MUNICIPALITY OF ANCHORAGE

Office of the Mayor

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Mayor Dan Sullivan

My fellow citizens of Anchorage,

I want to express my sincere thanks to the dozens of citizens who willingly gave up many hours of their time to prepare this transition report. It is this kind of public service that makes Anchorage a great place to live and it is this kind of public service that will help us meet the challenges ahead.

The transition report looks at each city department and provides a critical assessment of the strengths, weaknesses, opportunities and threats within that department. Overall, I believe this report shows that we have outstanding public employees who do a very good job for their customers – the residents of Anchorage.

As with any large organization, however, room for improvement always exists. My administration will strive to make those improvements. We will do that by establishing new ways of managing government, prioritizing spending, and by re-emphasizing the importance of customer service.

The key issues identified in the report are summarized in the following pages. Of critical importance are the shortfall in both this year's budget and the potential shortfall in the 2010 budget. Most notably, millions of dollars in reduced expenditures need to be identified. This will not be an easy task, particularly since this year's budget has already been through a $17 million reduction.

Among other critical issues are the looming energy crisis in southcentral Alaska and Anchorage's rising violent crime rate. Clearly, we have some big challenges ahead. I am confident that the management team we have assembled, along with the residents of our great city, can meet these challenges.

Dan Sullivan

Daniel A. Sullivan
Mayor

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Table of Contents

TABLE OF CONTENTS

TRANSITION REPORTS – KEY ISSUES

After being elected on May 5, Mayor Sullivan asked more than 60 citizens to join his transition team and help review all aspects of city business. These team members submitted their findings in mid June; those findings are included here as the Transition Reports to Mayor Dan Sullivan.

After receiving these reports and making an initial review, Mayor Sullivan forwarded each report to the corresponding department heads and asked them to review their respective areas of responsibility. Between June 15 and July 1, Mayor Sullivan met personally with the authors of each report, as well as most municipal department heads, to discuss the reports and the operations of their departments.

Mayor Sullivan, who during his political career has always advocated for open public policy-making, offered current department heads the opportunity to respond to the transition reports in writing. Space has been reserved at the end of this document for those written responses.

This section is intended to highlight the key issues Mayor Sullivan believes to be of critical importance as indicated in the transition reports and during the aforementioned meetings. The following is merely a brief synopsis of the issues; more in-depth information can be found within the main body of the transition reports.

CURRENT FISCAL YEAR ISSUES (FY 2009)

Revenue Shortfall

Projections are that there still is a $9 million shortfall in revenues required to support the level of spending approved in April. This shortfall in income is after the $17 million in spending reductions and other shifts in revenues were made during first quarter budget amendments. This $9 million includes:

Taxes and Reserves		**$ (4,212.500)**
Includes:		
Real Property Taxes	$ (431.9)	
Personal Property Taxes	$ (238.9)	
Automobile Tax	$ (316.9)	
Room Tax	$ (456.7)	
Construction Investment Pool Interest	$ (1,810.6)	
Short Term Interest	$ (147.8)	
Unrealized Gains/Losses	$ (1,668.9)	

Fees		**$ (2,931.500)**
Includes:		
Planning platting fees	$ (392.3)	
Egan Center Capital Fund contribution	$ (236.4)	
Parks/Recreation fees	$ (83.1)	
PFD garnishments trial court fees	$ (1,162.0)	
Inspection, plan review fees	$ (935.9)	
Sub-Total		**$ (7,144.000)**
Other Revenue Shortfalls		
AWWU Dividend		**$ (600.000)**
Fund Balance - FY 08 audit error/revenue understatement		**$ (1,300.000)**
Total		**$ (9,044.000)**

Spending

Budget Impact of Labor Contracts – Still Short $265,000 in Savings

- The union contracts approved by the Assembly in late 2008 added $7.5 million in costs to the FY 2009 budget.

- Budget decisions in April assumed that the trade-offs negotiated by the Administration with the labor unions would result in a $3.1 million savings in the current year.

