTAGEOUS TO GENERAL CONTRACTORS, SPECIALTY CONTRACTORS, AND TO THE CONSUMER AS WELL.

LICENSED AND BONDED CONTRACTORS MEETING
NOVEMBER 29, 1983
2:00 PM

The meeting was called to order my Rep. Furnace. Persons present at the meeting were:

Rep. Furnace
Rep. Cowdery
Rep. Uehling
Allairy
Ken Johnson
Steve Levi
Dianna Smith
Earl Carlyle
Ray D. Agen
James N. Malapanes
Clay Porter

Earl Carlyle passed out a paper with 15 suggestions to support specialty contractors and these suggestions were discussed in detail and the following recommendations were made:

1. Come up with a modified definition of a "Contractor". Make it mandatory for all licensed contractors to include their license number in all advertisements; including business cards, signs, newspaper ads, television ads, radio ads, and yellow pages for easier identification by the license enforcement investigator.

2. Put in the statutes that the contractors license number or administrators license number should appear on all vehicles used in the conduct of business.

3. Bonds should be increased to $5,000 and $10,000 on the initial draft.

4. Concern was expressed over the lack of enforcement offered by the Dept. of Labor and the suggestion was made to transfer the enforcement function to Dept. of Commerce and Economic Development, Division of Occupational Licensing which is a more reasonable, supervisory governmental unit. It was noted that we should give the inspectors more ability of checking for violations. Concern was also expressed with the regard to the ability of the enforcing agency to issue citations with "teeth". For further information, staff was advised to contact, Ron Wates with the Municipality at 786-8307.

5. Establishment of a statewide Board of Builders which shall meet on a monthly basis and shall include a membership of the following:
    1) Speciality Contractor
    2) Remodeling Specialist
    3) Private Sector Representative
    4) Local Government Representative
    5) Two General Contractors
    6) One Heavy Highway Contractor

6. This statement is already covered in number one.

7. It was recommended that House Counsel examine the constitutionality of legislation to terminate phone service for those companies who are inviolation of the licensing and bonding provisions of the statutes and regulations. House Counsel was contacted and staff has been informed that there is probably no constitutional question involved in the discontinuance of telephone service for those businesses which advertise falsly or falsly portray themselves as bonafied businesses. The only difficulty that could arise would be the instance in which a business phone and a personal phone are used for the same purpose and for some reason the individual could not disassociate the two entities.

8. It was noted that the laws for violators are there and the problem we are having is with enforcement. It was recommended that a monetary fine of not more than $250 a day for contractors in violation of the law (see page 15 of the Oregon law).

9. This statement is covered in suggestion number one, but it was recommended to maybe include a monetary fine of $250 a day.

10. It was noted that since there is some support for this issue, we would propose this to the drafters and let them work with some language as to how we can best do this. The general contractor is already covered, we want to reach the subcontractor.

11. It was noted that a list can be obtained, but that it takes a long time to get. A person requesting a list of contractors you should be able to get one within a certain period of time that is fairly predictable. It was recommended that we should advise that a list is available upon request for a nominal fee, if any, and that the list can be expected to be received within a two week or 30 day time frame. It was suggested that we may want to contact, Dick Lyon with the Dept. of Commerce and Economic Development to further discuss the possibilities of this of instigating this.

12. It was noted that this statement should have been on a separate sheet of paper and is not to be included under this heading because it pertains to the motor vehicle laws.

13. It was recommended that we restate this in whatever new section we develop on general contractors and specialty contractors.

14. It was recommended that a owner/builder can only build one home or one structure per year to take advantage of the owner-builder option to remain unlicensed.

NAME		
Ray D. Agen	P.O. Box 871370 WASILLA, AK 99687	376-3313
JAMES N. MALAPANES	PO Box 872040 WASILLA AK	3765130
CLAI PORTER, NCP CONST.	118 E. JATER. AIRPORT RD.	522-2283
CARL J. CARLYLE	S'41 E 25=	2761724
John Carlyle	~~8020~~ 8020 LAKE OTIS	344 2407

Chubrich

ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES
RESEARCH AGENCY

Pouch Y, State Capitol
Juneau, Alaska 99811
(907) 465-3991

January 10, 1984

MEMORANDUM

TO: Representative Jack McBride

FROM: Nancy Pease
Legislative Analyst

RE: Licensing and Bonding of Contractors in Other States
Research Request 83-251

Rena Bukovich of your staff requested information on the licensing and bonding of contractors in other states. Specifically, she asked how certain contractors--plumbers, electricians, builders and specialty contractors--are licensed and regulated in the following states: California, Colorado, Idaho, Michigan, Montana, Ohio, Oregon, and Washington.

Regulation of Contractors in the Eight States

Licensing. Altogether, 28 states license contractors. The licensing and bonding requirements for contractors in the eight states about which you inquired are summarized in the attached chart (see Attachment A). Of these states, Ohio is the only state which does not license contractors in any of the trades you specified (electrical work, plumbing, or general or specialty contracting). Colorado does not license general or specialty construction contractors, and Idaho and Montana require licenses of construction contractors only if they wish to bid on public works. With these exceptions, the states generally require contractors to be licensed.

Bonding. California, like Alaska, requires that all contractors post bonds with the state as a prerequisite for license approval. Washington and Michigan require bonding for electricians; the other states do not require electricians or plumbers to post bonds in order to obtain a license. Four of the eight states--California, Michigan, Oregon, and Washington--require general or specialty construction contractors to post bonds with the state. The largest bonds are required by Michigan, where a residential building contractor must post a bond of $10,000 to obtain a license.

Regulations. As requested, we are providing copies of the other states' statutes for the trades of electrical work, plumbing, and general and specialty contracting.

In some instances, we have included license applications and printed regulations supplied by the states' trade boards. Please let us know if you require further analysis of the statutes and regulations; we will be happy to summarize and compare them if needed.

Requirements for a Contractor's License

Licensing requirements for contractors vary from trade to trade and from state to state. The procedure for obtaining a license may require the applicant to complete some of the following steps:

- pass a written or oral examination;
- submit a financial statement;
- submit references from material suppliers and/or bank;
- attest to ownership of equipment and/or experience related to the given field;
- report an in-state business address;
- report personal or corporate bankruptcies;
- obtain bonding; or
- obtain insurance covering public liability, property damage, and workers' compensation.

Exemptions. Some states exempt from licensing those contractors whose contracts do not exceed a specified dollar amount. Other states waive the license requirement if a person intends to work only on his personal property. For example, Alaska does not require a person to license himself to repair his own property, while Arizona requires that work on personal property be performed by a licensed and bonded contractor if the building is to be rented or sold within one year of completion of the work. Two states, Kansas and Nebraska, license only nonresident contractors, and Delaware licenses contractors for revenue purposes only.

Limited and reciprocal licenses. In skilled trades such as plumbing and electrical work, states frequently issue licenses that limit the licensee to working at a particular skill level for which he has demonstrated competency or proven his experience. For example, Colorado licenses electrical workers at four skill levels: trainee, residential wireman, journeyman electrician, and master electrician.

