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November 9, 2007

Board of Directors
Chugach Electric Association
Attn: Ms. Elizabeth Vazquez, Chair
5601 Electron Drive
Anchorage, Alaska 99519-6300

Re: Blue Ribbon Panel Report

Dear Ms. Vazquez:

The Blue Ribbon Panel has concluded its meetings and deliberations in accordance with its assignments from the Chugach Electric Association Board of Directors. Our report is conveyed with this cover letter and executive summary.

The Panel looks forward to meeting with the Board at your November 14th meeting, at which we can talk with one another about the report's comments and recommendations.

To begin with, we would like to thank the Board for the opportunity to engage in this effort. It is timely and courageous for the Board to reach out to the community and ask for a high level assessment, such as you have done with the Panel. The Panel members are:

David Gottstein, President, Dynamic Capital Management
Robert Hickel, President, Hickel Investment Company
Loren Lounsbury, Former APUC Commissioner and Commerce Commissioner
Richard Lowell, President, Ribelin Lowell & Co. Insurance Brokers (retired)
John Wanamaker, Vice President, Seattle-Northwest Securities Corporation

Facilitator: William Noll, former Commissioner of Commerce, Community and Economic Development

The Panel believes that Chugach is a leader in supplying reliable power to Railbelt customers. Not connected to America's national energy grid, getting electricity and power to Alaskans once was a challenge even in Anchorage. The current high level of reliability is a great tribute to Chugach and the efforts of a long line of current and past employees.

However, the Panel finds evidence suggesting that Chugach has several major and systemic deficiencies in its cost and delivery structure and operations, including among its collective bargaining units.

The Panel recommends that the Board adopt three basic principles in approaching the future of Chugach:

1. Take all steps necessary to deliver the lowest possible long-term cost and rate structure for CEA's customers, coupled with the long-term viability and financial health of the utility.

2. Improve long-term planning, but particularly in terms of power generation and financial matters.

3. Take steps to eliminate the co-op as the business model and concentrate on other models to achieve a more efficient, cost effective and financially healthy utility.

Some of the reasons for the latter are: no one acts as owners; only about 15-20% of Chugach members bother to vote; management and labor are often stalemated; risk capital management is not properly motivated to take or mitigate investment risk, resulting in a climate where both management and labor cannot optimize their performance for Chugach's long-term financial health.

Chugach and ML&P discussions should continue, but the Panel also feels the need for Railbelt-wide joint discussions for the good of the utilities and, more importantly, for the good of the Railbelt consumers.

As part of any internal assessment and restructuring opportunities, the Board should have an appraisal done of CEA by an appropriate contractor.

There are three areas of concern in financing. Hundreds of millions of dollars of balloon debt is coming due in early 2011 and 2012. This occurs during the period where Chugach's two largest customers, Matanuska Electric and Homer Electric Associations, may look to other sources of power.

Secondly, the fact that the debt coming due represents unamortized costs of generation assets that have passed their useful life means that the utility is faced with paying for the past from the future and is looking to rely on increased generation efficiencies and population growth in order to fund it.

Thirdly, unless Chugach is able to normalize its relationship and costs with its operational units, and cost-optimize the generation, transmission, and distribution of electricity for itself and other utilities within the Railbelt, it will either face having to pass unjustified costs onto the rate payers, or will face financial decay and or future crisis.

The Panel recommends that CEA should develop a more comprehensive plan of finance within the next 60-90 days, with particular attention to debt management. Suggestions:

1. The useful lives of CEA's assets should be matched, in the least case, with debts associated with those assets. For example, if an asset has a remaining useful life of fifteen years (sometimes irrespective of its book-assigned remaining depreciable life), then the debt should at least be paid off by the time the asset needs to be replaced.

2. Have near, mid and far range debt plans that demonstrate the debt allocation that will bring the best average or blended cost of funds.

3. Test the debt plan against the market on a regular basis.

4. Long-term debt should be paid on a fully amortized basis or have the flexibility (without penalty) to pre-pay principal payments prior to maturity on interest-only debt. The existing bond/debt covenants should be reviewed as to their flexibility in early pre-payment and/or refinancing of existing debt. Seeking longer amortization schedules with no pre-payment penalties or "factored in" pre-payment penalties needs to be reviewed periodically.