- As of mid-July, there still is about $265,000 in savings expected that has not yet been realized, contributing to the current year budget being out-of-balance.

Fund Balance/Reserves

The Municipality is required by ordinance to set aside a certain percentage of property tax and other revenues in "fund balance"

- Protect Bond Rating
    - 8.25% in property taxes and other revenue is set aside to protect the Municipality's bond rating (better bond rating means lower interest costs when voters approve issuing bonds to pay for capital projects);
- Emergencies
    - 2 to 3% in property taxes also is saved in an "emergency" fund

In the current fiscal year:

- 8.25% ($27.4 million) has been set aside for bond rating purposes
- The emergency fund is short—only 1% ($3.1 million) has been set aside
    - The Municipality would be able to bring the emergency fund in to compliance by saving the $5.7 million it received in Federal stimulus funds. If saved, it would bring the emergency reserves to nearly 2.75%.
    - This requires no additional spending in the current year.

FISCAL YEAR 2010 ISSUES
Preliminary estimates are that expected revenues will fall at least $17.5 million short of funding two major increases in spending:

Spending

New labor contracts	$	11,600.0
Police & Fire Retirement System	$	12,000.0
Health benefits, utilities, leases, etc.		?
Total	**$**	**23,600.0**

Voters have approved another $3.2 million in increased spending (and taxes to support it) associated with general obligations bond projects ($1.1 milion in increased debt service payments; $2.1 million for project O&M)

Revenues

Tax Cap Variables (estimates):

Increases allowed due to population, inflation	$	8,700.0
Property taxes from new construction	$	2,800.0
MUSA back under Tax Cap (Proposition 9)	$	(5,400.0)
Total	**$**	**6,100.0**
Revenues Compared to Spending	**$**	**(17,500.0)**

Of note is that this shortfall does not reflect increased spending for other obligations such as employee health insurance nor increased operational expenses such as utilities and leases.

Spending Increases

Police & Fire Retirement System - $12 million

The system's 2008 actuarial report estimates $180 million is required to fully fund the system's requirements and that it be paid over 15 years. This means a $12 million payment in each of the next 15 years. The cause of the shortfall primarily is investment losses. The amount required to fully fund the system may change in the future, which would either increase or decrease any annual municipal contribution.

Revenues – Tax Cap/Proposition 9

The Tax Cap places a ceiling on all taxes that can be collected each year. The ceiling is adjusted each year using a five-year average for inflation and population changes. It also is increased by the amount of property taxes to be collected from new construction that was not taxed the prior year.

For FY 2010, very preliminary estimates are that the Tax Cap would increase by $8.7 million due to population (1% increase) and inflation (3% increase). New construction would adjust the cap upward by $2.8 million (20% decrease from the current year).

In addition, FY 2010 is the first year for phasing in the change made by voters in passing Proposition 9. The proposition returns payments made by utilities (Municipal Utility

Service Assessments, or MUSA) to fall under the Tax Cap, estimated to be $5.4 million in FY 2010. Every dollar collected in a MUSA replaces a dollar in property taxes. But because MUSA payments were being spent as a non-tax revenue source in the current budget, this will mean $5.4 million less in overall revenue in FY 2010.

Accountability to Taxpayers

Given the spending/revenue challenges, the Mayor should lead efforts that make the Municipal budget transparent and accountable to taxpayers:

- Instead of a budget that only focuses on why programs want more money, report to taxpayers the results being delivered with the $422 million now being spent;
- Asks citizens what *their* priorities are—instead of only hearing from departments about their budget requests.

ISSUES WITH EXTENDED LABOR CONTRACTS

Union contracts have been locked-in for as long as six years with limited ability to make changes. Based on calculations provided by the Municipality Internal Audit Department and reported to the Assembly, these contracts will cost between an additional $84.4 Million and $119.6 Million over the next five years. Using a methodology that projects actual costs, a realistic $106.8 Million will be required.