In granting a license to a contractor, some licensing boards also: (1) determine the construction classification at which the contractor may work (i.e. industrial, commercial, residential, public works); and (2) set a contract bid limit based on the contractor's working capital, i.e., he may not bid over $200,000 on a single contract or over $500,000 on separate, concurrent bids.

A few states have agreed to reciprocally recognize other states contractors' licenses; for example, Michigan and Indiana permit plumbers licensed in either state to do contract work in both states.

Licensing Boards

In states which thoroughly review the qualifications of contractor applicants, the licensing procedure is usually handled by a licensing board. Typically, this board is composed of licensed, experienced contractors who are appointed by the governor or the state legislature and who convene intermittently throughout the year. Recently, many states have included members of the general public on regulatory boards so that the boards are not composed exclusively of representatives of the regulated industry or profession.[1]

Bonding Requirments

Of the 28 states that license contractors, eleven states require the contractor to be bonded as a condition of license approval.[2]

As you may know, Alaska requires a surety bond of $5,000 for a general contractor and $2,000 for a specialty contractor, or an equivalent cash deposit.[3] The surety bond, also termed a "license bond", is intended to assure payment of (1) taxes, (2) employees and suppliers, and (3) any judgments against the contractor for negligent or improper work, breach of contract, or damage to public facilities.

The bonds that some states require before they will license contractors are independent from the bonds that construction clients may require before they will accept a contractor's bid. Construction clients may

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[1]State of Tennessee "Program Evaluation on the Board for Licensing Contractors", Division of State Audit, July 1978.

[2]Ibid

[3]AS 08.18.071.

require (1) performance bonds to guarantee that the work will be completed on time and according to specifications; (2) payment bonds to guarantee that suppliers and employees will be paid; and (3) bid bonds to guarantee the sincerity of the bid.

Penalties and Enforcement

Penalties. AS 08.18.141 states that "a person acting in the capacity of a contractor in violation of this chapter is guilty of a misdemeanor." The contractor is usually given a hearing before the trade or licensing board, and if found guilty, he may be fined in addition to having his license revoked. This same penalty appears to be common among states that require contractors to be licensed.

The method of recovering damages from bonded contractors in Alaska also appears to be normal procedure in other states. The surety bond issuer is not liable for claims in excess of the amount of the bond, and claims for breach of contract are assigned a lower priority than claims for labor costs and taxes which may be owed to government units.

Enforcement. Most states share with local governments the responsibility for monitoring contractors. For example, Colorado plumbing laws prescribe that cities with populations of over 70,000 must appoint inspectors of plumbing to their local boards of health to help report violations of plumbing laws to the State Examining Board of Plumbers. In addition, Colorado's State Examining Board of Plumbers is authorized to hire its own plumbing inspectors.

In states which have a single board of licensing for contractors in all trades, enforcement duties may be divided among state agencies as well as between state and local agencies. For example, in Tennessee, the Board for Licensing Contractors only investigates complaints about licensing, while violations of the technical rules of a particular trade are dealt with by the appropriate trade board or by state health and safety agencies.

* * *

I hope you find this information useful. If we can be of further assistance, please let us know.

NP

Attachments

Attachment A
Table 1

LICENSING AND BONDING OF CONTRACTORS IN EIGHT STATES

	Electrical work	Plumbing	General Building Contracting[1]	Speciality Contracting
California[2,3]	license bond ($5,000)	license bond ($5,000)	license bond ($5,000)	license bond ($5,000)
Colorado	license ---	license ---	--- ---	--- ---
Idaho	license ---	license ---	license for public works ---	license for public works
Michigan	license bond[4]	license ---	license for residential builders ---	license[5] bond ($2,000-$10,000)
Montana	license ---	license ---	license for public works ---	license for public works ---
Ohio[6]	--- ---	--- ---	--- ---	--- ---
Oregon	license ---	license ---	license for bldg. construction bond ($6,000)	license bond ($4,000)
Washington	license bond ($3,000)	license ---	license bond ($4,000)	license bond ($2,000)

Footnotes: See Next Page

FOOTNOTES TO TABLE 1

1 AS 8.18.171 defines "general contractor" as a contractor whose business operations require the use of more than two distinct trades whose work the general contractor superintends; the terms "general contractor" and "builder" are synonymous; a "specialty contractor is a contractor whose operations do not fall within the definition of "general contractor". Contractors are persons who undertake or bid for projects to construct, alter, repair, move or demolish a building, highway, road, railroad, or a type of fixed structure, including excavation, site development and erection of scaffolds.

2 A bond of three to ten times this amount is required for the licensing of applicants who have been a party to business infractions resulting in the revocation of their own or other contractors' licenses (CRS 7071.8). Swimming pool contractors must post a bond of $10,000.

3 The co-owner of a licensed firm, or the subsidiary or joint venture partner of a licensed firm, may in some circumstances be required to post an additional bond of $2,500. CRS.7068 and CRS.7071.9.

4 The bond takes the form of a deposit to the Homeowners Construction Lien Recovery Fund. The required amount of the bond varies. MCL 338.883.

5 Contractors in the fields of residential building, maintenance, or alteration must post bonds of $2,000 for each trade for which they are licensed, not to exceed a total of $10,000. MCL.338.1504.

6 ORC 3781.102 delegates the licensing of contractors in Ohio to local governments. However, legislation is now pending before the Ohio General Assembly to establish requirements for state licensing of electrical contractors.

ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES
RESEARCH AGENCY

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Juneau, Alaska 99811
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September 6, 1983

MEMORANDUM

TO: Representative Walt Furnace

FROM: David Teal
Legislative Analyst

RE: Licensed/Bonded Contractors
Research Request 83-213

Steve Levi, of your staff, asked whether or not Alaska had the least restrictive standards for licensed and bonded contractors. We contacted the Council of State Governments, the National Conference of State Legislatures and the Associated General Contractors of America to determine Alaska's standing in this regard. We discovered that training/experience requirements in Alaska are minimal relative to other states which require licensing and bonding of contractors, but that nearly half of all states do not require contractors to be licensed. Further, fewer than half of the 50 states require contractors to be bonded.

This memorandum discusses standards for contractors from three perspectives: when a licence is required; requirements for obtaining a license; and the consequences of failure to meet legal standards. Each of these topics is discussed below.

Who must obtain a contractors' license?

The attached table shows that 28 states require contractors to be licensed and that only 11 of those states require licensed contractors to be bonded.[1] From the perspective of whether or not a license is required to operate as a contractor, Alaska's standards are clearly more restrictive than those imposed by some states. However, relative to other states that require contractors to be licensed and bonded, Alaska is more liberal than some states. For example, no license is required for an Alaskan to repair his own property, while Arizona requires that work on personal property be performed by a licensed and bonded contractor if the building is rented or sold within one year of completion of the work.

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[1]The table is from a 1978 document prepared by the State of Tennessee. Much of the information appears to be outdated. More reliable information will be forwarded to you when it is received.

What is required to obtain a contractor's license?