In the Labor area, all employees contribute value in the delivery of reliable energy. However, political action efforts on the part of Labor, coupled with a non-active co-op membership, compromise the natural balance between the board/management and Labor, resulting in fractured and volatile management direction, and a labor cost structure that cannot be justified.

Lack of transparent benchmarking results in a significant lack of up-to-date critical management data. The lack of transparency has kept hidden the need for better and up-to-date tools and information.

The Board should take direct positive steps to re-establish and maintain a productive balance between Chugach management and the collective bargaining units. This includes public disclosure of benchmarking

To help overcome a national shortage of linemen and other electrical skills, Chugach should establish company-sponsored training programs. This can be done in cooperation with other employers needing the same skills.

Chugach must develop contingency plans for a strike or, for that matter, the loss of workmen for any emergency situation, such as epidemics or terrorist acts.

At least one study shows wages higher than average. Review the establishment of a productivity incentive program.

CEA should establish the cost per hour for CEA labor by adding all cost factors such as wages and fringe benefits, then dividing by hours worked. Further study should be done for "wrench time," which refers to the actual hours of work performed by an employee for the same time period. Thirdly, do an analysis of the work product for each actual hour worked to arrive at the total cost per unit of production. The results should be benchmarked with utilities nationwide, with appropriate adjustments for COLA, etc. This benchmarking should be performed by an independent company and should be made public in accordance with the principle of transparency.

The Panel recommends that benchmarking be kept up-to-date with at least a major study every five years, with updates annually and results made public. Benchmarking should be comprehensive and cover <u>all</u> activities. Distribution costs are high, and generation and transmission have not been benchmarked at the macro-level.

The Panel commissioned the national benchmarking firm of UMS, who reported that Chugach was off the charts in the cost of delivery compared to the norm for utilities of similar density. UMS says that CEA has a very inefficient distribution cost structure. Refer to UMS's report at Tab 10 of this report.

Chugach needs to design and deliver an information campaign to its employees, members, and other local and Railbelt residents. This strategy should bring honest information on where the utility is now, not only in terms of reliance but also in its quest to deliver the lowest possible rates to its customers, demonstrating where Chugach meets the performance of its peers, where it is lacking and how it is working to improve.

Management's implementation of this strategy needs to conform to the Board's vision of transparency and dedication to an open process, which are stepping stones to a fully informed membership and public, which in turn leads to the most efficient and cost effective system possible.

Statements that our Railbelt power system is broken ring true. Those elements that worked so well in developing reliable power during earlier years seem now to clash, and that works against the consumers' best interests.

The co-op model system is broken and obsolete. Replacement models include privatization, more municipal ownership or involvement, a Unified System Operator, an Investor Owned Utility, or some other form, including any hybrid of the aforementioned.

Chugach should play a leadership role in addressing these questions and deciding the answers. To this end, the Panel highly commends the Board for taking the bold step of asking for outside recommendations from the Panel members, and the Panel again thanks the Board for the opportunity to provide its input.

The Panel strongly urges that Board members start now to work cooperatively together, moving aggressively with sister utilities, the Regulatory Commission of Alaska (RCA), and the Alaska Energy Authority (AEA) on the subject of Railbelt rationalization. (In the business world "rationalization" means to align and deploy assets in the most economic and efficient manner.)

Summary

1. Immediately engage in an all-out effort to rationalize the Railbelt utilities, considering whatever form or combination of forms benefits the rate payers the most.
2. Take all steps necessary to deliver the lowest possible long-term cost and rate structure for customers.
3. Strengthen planning particularly in terms of power generation and financial matters.
4. Take action to eliminate the co-op as the business model and concentrate on other models to achieve a more efficient, cost effective and financially healthy utility.
5. Take steps to normalize relations between management and labor.
6. Comprehensive benchmarking in all activity areas must be kept up to date, with at least a major study every five years and updates annually.
7. Transparency must be an integral part of the agenda. Improve internal and external information and communication strategies.

Start the leadership process with that which it controls: transparency, planning, benchmarking, labor and structure. CEA should use its powers of communication and advocacy and work zealously for the benefit of its members. Today, frankly, CEA does not give forth that image. It seems reactive rather than proactive, perhaps a product of the long struggle for delivery of reliable energy, but no longer acceptable.

Sincerely,

William C. Noll
Manager

Cc: All Chugach Board and Panel Members