In addition to direct economic costs, these contracts dictate work rules that can consume resources and limit management's flexibility. This can inhibit development and implementation of initiatives for better, more efficient and more economic public services. The employee grievance procedures, the resources required to manage these procedures and the costs for legal services and binding arbitration further contribute to high costs of workforce management.

Systemization, automation and consistency are inadequate for managing a modern workforce. Investment in information management systems to better manage and streamline workflows would offer significant efficiencies and cost savings.

In summary, the Municipality has a significant challenge in the meeting the financial and management requirements associated with a highly unionized workforce, especially in light of a pressing need for better and more economic service to the public.

INCREASED LABOR CONTRACT COSTS $106.8 MILLION TOTAL	2009	2010	2011	2012	2013
Internal Audit (Low)	$4,818,079	$11,542,879	$16,761,550	$22,502,176	$27,232,808
Transition Team	$7,518,517	$13,962,329	$20,743,426	$27,946,224	$36,886,777
Internal Audit (High)	$5,704,723	$14,165,156	$22,802,199	$33,141,761	$42,210,053

UTILITIES (AWWU AND ML & P)

Because all Anchorage citizens are beneficiaries of municipal ownership of these three utilities, yet only a portion of the citizens of Anchorage are served by the utilities, an issue of cross subsidization exists between the two groups of beneficiaries. Raising rates for utility customers so that "dividends" to the municipality can be used to increase spending outside of the tax cap has been very controversial. It is reasonable to argue that there should be some benefit to all of the citizens of Anchorage from ownership of each of the utilities in the form of a dividend. This issue remains unsettled.

For each of the utilities there is also an issue of the utilities value if it were to be sold (privatized) or even absorbed into another governmental entity. The revenue from such a sale would not go to the customers of the utility but to the municipality at large, i.e. the ATU model. It's reasonable to argue that there should be some benefit to all of the citizens of Anchorage from ownership of each of the utilities in the form of a dividend. This assumes that the utility has significant value, which may or may not be the case.

Liabilities to the municipality of owning a utility also exist. For example, should the decommissioning costs of ML&P's Beluga gas field encounter unforeseen problems in much higher than anticipated costs, all Anchorage citizens could wind up having to pay for the deficiency. The decommissioning and closure costs of the gas field and the necessary reserves that should be accumulated need to be closely reviewed.

Utility service expenses are a basic component of the cost of living and doing business in the Municipality of Anchorage. They are also one of the most regressive of costs in that they that affect low and fixed income residents the most. In addition to directly helping MOA residents, lowering such costs will make our region more competitive in the world economy and lead to job growth. It is one of the "low hanging fruit" of economic development objectives.

ENERGY

The energy transition report focuses on effectively confronting Anchorage's energy crisis. A broader view is then presented of Anchorage's energy challenges as it fulfills its responsibility as Alaska's headquarters city.

Here are the key findings of the energy transition report:

1. The need for reliable, affordable energy delivery--heat, light and power--to residents is a high priority issue for the Municipality of Anchorage.

2. There is widespread consensus that the Municipality of Anchorage faces the possibility of a gas deliverability disruption this coming winter and for the next several winters.

3. Energy disruptions this coming winter, and in future winters, due to diminishing gas supply and deliverability, have the likelihood of serious consequences. The implications for the residents are, at best, seriously inconvenient, and at worst, catastrophic.

4. The immediate problem for Anchorage is this: Alaska's energy delivery systems are isolated from other states; we are not interconnected to the national power grid or nationwide network of natural gas pipelines.

5. The need is "now" and the solutions are "future." Anchorage has an immediate energy deliverability problem and solutions will take from three to 15 years to implement.

6. Energy solutions from "big ticket" billion dollar projects, like a gas pipeline from the North Slope or hydro electric dams, are at least 10 to 15 years into the future.

7. Shorter term solutions, such as gas storage facilities (to store gas produced in the summer for use during peak cold periods in winter), imported LNG, new, more efficient equipment, and new supplies from exploration in Cook Inlet are, at best, three to five years out.