Among those states that require contractors to be licensed, Alaska's standards are relatively nonrestrictive. Alaska does not require demonstration of knowledge or experience in order to obtain a license to contract for general building construction or repairs. Alaska requires only that an applicant complete an application, pay the registration fees, obtain a $5,000 surety bond ($2,000 for specialty contractors) or file an equivalent cash deposit, obtain a business license and provide evidence of insurance covering public liability, property damage and workers' compensation. Several states require that an applicant pass an examination and provide evidence of four or more years of experience in the construction field. Some states have more stringent requirements related to an applicant's financial situation, character, integrity, qualifications and age.

What are the consequences of failure to comply with the law?

AS 08.18.141 states that "a person acting in the capacity of a contractor in violation of this chapter is guilty of a misdemeanor." This penalty appears to be common among states that require contractors to be licensed. The method of recovering damages from bonded contractors in Alaska also appears to be normal procedure in other states. The surety bond issuer is not liable for claims in excess of the amount of the bond, and claims for breach of contract are assigned a lower priority than claims for labor costs and taxes which may be owed to government units.

* * *

The Associated General Contractors of America has written a letter on this subject to each state. When results from that survey are available, they will be forwarded to your office. Previous work by the House Research Agency on the subject of contract bonding is attached to this memorandum. I hope you find the information useful.

DT

Attachments
Research Request 80-147
Exhibit I, State of Tennessee Program Evaluation

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

JULY 2, 1974

Mr. Victor L. Lowe
Director
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Lowe:

This is in response to your request for comments on the draft report entitled "Surety Bonds in Federal Construction: A Study of Their Application and Effectiveness."

[See GAO note 1, p. 40.]

Operation of the Program

Before we get into the specific areas listed, we must bear in mind that the report itself is 14 months old, and we should like to provide an update on the statistical data listed in the report as of March 31, 1973, and bring that up to May 20, 1974. The Surety Bond Guarantee Program is the fastest growing program of the SBA. Following is a table indicating levels of activity:

Fiscal Year	No. Guarantees Approved	No. Contracts Awarded	Value of Contracts
1971 (Pilot)	21	7	$ 312,252
1972	2,316	1,339	$ 94,434,157
1973	8,657	5,597	$ 351,169,011
1974 (Thru 5/20/74)	11,856	8,150	$ 571,426,269
TOTAL	22,850	15,093	$1,017,361,689

The total number of contractors that have received this assistance since the inception of the program had been 8,342. There are 99 sureties that are currently participating in the program. Approximately 35 percent of our total guarantees are for minority contractors.

Next, we should like to outline the procedures through which an applicant goes in obtaining a surety bond guarantee: (1) The contractor obtains a copy of our application form from one of our district offices or, in most cases, through a broker or agent. (2) The original application goes directly to our surety bond personnel in the regional office, a copy to the surety, and an information copy to our local district office.

If an agent or contractor is unable to locate a surety willing to participate in our program in his area or feels that the sureties are unreasonable in their underwriting standards, our offices are prepared to give him a list of the sureties which have demonstrated a responsiveness to our program. Agreement with the surety industry provides that, if a surety decides that it cannot issue a bond even with an SBA guarantee, SBA will be supplied with the reasons for decline. Three major reasons for declination are:

1. The financial package is inadequately prepared,

2. The surety feels that the contractor does not have sufficient working capital to handle the contract under consideration, or

3. There is a lack of sufficient technical and/or managerial skills to perform the contract or to handle the extra managerial and financial load of one more contract in addition to his work in progress.

SBA can and does assist the contractor to eliminate deficiencies by the following means:

1. Refers the contractor to funded organizations which specialize in assisting the contractor in putting his financial package together properly.

2. Refers the contractor to SBA loan specialists for consideration of either a working capital loan or the revocable, revolving line of credit, which was designed specifically for construction contractors.

3. Refers contractor to our management assistance personnel.

If the surety decides that a bond can be issued with our guarantee, they will forward to our office a copy of the contractor's financial statement, together with a copy of our Surety Bond Guarantee Underwriting Review, SBA Form 994-B. The SBA Form 994-B is primarily a checklist of virtually all of the normal underwriting requirements that a surety would check out prior to issuing a bond, be it with SBA or on their own. Upon receipt of the Underwriting Review, the financial statement, and the surety's recommendation, the SBA makes its own underwriting review, and, if favorable, completes the guarantee agreement and returns it to the surety.

The following is an update on our claims and defaults. We compute our loss ratios on a quarterly basis, the last of which was as of April 20, 1974. At that time we had 548 default notifications, with 393 of these that have established incurred loss of $9,260,21[illegible]. The incurred loss figure included paid losses plus reserves. In computing our loss ratios, we use our average sized contract of $68,000 and prorate the contract over a 10 month period. In other words, our $68,000 contract is 50 percent completed in 5 months and 100 percent complete in 10 months. Our loss ratio, based on completed commitments, is 1.24 percent.

SBA loss RATIO

The sureties compute their loss ratios on an earned premium basis rather than commitments. An average contract of $68,000 would carry a 1 percent premium. Therefore, the industry loss ratio, based on earned premiums, would be 124 percent versus 1.24 percent on commitments.

We break down our loss ratio by region as well as by surety. At any given time we can determine the loss ratio of a specific surety company, either nationwide or in any region.

All claims are handled out of our Central Office. Our field office sends us a copy of the complete underwriting file. A desk audit is made on each claim submitted. In addition to normal verification and audit of claims data, we also assure that the surety made no misrepresentations, etc., as well as attempting to establish reasons for default. We have found that the reasons our contractors go into default are basically the same as those that the sureties sustain under normal programs - insufficient capitalization to carry them over when they run into trouble, and going beyond their capacity. Only about 3 percent of our contracts go into default. Therefore, we have a success rate of 97 percent.

As a matter of information, we also have broken down some other statistical data with regard to our loss ratios. A study made by us in February shows the surcharge rate companies had a 1.56 percent loss ratio versus a 1.34 percent for the standard rate companies. This includes only those companies that have one or more losses. The commitments of the other companies are not included.

Minority contractors have established a 1.8 percent loss ratio versus non-minority at a 1.1 percent loss ratio. Our four largest producers in this program have the following loss ratios: 1.58 percent, 2.3 percent, 1.67 percent, 2.58 percent. These are all smaller companies that specialize in smaller contracts. One of the major companies, which is one of the largest surety bond writers in the country, has established a loss ratio of 1.60 percent in our program. A copy of the loss ratios is enclosed with this report and, as you will note, one company has a 7.5 percent loss ratio. However, there were only two claims that were quite substantial and would be considered as shock losses in determining loss ratio. We will debar any surety that has a consistent and inordinately high unexplained loss ratio.

We have taken the position, unless Congress feels to the contrary, that a 2 percent loss ratio on commitments should be the maximum allowable in the program. This, we feel, is a reasonable loss expectation for the marginal contractor. As a comparison in loss ratios, GAO reports show that sureties have a 51 percent loss ratio on government work, based on their premiums. Converting this to our method of computation would show a .51 percent loss ratio on the "blue chip" contractors. Comparing this contractor to the marginal contractors that we are dealing with, our loss ratio of 1.24 percent would fall in line with the intent of the program.

.51% vs. 1.24% SBA

Need for Increased Participation by SBA in Program Operations

Our position is that any contractor who meets our size standards is eligible to apply for surety bond guarantee assistance. The initial evaluation of the contractor is up to the surety. The premiums charged by sureties include efforts expended in the prequalification of contractors. This is a function that we feel should be performed by the surety itself. Our function is only reviewing what the surety has submitted to us and to see whether it falls in line with our legislative and regulatory requirements. The industry itself does not have any iron-clad formal underwriting criteria. Each case must stand on its own merits. We feel this same procedure should be followed within our own program. However, we do have our underwriting review, which is an official checklist for the industry of the information we expect them to develop in order to make an underwriting determination. As we have mentioned earlier, should a surety decide that a contractor does not qualify for a bond, even with an SBA agreement, and, if we feel that the contractor can perform, we will refer him to a more responsive surety.

One factor which makes it difficult to establish formal underwriting guidelines for the sureties is that these guidelines can be used to turn down applicants, as well as to make them eligible. As a rule of thumb, for construction contractors, many sureties require a ratio of 1 to 10 of the contractor's net quick assets to his total work in progress. There are cases where the surety may want a 1 to 5 ratio. There are other cases where another surety may go 1 to 20 on a specific contractor. Availability of additional credit, size of the job, and the amount to be subcontracted are all elements that enter into a decision on net quick asset requirements. If we were to establish a standard of, say 1 to 15, a ratio of less would automatically trigger a decline by the surety industry. It would become too complex to establish these types of standards. The industry itself has general guidelines in their normal underwriting; we expect them to use their guidelines, consider that these are marginal contractors, and that the SBA will accept risks that the industry would normally decline. All we ask them to do is to give us the normal underwriting data with all of the facts and their opinion as to whether the contractor can perform the specific contract. Based on that analysis, SBA will further analyze the facts presented and make a subjective judgment.

We have even had cases where we have extended our guarantee where the contractor had a deficit net worth and where h. performed successfully. However, we could not write a guideline that would permit the issuance of a guarantee to a contractor with a deficit net worth. Such a determination would depend upon the individual contractor and circumstances of the specific case.

A contractor has every right to appeal to SBA for assistance should he be turned down by a surety, and, as a matter of fact, frequently does. We have met with several minority contractor associations throughout the country. There is a favorable consensus among these groups.

The question of "graduation" is a difficult one. The sureties do not notify us when they take a contractor out of our program and put him into their own. The only assumption we can make is that, if there is no activity in a particular file for 6 months to a year, we can assume that the contractor, if he has not gone into claim, has gone into the surety's normal business. We do, however, have certain guidelines for our surety bond personnel in the field. As an example, a valid reason for keeping a contractor in our program after he completes several jobs could be that his financial statements show insufficient earnings to justify bonding him without SBA support. Another reason is that the contractor is increasing the size of job or total work program beyond what the surety would accept in its standard business. Again, this is a form of graduating from small contracts to larger contracts.

There is considerable room for upward mobility within the program. The average job is now $68,000. Our limit is $500,000. We also find that the marketplace itself assists in this area. We have noted that even in the cases of some surcharge rate companies, which may not write standard rate bond business, a contractor who can qualify for standard business will go with one of the major companies. The reason for this is twofold:

(1) The contractor will not pay the higher premium if he can avoid it, and

(2) There is a certain pride among contractors when they can get bonding on their own with one of the major sureties.

We must remember that the contractors in our program are considered marginal and no contractor wants to be tagged with that label for any longer than absolutely necessary. In checking with one of the large producers in the surcharge rate area, we find that they average 1-1/2 contracts before they lose a client to one of the other surety companies. Our national average is less than two contracts per contractor since the inception of the program.

When we originally discussed the prospects of this program with the industry, one of the objections of the industry in handling our type of business - the marginal contractor - was the fact that the administrative expense alone, aside from the losses, would be far greater than the normal business. Our experience so far has proven this to be the case.

In February we had a meeting with 19 surety companies, each of which write 1 percent or more of our total volume. Combined, they represented 89 percent of the total volume in our program. Also attending were representatives of the American Insurance Association, the Surety Association of America, and the Agents' Associations. The purpose of the meeting was to discuss premium sharing, percentage of guarantee, and contractors' fees.

The major companies expressed a willingness to increase the SBA share of the premium and to consider a reduced guarantee percentage. They also stated that they were losing money on the program. Our analysis of their activity would bear this out.

The smaller companies took a very strong position on maintaining the present fee and guarantee structure. They stated that they were making money on the program, that increased fees and decreased guarantees would eliminate profit, and that without profit they would not remain in the program.

There are many factors to consider. Why are the major companies willing to participate in the program at loss? Is it because their big business clients are applying subtle pressure to eliminate competition? Is it because they know that the smaller sureties cannot remain in the program at a loss?

To remain in the program with higher fees or a lesser guarantee, the smaller sureties would have to tighten up on their underwriting. What would the effect be on the minority contractor? The loss rate on his business is 1.8 percent versus 1.1 percent for nonminority. With a tightening of underwriting standards, the benefits of the program would be denied to those who need it most.

We are not prepared to adjust either the fees or percentages of guarantee at this time. We will, however, make adjustments at such a time as our continuing analyses might justify.

We are enclosing a list of all the sureties participating in our program as of May 20, 1974 (from the inception of the program). This list includes the number of contracts and the dollar values by region and total. As you will note, there are many sureties listed that are national companies but have written very few bonds through our program in the almost 3 year period since its inception.

The report also states that the maximum allowable premium rate that SBA permits was $20.00 a thousand and a change to $15.00 a thousand under contemplation. Our maximum allowable rate as of March 1973 is $15.00 per thousand for the first $50,000 and $10.00 per thousand on amounts in excess of $50,000. Therefore, we only allow the additional 1/2 percent on the first $50,000. Any surety that is using the standard 1 percent in their normal business, because of filing with the various state insurance departments, must use the same rate for the business with the SBA program. Therefore, there are very few companies charging the 1-1/2 percent rate, though it is true that a substantial amount of our volume comes from sureties which charge the higher rate. We have no quarrel with those sureties which are in the program for profit. Profit, if kept within reasonable bounds, is a perfectly legal and proper incentive.

Lack of Incentives

Our experience in the program alone seems to dispute this point.

1. For the surcharge rate companies, their records show that a contractor, on the average, has 1-1/2 contracts prior to leaving them.

2. The total number of contracts in the program versus the number of contracts guaranteed is still less than two contracts per contractor.

It is true that the surcharge rate companies would prefer to keep the contractor with them for a longer period of time, but, because of market conditions and the lower rates with the standard surety companies, the contractor automatically will go where the price is right. It must also be noted that publicly the Surety Association and American Insurance Association have indicated to us that they feel the program is getting too large. Therefore, they are encouraging their members to graduate contractors out of our program and write them in as their standard business. This philosophy of the industry is understandable. They are afraid of any government interference in the surety bond field. Total underwritings through the SBA are probably between 1 to 2 percent of the total value of construction bonds written throughout the country, and it is evident that they do not want government participation to become a much bigger factor than it now is.