8. Solutions will require staggering amounts of investment – amounts that will be borne by Anchorage residents.

9. While federal agencies estimate significant quantities of additional gas reserves exist in Cook Inlet, no new large discoveries have been made for decades. Cook Inlet exploration and development face high costs, geologic risks, and regulatory uncertainty in an isolated, low demand market.

10. Long-term gas supply contracts are necessary to provide certainty to residents, producers, and utilities. The Regulatory Commission of Alaska (RCA) has not approved a long-term gas supply contract since 2001. The RCA's repeated rejection of negotiated agreements has created uncertainty for residents, consumers, and producers. This is a crucial issue that must be resolved.

11. All of the proposed short- and long-term solutions are complicated by technical, competitive, legal, economic, financial, policy and political issues. These issues have discouraged or deadlocked decision making – to the detriment of the residents of Anchorage and Southcentral Alaska. Mayor Sullivan can and should play a strong role on behalf of Anchorage residents regarding energy deliverability.

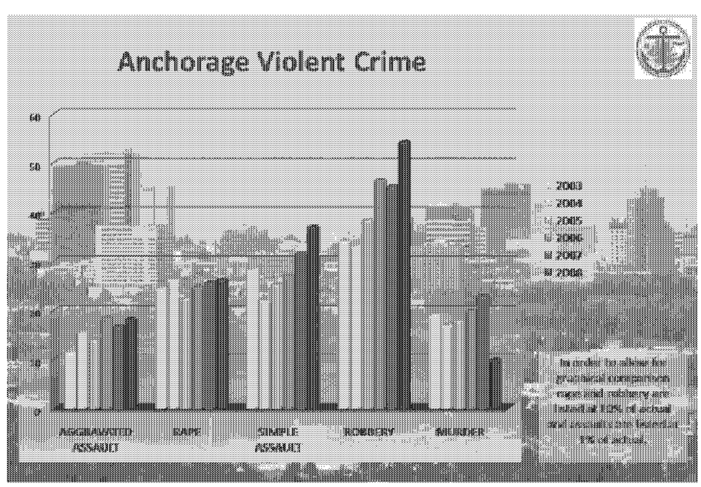
ANCHORAGE COMMUNITY DEVELOPMENT AUTHORITY

There is concern regarding the development activities of the ACDA. Several of their most visible projects have not turned out to be good deals for the city, bringing the purpose and the viability of the authority into question.

The leasing of parking lot at 6th and G streets, the "Augustine parking lot", for over four times the market rate drew strong criticism and the city eventually was forced to ask for better terms, although some contend that the revised lease rates were still too expensive for the city. The purpose in acquiring the lease was to help ease the parking crunch downtown, but the owner had planned to use it for parking regardless of the Muni's interest. The city is no longer leasing the lot.

The site of the former Hollywood Vista Apartments has been cleaned up and developed into a new subdivision. The original developer was unable to complete the project and the city had to buy its way back into ownership. ACDA purchased the property at foreclosure and is now offering lots for sale. Homes will be built and new residential properties will be added to the tax base. However, marketing strategy for Northpointe Bluff may not reflect realities of the current market. Options include lot re-pricing, re-sale to another developer or development as low income housing.

INCREASE IN VIOLENT CRIMES



In 2008, the Anchorage Police Department's Uniform Crime Report shows violent crime in Anchorage increasing from the previous six years with the exception of murder. APD reported 10 murders (56.52% decrease from 2007 when it reported 23) 263 cases of forcible rape (8% increase from 2003) 543 robberies (59% increase from 2003) 1830 aggravated assaults (60% increase from 2003) and 3704 simple assaults (34% increase from 2003). Murders had been on a six year upward trend until 2008, forcible rapes are on a six year upward trend, robberies are on a six-year upward trend, and aggravated assaults are on a six-year upward trend.