We have found no instance where the surety found that it was advantageous, economically or administratively, to allow the contractor to default rather than provide financial and technical assistance. On the contrary, the sureties check with us on all claims and we work together in attempting to handle claims in the best way possible. There are many cases where the sureties have financed the contractor. When the surety finances the contractor, we do not provide any funds to the surety while they have the funds in a controlled account. However, once the funds are expended from the account, then the sureties receive their 90 percent reimbursement. This is much the same way that claims are handled between the sureties and their reinsurers. So again, we have found no cases where the surety has defaulted a contractor rather than go through additional administrative expense in trying to have the contractor himself complete the job. It is an unfortunate fact that, once a marginal contractor defaults, the chances of his survival are minimal. In a few cases, however, through the mutual efforts of SBA and the surety, we have been able to help a contractor so that he corrected his default and was able to continue in business.

Conclusions

Based on the information given herein, we feel that we have covered the three points in your recommendations:

[See GAO note 1, p. 40.]

ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES
RESEARCH AGENCY

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MEMORANDUM July 1, 1980

TO: Representative Patrick O'Connell

FROM: Anne DeVries, Issues Analyst AD

RE: Availability of Contract Bonding
Research Request No. 147

This memorandum is in response to your request for research on the availability of contract bonding for small contractors. I understand you are interested in possible legislative action to relieve the problems some contractors face in obtaining contract bonds in amounts over $500,000.

Summary of Findings

Briefly, there are three major findings from this research:

- Overall, contractors are able to get bonding in the amounts for which they are qualified. It is not evident that sureties are denying bonds to contractors on the basis of criteria which are irrelevant to their ability to complete a contract.

- A State reinsurance program is the major way in which bonding could be made more available. The primary problem of such a program is that it would expose the State to financial losses on defaulted contracts.

- The availability of bonding is important to contractors because bonds are required for most public works contracts. An alternative to making bonds more available is to modify access to public contracts. The State has two main alternatives: to raise the amount of the contract below which no bonding is required, or eliminate bonding altogether. There are two problems with these alternatives: they expose the state to financial losses from defaulted contracts and they shift the responsibility of determining contractor qualifications from a non-political body, the surety, to the State. These are the same problems that the surety system was designed to eliminate.

Introduction to the Question of Bond Availability

Contract bonding is the way in which a corporate surety, usually a large insurance company, extends its financial backing to qualified construction contractors. It is a means of assuring the construction client that he will not have to suffer a financial loss because the contractor fails to complete a contract. The demand for bonds arises primarily from the public sector as bonds are a means of protecting the taxpayer from contract losses.

In return for a service fee, a surety company will bond any contractor it deems qualified to do the work for which a bond is required. If the contractor defaults on the job, the surety is obligated to assure that the contract is satisfied with no financial loss to the client. If the surety incurs a loss in meeting its obligation to the client, it will take action against the contractor to recover its losses. Under established surety underwriting practices, the risk of financial loss from default remains with the contractor. As a consequence, the surety will bond only those contractors in situations where it anticipates that no default will occur, and where the contractor is financially able to cover any losses that may occur (if, for instance, where one of the principals dies and the firm cannot complete the contract). The availability of bonding, therefore, is determined by the criteria surety underwriters use to define a "qualified" contractor.

Interest Groups

The question you have raised concerning the availability of contract bonding directly affects the economic interests of four groups, often in conflicting ways. The interests of these groups - the contractors, the sureties, the construction clients and the State - are described in this section.

The Contractors: As a group, contractors share two interests:

- They desire ready access to work, and to the extent that the lack of bonding denies access, they want ready access to bonding as well.

- They would like to limit competition to qualified contractors. An unqualified contractor may be the low bidder because he lacks full knowledge of costs and potential problems in a job. He may get a contract and then fail to perform. This creates "unfair" competition to qualified contractors.

Obviously, those contractors who have no trouble obtaining bonds do not necessarily see their interests enhanced by measures making it easier for other contractors to secure the same means of access to work.

The Sureties: As a group, sureties share an interest in making money. However, there are two types of surety companies with distinctly different ways of making money:

- Standard sureties make money by writing all the bonds they can. However, as they are not compensated for risk, they adhere to underwriting criteria that are established based on the presumption of "no losses".

- Specialty sureties make money by exploiting the government subsidy inherent in the Small Business Administration's re-insurance program. This is discussed in greater detail later in the memorandum.

The Construction Clients: Demand for bonding originates primarily from the public sector, all discussion in this memorandum will focus on the interests of municipal, state and federal construction clients. As a group, these entities share two interests:

- They want to protect the taxpayers' interests by obtaining the best quality construction work at the lowest price.

- In order to insure the lowest feasible costs, state and federal governments want to insure adequate competition among qualified contractors by removing any artificial impediments to competition, such as minority discrimination.

- They want to protect themselves from the claims of suppliers or laborers who were not compensated by a contractor on a public works job. Bonds are necessary as public works are not subject to liens designed to protect suppliers and laborers on private jobs.

The State: The State, as a protector of its citizens, wants to:

- Insure that citizens are not prevented from enjoying their livelihoods by the arbitrary acts of others, such as a private company discriminating against minorities.

- Insure that citizens have "fair" access to all work that the state provides.

Of these four parties, the State faces the strongest conflicting interests. It may want to make access to bonding easier in order to insure some of its citizens better access to their livelihoods, while at the same time it is the largest single beneficiary of the contract bonding system. This conflict will be the focus of this memorandum.

What is Contract Bonding?

Construction is an inherently risky business. A contractor can fail to perform on a job for any number of reasons:

- Key personnel die or become disabled, either physically or emotionally - a divorce or death in the family, a drinking problem, etc.
- He is overextended; either he has committed his firm to too much work or to a job which may have unexpected problems beyond his capability to solve.
- He has inadequate supervision.
- He has an inefficient operation.
- He lacks the appropriate job cost accounting records and procedures.
- He has uninsured losses.
- He is the victim of employee dishonesty.
- He has submitted an improper bid: it may contain mistakes, it may not allow for unforeseen contingencies and/or price increases, or it may not have adequately provided for overhead.
- He has failed to arrange proper financing.
- He has made a poor selection of venture partners.
- He is adversely affected by weather conditions.

Awarding a contract to the "lowest qualified bidder" increases the risks of a project, for the contractor who wins the job has given himself the smallest possible financial cushion with which to absorb the cost of any problems.

The construction client recognizes that these problems can occur and he has two alternative ways to protect his interests:

- If a contractor fails to perform, the client can arrange to complete the job himself and take legal action against the contractor.

- He can require that the contractor secure the backing of another party who will assure the client that he will suffer no financial loss from a contractor failure. This third party may be an individual or a corporate surety.

Under either alternative, the client pays for the cost of this protection. In the former instance, he incurs the costs directly; in the latter, the cost of the surety's bond is included in the bid price.

Types of Bond Required: Three types of contract bonds are generally required:

Performance bonds guarantee that the work will be completed in accordance with the plans and specifications and at the contract price.

Payment Bonds guarantee that the suppliers and employees of the contractor will be paid. Payment bonds are required on all public works projects because that property cannot be made subject to a Mechanics and Materialmen's Lien which protects these interests on private projects. A payment bond also makes it easier for suppliers to get credit, as they are assured of being paid.

Bid Bonds guarantee the sincerity of the bid. A bid bond in the amount of 10% to 25% of the bid is usually required. If a contract is awarded to a bidder who is then unable to secure the other required bonding or for some reason cannot enter into a contract, the bid bond is forfeited. A surety will usually issue a bid bond only when it is prepared to issue payment and performance bonds, as required.

Both payment and performance bonds are required because it is possible for a contractor to finish a job and then "leave town" before his suppliers and employees are paid, or he might meet his obligations to his suppliers and employees without satisfactorily completing the job.

Underwriting Requirements: The surety decides whether or not to provide bonding to a contractor through a careful analysis of his job history and financial capacity. This process is termed underwriting. It is underwriting which determines the availability of contract bonding.

There are two major factors considered in underwriting:

- The total amount of work the contractor will have if he is awarded the contract for which a bond is required.

- A combination of his performance record, his experience with the type of work required by the contract, the suitability of his equipment and the skill of his employees for the type of construction, the soundness of his bid and his financial capability.

The contractor will usually be asked to supply his bond agent or broker with the following:

- Financial statements for the last three years. Depending on the size of the job and the surety, these statements may have to be prepared by a certified public accountant and may have to be auditied.

- Completion of a contractor questionnaire which requires resumes of experience — job size, client, etc.

- A letter from his banker stating his credit experience with the contractor - what credit has been extended, how it has been handled, what credit is available for the upcoming contract, etc.

- Two or three letters of recommendation from former clients.

- One to two letters of recommendation from major suppliers.

An underwriter evaluates two aspects of the contractor's financial status: the amount of working capital he has in relation to the dollar volume of his projected workload and his net worth. Sufficient working capital is necessary to cover cash outlays for which the contractor will be reimbursed later. Contractors are usually paid on work as it is completed, therefore they must finance each portion of the work themselves. In addition, clients retain a portion of the payment, usually 10%, until the project is completed in order to guarantee performance. The contractor has to finance that 10% for the duration of the project. Without adequate working capital, a contractor may have to stop work on the project and be in default on the contract. A contractor's net worth, total assets less total liabilities, is the second component of his financial status that is important to a surety. The surety relies on a contractor's net worth as the primary loss paying fund, should the contractor default on the contract and the surety incurs losses in completing the contract.

Cost of Bonding: Contractors are charged a premium for the bonds they are issued. The premium is determined by the amount of the bond, the duration of the bond obligation and the type of contract being bonded: as the amount of the bond increases, the cost per thousand dollars of bonding declines; as the duration of the bond obligation lengthens beyond a specified period, the cost of the bond increases; and as the complexity of the construction task increases, the cost of the bond increases. The Surety Association of America has established rates which are used by most standard sureties; in its rate setting manual, it divides construction contracts into three major groups:

Class B	These are the most difficult types of construction involving architectural building construction, most engineering construction, concrete and excavation work performed underground or in or under water, etc.
Class A	These are general contracts and subcontracts of generally less difficult nature than those included within Class B such as most earthmoving work of a non-excavation nature, etc.
Class A-1	Contracts of this description include those generally less difficult than "B" or "A" of the construction classification and contracts for furnishing and installing, or installing only, or providing various services and equipment, such as a data processing contract.

As an example of the rate structure, the premium established for a Class B contract is 1.2% of the contract amount under $500,000, .725% of the next $2,000,000; .575% of the next $2,500,000; .525% of the next $2,500,000; and .48% for any additional amounts. This covers a bond obligation of 24 months.

The premium charged by a surety is distinctly different from that charged by an insurance company. The surety premium is not meant to create a loss-paying fund as an insurance premium does. In insurance, risk is transferred to the insurer, whereas in bonding that risk remains with the contractor. The function of a premium is clearly stated in the following excerpt from a Surety Association of America publication:

> Suretyship transaction does not intend a transfer of risk from the contractor to the surety. .... The surety's obligation is collateral or secondary to the contract obligation assumed by the contractor.. The surety's fee is essentially a flat rate charge for the services performed by the surety and as such it is more related to averting or controlling loss than to funding ultimate loss."
>
> The Unseen Services of a Surety, Surety Association of America

Reinsurance and Cosuretyship: A surety has two options for limiting his exposure on a contract bond: reinsurance and cosuretyship. Reinsurance is a means of sharing the premium and risk with another company; and it is a standard practice in the industry. The most commonly used mechanism is for the reinsurer to take a percentage of the premium (net of commission) and to assume the same percentage of any loss. The SBA program is a form of reinsurance; however, the government assumes a disproportionately large share of the risk for the premium it receives.

Cosuretyship is the means by which two or more sureties jointly issue a bond. Each surety has a limit on the amount of single bond it can write, depending on its financial position; this limit is established by the U.S. Treasury. By jointly issuing a bond with another surety, a surety can bond a contractor for an amount greater than the Treasury limit of either surety. Most cosuretyship arrangements limit the liability of each surety to a specified amount.

Regulations Pertaining to the Contracting Industry

The following sections outline the State's requirements for entry into the contracting business and its requirements for bonding on public works contracts.

There are about 3,000 contractors licensed by the State to operate in Alaska. About half of these are general contractors, the remainder are specialty contractors.*

According to AS 8.16, in order for a construction contractor to operate in the state, he must be issued a certificate of registration by the Department of Commerce and Economic Development. The following are required before a certificate is issued:

- a completed application
- a registration fee of $100 for a general contractor and $50 for a specialty contractor
- a surety bond of $5,000 for a general contractor and $2,000 for a specialty contractor or an equivalent cash deposit
- public liability and property damage insurance no less than $20,000 for property damage, $50,000 for injury or death to one person and $100,000 for injury or death to more than one person.

The surety bond, also termed a "license bond", is intended to assure payment of:

- all taxes and contributions due the state and political subdivisions
- payments to all persons furnishing labor or material or renting or supplying equipment
- payments for all amounts that may be adjudged against the contractor by reason of negligent or improper work, breach of contract or damage to public facilities occurring in the course of a construction project.

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* AS 8.18 defines a contractor as "a person who, in the pursuit of an independent business, undertakes or offers to perform, or claims to have the capacity to perform, or submits a bid for a project to construct, alter, repair, move or demolish a building, highway, road, railroad, or any type of fixed structure, including excavation and site development and erection of scaffolding; a "general contractor" is a contractor whose business operations require the use of more than two distinct trades whose work the general contractor superintends." A specialty contractor is one involved in only one or two distinct trades.