Anchorage Violent Crime Statistics

	2003	2004	2005	2006	2007	2008
AGGRAVATED ASSAULT	1143	1553	1407	1862	1673	1830
RAPE	244	263	224	248	257	263
SIMPLE ASSAULT	2829	2197	2533	2717	3167	3704
ROBBERY	340	331	384	465	453	543
MURDER	19	17	18	20	23	10

UTILITIES
(Transition to Board Managed Organizations)

UTILITIES (Transition to Board Managed Organizations)

Submitted by Steve Pratt

Summary

Title 32 was added to Anchorage Municipal Code in 2008, eliminating the Anchorage Municipal Light & Power Advisory Commission and vesting operating and management authority for ML&P in a new nine member Board of Directors. Modeled after Title 31, under which the Anchorage Water and Wastewater Utility has operated since 2005, Titles 31 and 32 are designed to allow the utilities to operate in a manner consistent with best utility operating business practices irrespective of their association with, and ownership by, municipal government. While the General Manager of each utility serves at the pleasure of the Mayor, a transition away from combined utility and general government functions is in progress. Compensation for board members, set by the Salaries and Emoluments Commission, is $500/month for the Chairman and $400/month for other members.

The most important decision for the Mayor-elect regarding the relationship of these utilities to the municipality is sanctioning the extent to which utility business operations and strategic decisions are to be independent from municipal oversight and operations. These decisions are surrounded by synergies and conflicts within the municipal administration and can have impacts on how competitive employee pay levels are determined as well as the degree to which the utilities engage in autonomous business actions that may have both positive and negative impacts on other government departments.

Since implementing the first phase of independent operations, financial contributions by AWWU to the integrated business operations of the municipality have been significantly reduced. Such impacts, in concert with, and perhaps juxtaposed against, dividend policies applicable to the utilities, should be reviewed for AWWU and considered for ML&P as it moves into its transition plan. It is unclear whether or not net cost savings and/or business efficiencies accrue to the municipality as a whole from these changes. The total number of employees required under separate operations might, and probably do, exceed joint operations due to a loss of scale economies. Nevertheless, regulated utilities have unique business, financial, and reporting requirements compared to those of general government and independent operations might make sense.

One utility board representative indicated that separate systems might result in over-riding business decision-making efficiencies that allow for greater dividends to be paid to the city, more than offsetting the cost of a few extra employees. Separate systems might also allow for greater experimentation with new methods of operation and/or introduce more outsourcing opportunities for particular functions. Lastly, a utility operating independent of municipal financial and

business functions would be easier to sell, merge, or divest should the MOA decide to do so at some time in the future.

Both AWWU and ML&P are significant assets of the MOA, and their operations have far-reaching health, safety, and financial implications. Nevertheless, the city needn't necessarily treat them equally with regard to autonomy and oversight. For various reasons, city-owned utility operations have always been, and will remain, controversial. An entity like ML&P, which competes with other energy suppliers for economy energy sales, fuel supplies, trained employees, and influence over state energy policies, is qualitatively different from an entity like AWWU, which provides water and wastewater service on a substantially non-competitive basis.

These utility boards face significant governance challenges and decisions which can have significant long-term impacts on the city. For example, AWWU faces a potential multi-million dollar refund liability[58] which is being reviewed by the Regulatory Commission of Alaska, and ML&P is participating in a rail belt energy planning process that has the potential for ML&P assets being transferred to a state corporation. These issues, along with many others facing the utilities, carry significant implications for the MOA and its citizens.

With regard to board structure, the Mayor-elect should consider proposing changes to Titles 31 and 32 with respect to the designated municipal employee that sits on the board. Each utility board has as one of its members an employee of the municipality, and each elects a Chairman from among its members. There is currently no restriction on which of the members may be elected chair. Since the chairman has influence over the agenda, committee assignments, and relationships with the Assembly and Administration, it would be wise to consider excluding the appointed municipal employee from the chairman's role on each utility board. In addition, since the appointed municipal employee serves at the pleasure of the Mayor, Titles 31 and 32 should be modified to remove the time limit on the municipal employee's assignment.