In addition to this bond, the State requires payment and performance bonds on construction work exceeding $50,000 in value. AS 36.25 establishes the minimum bond coverage; the contracting officer is empowered to increase these amounts as he sees fit. The bond requirement can be satisfied by either a corporate surety, a large insurance company, or by two individual sureties who "shall each justify in a sum equal to the amount of the bond". The relevant portions of the statute are quoted below:

> . . . before a contract exceeding $50,000 for the construction alteration, or repair of a public building or a public work of the state or a political subdivision of the state is awarded to a general or specialty contractor, the contractor shall furnish to the state or political subdivision of the state the following bonds, which become binding upon the award of the contract to that contractor.
>
> (1) a performance bond . . . .; the amount of the performance bond shall be equivalent to the amount of the payment bond.
>
> (2) a payment bond . . . for the protection of all persons who supply labor and material in the prosecution of the work provided for in the contract; when the total amount payable by the terms of the contract is not more than $1,000,000, the payment bond shall be in a sum of one-half (50%) the total amount payable by the terms of the contract; when the total amount . . . is more than $1,000,000 and not more than $5,000,000, the payment bond shall be in a sum of 40% of the total amount . . .; when the total amount . . . is more than $5,000,000 the payment bond shall be in the sum of $2,500,000.

The statute also provides for a municipal exemption which allows municipalities to exempt contractors from these bonding requirements on contracts not exceeding $400,000 if the following conditions are met:

- The contractor has been licensed in the state for a period of two years and his principal office is in the state.
- The contractor has certified that he has not defaulted on a contract awarded to him during the previous three years.
- The contractor submits a financial statement, prepared within a period of 9 months preceding the submission of a bid, . . .

certified by a public accountant . . . demonstrating that the contractor has a net worth of not less than 20% of the amount of the contract for which the bid is submitted.

The total amount of all contracts which the contractor anticipates performing during the term of performance of the contract for which a bid is submitted does not exceed the reported net worth by more than seven times.

The Federal statutes, the Miller Act, served almost verbatim as a model for the State statute. There are only two differences: the Federal government requires bonds for all contracts in excess of $2,000 and it leaves the amount of the performance bond to the discretion of the contracting officer.

While the State statute requires a combination of payment and performance bonds amounting to 100% of the contract amount on jobs under $1,000,000, 80% on jobs between $1,000,000 and $5,000,000, and a flat bond of $5,000,000 on jobs over $5,000,000, in practice 100% bonding is required on all projects over $50,000. On projects which involve federal money, a 100% performance bond and a 100% payment bond is usually required. Municipal practices differ with the municipality and the source of funds it is spending; however, they are usually at least as strict as the state practices.

The Alaska Bond Market: Contracts bonds are supplied by 71 companies licensed to do business in Alaska. All are regulated by the Division of Insurance of the Department of Commerce and Economic Development, to which they must submit their premium rates for approval.

There are three types of firms: the standard companies, the specialty companies which are involved in the SBA reinsurance program, and sub-standard companies. This last group is able to supply bonds for the most marginal contractors by charging higher rates. It is not a significant part of the market.

The standard companies dominate the bonding market. The four largest companies, Travellers, Firemen's Fund, Fidelity and Deposit of Maryland, and Safeco, control over 50% of the Alaska market. Forty-nine companies, each writing less than $50,000 in premium annually, account for only 5% of the market.

In 1978, the last year for which data is available, $5.6 million of

direct premiums were written for surety bonds on Alaskan construction. Premiums average about 1% of the bond amount, so approximately $562.6 million of construction jobs were bonded. Direct losses to surety companies, net of recoveries, were $0.2 million, or 4% of the premiums written or .04% of the construction activity. The table below summarizes bonding activity since 1974.

TABLE 1

Surety Bonding Activity in Alaska, 1975 - 1978

	1975	1976	1977	1978
Number of Companies	93	70	68	71
Direct Premiums (000)	$3950.5	$4178.0	$4442.0	$5626.0
Direct Losses (000)	$1838.7	$ 964.0	$2863.0	$ 209.0
Losses/Premiums	47%	23%	64%	4%

Source: Insurance Reports for 1977-1979, issued by the Department of Commerce and Economic Development, Division of Insurance.

As you are aware, some small contractors have noted a tightening in the availability of bonds. They are unable to get the same levels of bonding that they have gotten in the past or they are unable to find sureties willing to write larger bonds for them. Apparently, they are experiencing the impact of tighter underwriting standards which have been made necessary by the large losses the sureties suffered in the mid-1970's, as indicated on Table 1; normal surety losses average between 5% to 10% of premiums while losses in Alaska got as high as 64% in 1977. One surety termed Alaska the "cemetery" of surety companies.

According to members of the industry who have followed the developments in the Alaska market, underwriting standards by most sureties were relaxed in the early 1970's in response to competitive pressures. Sureties are in the business of writing bonds and the primary limitation on the amount of bonds they write is their underwriting criteria. In

the late 1960's, a company entered the Alaska market agressively seeking business by writing bonds more readily than the existing companies. It offered larger bonds and larger bonding capacities to firms in order to take business away from competitors. The other companies were forced to match its tactics in order to retain customers. By the mid-1970's, this company, which had followed the same strategy across the country, was incurring large losses and decided to leave the surety business.

The problem of losses due to loosened underwriting standards was exacerbated by the recession in the mid-1970's. High interest rates affected a contractor's ability to get financing and inflation adversely affected his ability to project costs for materials and labor; both could lead to default on a contract.

As a response to these problems, some sureties chose to leave the Alaska market, while the remaining ones revised their underwriting criteria. One broker characterized this as a return to normal underwriting practice after a period of too-loose underwriting. He noted that the market in Alaska is "coming back". The current market has been characterized as the best one in Alaska for years; the comment that "any qualified contractor can get bonding" was made repeatedly by the surety representatives interviewed.

Means of Increasing Bond Availability

It is the question of what constitutes a "qualified contractor" which is central to the issue of availability. For the client, bonding serves a twofold purpose: it protects him from financial loss and it is a means of pre-qualifying contractors who want to bid on work. The client is protected by the surety's financial stake in only bonding qualified contractors. Because contract bonding is both a form of credit and a pre-qualification process, there are always some contractors who are unable to secure bonding for jobs which, in the opinion of the surety, exceed their financial or technical capability. Consequently, it is impossible to judge whether the contractors who have been experiencing problems in bonding are being subjected to unfair discrimination or are simply not sufficiently qualified to warrant the surety's financial commitment. If, through additional extensive research, it is found that there is some significant pattern of discrimination against a particular type or class of contractor, the State has two types of approaches to relieve their dilemma:

- It can permit sureties to lower their underwriting standards by assuming a large share of the risk of contractor defaults.

- It can remove the bonding requirement, on all jobs or on jobs over a certain amount, and assume the surety's dual functions. The State would be responsible for recovering its own losses on contractor defaults and it would have to devise a means of pre-qualifying contractors. These qualifications could reflect preferences to particular types of contractors if it could be shown they had been excluded unjustly from work because of surety discrimination.

There are variations on these approaches; however, these are the two major ones which have been considered by the Federal government in its frequent reviews of the surety bonding process.

Again, I have been unable to conclude that any group of contractors has been denied bonding for reasons unrelated to their ability to perform. As a third-party, often the State of Alaska, relies on bonding to protect the taxpayers and simplify its contracting process, it would seem that such a pattern of discrimination would have to exist before the State encourages the lowering of underwriting standards or becomes its own surety. That reservation aside, the following section describes how the Small Business Administration's reinsurance program works. This is the type of program which the State could implement if it choose the first of the two alternatives listed above.