Anchorage Water and Wastewater Utility

(See AWWU Response to General Boards and Commissions Inquiry)

The transition to effective independent operation takes time and commitment. The AWWU board has, since its establishment in 2005, made significant progress in establishing itself despite struggling somewhat in defining its governance role vis-à-vis management as a department of the municipal administration. A visit to the board's website page reveals its public presence, purpose, and focus on its mission.

AWWU has undergone a gradual transition, substantially completing Phase I of its plan to bring some functions in-house (e.g. accounting and purchasing). The utility intends on moving forward with Phase II, which may involve modifications to Title 31 to give the board the authority to develop personnel rules independent of Title 3, and finding replacement Human Resources, Remittance Processing, Financial, Customer Service and Enterprise Resource Planning (ERP) systems to meet the needs of the utility. The utility currently interfaces with the municipality's People Soft system, which has outlived its usefulness and does not meet business requirements.

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[58] The Alaska Supreme Court has ruled that the RCA did not present sufficient justification to require the refund in its Order and decision. No reserves have been set aside for this eventuality should refunds ultimately be required.

These replacement systems represent significant financial commitments on behalf of the utility, have resource impacts on many municipal departments, and will further reduce AWWU's contribution to systems jointly utilized within the municipality. The main benefit of moving forward independently, from AWWU's perspective, is to operate at a higher level using its own processes and setting its own priorities for system development, maintenance, and functioning. AWWU has requested the new administration to either commit to moving forward together to install a new ERP system that would meet the needs of both general government and the utility or endorse its ability to move forward independently. Stakeholder departments within the municipality, perhaps coordinated through the CFO, need to address this early on.

One unique new management tool deployed by AWWU allows the utility to fine tune asset identification, replacement, and maintenance based on physical requirements rather than schedules. The city should follow the operations of this group and the city's representative to the board should watch for applications of this model elsewhere in the municipality.

Anchorage Municipal Light & Power

(See AWWU Response to General Boards and Commissions Inquiry)

The ML&P board came into existence on January 1, 2009. Newly appointed board members bring a breadth of experience in politically appointed or elected positions and various public service roles, one has direct experience working for a utility, three have experience on the former ML&P Advisory Commission, and one doesn't appear to possess any exposure to or experience in utility matters. Both old and new ideas are therefore available for consideration by the board.

A call to MLP's administrative headquarters indicated that the board has not established its presence enough for general knowledge within the utility of who chairs the MLP Board. The new board has yet to publish board committee assignments, meeting notices, agendas or minutes on the MLP web site, so it is difficult for interested citizens to follow the utility's progress on issues affecting the city. This is not unusual for newly created organizations. Just as the AWWU board struggled in defining its governance role, there is likely to be a period of time during which the analysis of policy and financial decisions will be driven primarily by management. The Mayor's executive appointment to the ML&P board will therefore have particular significance.

No later than September 27, 2009 the ML&P board expects to offer a transition plan to detach MLP from general government operations and internalize decision-making and service provision. Structural decisions affecting the utility, including asset disposition, key personnel, payroll changes, and operating practices, should await the Sullivan Administration's comfort with the resulting governing structure of the board.

The ML&P Board indicates its mission is to "Provide service with competitive, safe, and reliable energy to 30,000 retail customers, all-requirements service to military bases, and economy energy sales to Golden Valley Electric and Chugach Electric". Operationally, ML&P has also provided financial support to the municipality at large in the form of a dividend in the neighborhood of $7 Million/year. During its transition toward an independent board, MLP and the Administration should establish clear policies regarding the return on, and potential use of, assets expected by municipal citizens to justify the risks and investment associated with the utility.

Significant issues face the new ML&P board. Effective January 1, 2010, the MLP Board will have the authority, subject to Assembly approval, to negotiate collective bargaining agreements that apply to utility employees. Regional energy issues (**see Energy Transition Team report**), ranging from fuel supply to asset acquisition and transfer have large potential impacts on the utility and community at large. ML&P states that it needs to offer competitive compensation to attract workers to fill current vacancies, although it is unclear when the last vacancy appearing on the "Job Opportunities" section of ML&P's website went unfilled - no current vacancies are posted.

The Administration should work closely with the ML&P Board on development of its Title 32 transition plan, making sure that the utility and municipal leadership are working towards consistent objectives. The extent to which MLP divests its business practices from the municipality will impact other municipal departments and the city's approach to energy policy.

As the state and railbelt move forward with energy plan development, there needs to be a clear demarcation of where ML&P's interests and participation are coincident with, and potentially diverge from, MOA's interest as a political subdivision. On April 29, 2009 the ML&P Board passed Resolution 2009-02 describing the principles under which ML&P intended to discuss potential participation in the Greater Railbelt Energy and Transmission Corporation. According to that resolution, these discussions "have the potential for dramatic impact on the rail belt and the future of ML&P as a municipal asset and as a provider of power for Anchorage residents and businesses." The Mayor's executive staff should obtain a full briefing on the status, extent, purpose, and potential outcomes, of these discussions at the earliest opportunity.

UTILITIES-Enterprise Funds

UTILITIES-Enterprise Funds

Submitted by Mary Ann Pease

The MOA owns three utilities: Anchorage Municipal Light and Power (ML&P), Solid Waste Services (SWS) and the Anchorage Water & Wastewater Utility (AWWU).

None of the utilities serves the entire area or all of the citizens of the municipality. ML&P and SWS serve downtown Anchorage and adjoining neighborhoods. Although AWWU serves a much larger area including the Anchorage bowl and well as Chugiak-Eagle River, Peters Creek, Eklutna and Girdwood, it does not serve all municipal residents even within these areas as some are on private water and septic systems.

Seeing that its citizens have basic electric, water, wastewater and waste collection services is a primary function of the local government. Governments accomplish this through either direct ownership or operation of such utilities or using regulation to manage private-sector provision of these services.

Normally, there should be no purpose for a municipality to be involved in such activities except to provide the services at the lowest possible cost to the community and customers, while maintaining safety for the both the public and utility employees and delivering services at national standard levels.

While it is easy for regulators to set rates based on the monies spent by a utility and its financing costs it is less easy to determine how well managed or efficient a utility is compared to similar utilities across the state and across the country and the best practices in the industry.

Comparative benchmarking is the accepted way to evaluate the overall value being received by customers for their utility bills. This is especially important where the customers have no choice in providers, because they are located in monopoly service territories, with only one operator. ML&P, AWWU and SWS customers are captive in such a service territory.

In varying degrees Anchorage's municipally owned utilities lack the operational transparency in reporting the key measures necessary to compare their cost efficiencies to the "best buys" for customers in their sector.

End user rate comparisons with other utilities are not enough. The fact is across the country, local conditions determine basic costs and handicaps that a utility has in serving its customers. An electric utility with low-cost hydro-generation may have lower rates than another utility with high cost diesel generation. But the low-cost hydro-utility may not be giving the benefits of hydro to its customers. It may be soaking up a good part of the benefit in its internal administration and inefficiencies while always appearing to be a better deal.

- It should be a high priority for ML&P, AWWU and SWS to benchmark themselves against the best performers in their utility sector and the results made public and disseminated to their customers as part of a continuous self-improvement program.

Because all citizens of Anchorage are beneficiaries of municipal ownership of these three utilities, yet only a portion of the citizens of Anchorage are served by the utilities there is an issue with all of them of cross subsidy between these two groups of beneficiaries. Raising rates for utility customers so that "dividends" to the municipality can be used to increase spending outside of the tax cap has been very controversial, and still not settled. The comparative benchmarking reports should also include the effects of such cross subsidies.