The SBA Program

The Small Business Administration manages a program of reinsurance for contractors with annual gross sales of less than $3.5 million who are unable to get bonding with a standard surety company. The SBA program will issue a bond up to $1 million. The average SBA bond in the Pacific Northwest Region is about $70,000. This program was originally intended to help minority contractors secure bonding. It has since been expanded to include all small contractors as a way to insure their access to the bond market, and hence to public construction jobs.

The standard market takes the theoretical approach to surety bonding - it bonds contractors assuming there will be no losses and charges a premium, not based on risk, but to cover the costs of offering the service. On the other hand, the sureties which specialize in SBA bonds - the specialty

market - are more liberal in their underwriting criteria because the federal government is subsidizing the defaults of less "qualified" contractors who are bonded through the program.

The contractor pays a higher price for SBA bonding than he would if he qualified for bonding in the standard market. Table 2 presents a comparison of the premiums charged for bonds of different amounts under the standard surety rates and the SBA rates. The standard surety charges 1.2% of the contract amount for the first $500,000 and .0725% for up to the next $2,000,000 of bonding. In return for this premium, the surety is obligated to the full extent of the contract amount. These are the maximum rates charged for the most risky class of contract according to the Surety Association of America rate filing.

For the specialty surety, the maximum premium is 1.5% on amounts less than $250,000 and 1.0% on the balance of the bond. In addition, the SBA charges .2% of the contract amount as a service fee. Therefore, on a $250,000 bond issued by the SBA, the contractor pays 1.7% of the contract amount, compared to 1.2% for similar standard bond. The surety retains 80% of the premium and the remainder goes to the SBA. For its 80% premium, the surety takes 20% of the risk of default (10% if the bond is less than $250,000). The SBA assumes 80% of the risk of default (90% if the bond is less than $250,000) and receives 20% of the premium and the .2% service charge.

The SBA makes it attractive for sureties to bond contractors through its program by taking a disproportionately large share of the risk for the premium it receives. Table 3 illustrates the cost of this reinsurance program to the SBA. Table 3 assumes a 1.25% loss rate on each bond; this is the loss experience for the Pacific Northwest over the life of the SBA program. This loss is divided between the surety and the SBA and then compared to the premium income each received. For instance, on a $500,000 bond the loss is assumed to be $6250 or 1.25% of the bond. The SBA would cover 80% of that, or $5000. In issuing this bond the SBA received $1250 in premium and $1000 in service fees, a total of $2250. The SBA incurs a loss/premium ratio of 225% by assuming the larger share of the risk while the specialty surety has a more moderate 25% loss ratio. Overall, the loss ratio is 86.2%. This compares unfavorably with the national average of 5% to 10% and the most recent Alaskan performance of 4%. Table 3 also illustrates why some contractors have trouble getting SBA bonding over $250,000. The loss ratio doubles on these larger bonds because the government is assuming less of the risk; therefore, the specialty sureties have lost some of their incentive to take chances on weaker contractors.

Standard sureties, the ones writing the majority of the business in Alaska, generally do not participate in the SBA program. They have a number of objections to it:

- The paperwork demands are great. A contractor has to be underwritten each time he wants a bond. This requires the compilation of financial statements, letters of recommendations, etc. for each bond application. A standard surety avoids this problem by establishing a bond capacity, good for up to a year, on which the contractor can draw.

- Paperwork requirements create time delays. For instance, bonds over $500,000 must be approved by the SBA's Washington D. C. office.

- The SBA duplicates the underwriting work of the sureties to some extent.

- However, the overriding objection to the program is that "unqualified" contractors are placed in competition with "qualified" contractors, those who got bonding in the standard markets. Standard sureties see themselves as applying one standard to a contractor - whether or not he can complete the job - if the contractor can not mmet this standard, then he should not be given bonding.

It is likely that a State program similar to the SBA's would face simila: problems: . duplication of work done in the private sector, creation of a bureaucracy, the resistance of standard sureties, etc. However, the two most important problems it would face are:

- the cost of defaulted contracts, and

- the difficulty of defining limits to the program

These are clearly related. The SBA program began to help minorities, the victims of racial discrimination. It was expanded to help all "small businesses" and is under pressure to increase its limits to raise the definition of "small". A state program would be faced with a similar dilemma of pressures for an ever expanding scope. And clearly, financial losses from defaulted contracts would be a function of how broadly the State defined the group of contractors worthy of subsidy and the extent of the subsidy it offered.

It has not been possible to provide an extensive analysis of the SBA program within the time frame of this research. The detailed questions which would require answers before any State program is considered, are:

- Why are contractors in the SBA program unable to get bonding elsewhere? (Minorities excluded)
- Why is the loss ratio so high? How does this relate to the composition of contractors in the SBA program?
- How many contractors are able to grow out of the SBA program into the standard surety market?
- What are the administrative costs of the program?
- Based on a range of assumptions about the scope of the program, the amount of the risk assumed by the State and loss experience, what are the potential costs to the State?

Modifications of Bonding Requirements

The State has another alternative way of addressing the problems some contractors face in obtaining bonds, and hence access to public work: it could eliminate all bonding on State jobs or it could increase the contract amount below which no bonding is required. There are two problems with this approach. First, the State would have to duplicate the capabilities of existing sureties. It would require personnel to arrange for the satisfactory completion of contracts in default and to bring legal action against defaulting contractors for any losses it incurred. In addition, it would require the development of criteria to determine which contractors were qualified to bid on State contracts. One of the reasons for the creation of the surety system was to remove the "qualifying" process from the potential distortions of the political process. If the State became its own surety, on some or all contracts, its loss experience would primarily be determined by the appropriateness of its qualifying criteria in relation to contract requirements.

As this memorandum has shown, underwriting is a subjective process. It has been impossible to determine, within the time frame of this work, whether any conditions exist which limit bonding available in a way that warrants action by the State to increase availability of bonding. The standards that sureties established are intended to protect the client,

notably the State of Alaska, and any actions to change underwriting standards to increase availability may create serious problems for the State. I will send shortly selected portions of a report to Congress on the surety industry and its effect in preventing contract losses to the federal government. This may be of interest to you. If you have any additional questions, please let me know.

AHD/bf

COMPARISON OF LOSS/PREMIUM RATIOS FOR THE SPECIALTY SURETY AND THE SBA

	BOND AMOUNTS				
	$249,999	$250,000	$500,000	$750,000	$1,000,000
SPECIALTY SURETY					
-Loss	312	625	1,250	1,875	2,500
-Premium	3,000	3,000	5,000	7,000	9,000
-Loss/Premium	10.4%	20.8%	25.0%	26.8%	27.8%
SBA					
-Loss	2,812	2,500	5,000	7,500	10,000
-Premium	750	750	1,250	1,750	2,250
-Service Charge	500	500	1,000	1,500	2,000
-Premium + Service Charge	1,250	1,250	2,250	3,250	4,250
-Loss/Premium + Service Charge	225.0%	200.0%	222.2%	230.8%	235.3%
OVERALL					
-Loss/Premium + Service Charge	73.5%	73.5%	86.2%	91.5%	94.3%

House Research Agency

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