For each of the utilities there is also an issue of the utilities value if it were to be sold (privatized) or even absorbed into another Governmental entity. The revenue from such sale would not go to the customers of the utility but to the municipality at large(The ATU model is a comparable example). It's reasonable to argue that there should be some benefit to all of the citizens of Anchorage from ownership of each of the utilities in the form of a dividend. That's assuming that the utility has significant value, which may or may not be the case.

There are also liabilities to the municipality of owning a utility. For example, should the decommissioning costs of ML&P's Beluga gas field encounter unforeseen problems in much higher than anticipated costs, all of the citizens of Anchorage could wind up having to pay for the deficiency. The decommissioning and closure costs of the gas field and the necessary reserves that should be accumulated needs to be closely reviewed.

Utility service expenses are a basic component of cost of living and doing business in the Municipality of Anchorage. They are also one of the most regressive of costs hitting low and fixed income residents the hardest. In addition to directly helping MOA residents, lowering such costs will make our region more competitive in the world economy and lead to job growth. It's one of the "Low Hanging Fruit" of economic development objectives.

Municipal Light & Power
Key Issues:

- A base rate increase of 8-10% is being contemplated by ML&P staff

- Unbundled costs and high level comparative performance benchmarking, must be done for all four parts of ML&P. ML&P has resisted doing this benchmarking which is the only way to determine the value received by customers for their utility service and properly plan for a more efficient electric utility infrastructure in the municipality.

- The only benchmarking available in the municipality is that done for Chugach Electric's distribution system, which has identified distribution costs as much as 60% higher (2¢ per kwh) than those of utilities with similar systems. The 2¢ per kwh in excess distribution rates at Chugach Electric amounts to about $25 million a year. It's not known where ML&P's costs would range. They could be even worse and be masked by low fuel costs.
- No high level benchmarking has been done for transmission or generation for any Railbelt electric utility.
- ML&P wants to sell out of their 30% participation of the planned joint new generation facility with Chugach Electric. This management decision needs to be closely looked into before finalization.
- Consensus exists on the fact the Railbelt has too many small electric utilities, too much duplication of administration and generation expenses. Substantial savings opportunities from a restructuring and reform would yield universal benefits. However, these synergies that would yield so many positive benefits to the consumers are difficult to realize because of the historical relationship between the Utilities – fragmented systems, lack of total economic dispatch, controversial proceedings before the RCA and a strong institutional culture that resists reform and perpetuates a chronic lack of cooperation.
- Governor Palin's utility merger bill (GRETC) recognizes this state of affairs and is a step forward, but still needs refinement.
- Reevaluate the move to independent authority status (2008) which is not complete. RCA regulation of ML&P should be reviewed as part of the development of a modern regulatory and organizational framework with a clear purpose, management objectives, transparency and performance reporting designed to be self executing as much as possible. Recommend that the administration seek the best possible regulatory and public utility management advice to design a long term solution that will deliver the best possible value for utility owners and customers. *See more discussion on aspects of the independent authority concept under the AWWU section. The issues are very similar to ML&P's situation.*
- The Aggregator concept (adopted and promoted by ANGDA) is a necessary step in securing the lowest cost fuel supply contracts for the Railbelt.

There needs to be a continued focus by the administration to restructure all aspects of the electric utility infrastructure and operation in the MOA, the Municipality's service boundaries and eventually the entire Railbelt--- with an expanded objective of looking at all the utility functional areas (fuel purchase/type, generation, transmission, and distribution) and maximizing the value to utility customers and MOA residents of each of the functional areas as well as the sum total.

FINANCIAL OVERVIEW:

ML&P is a public utility of the Municipality of Anchorage (Municipality). The following is a discussion and analysis of the Utility's financial performance, providing an overview of the activities for the years ended December 31, 2008 and 2007.
2008 Financials are still DRAFT, so numbers may still move slightly.

Financial Highlights

- The Utility's total plant increased by $12 million or 3% in 2008, while increasing by $14.4 million or 4% in 2007.

- The Utility's net assets increased by $9.2 million or 4% in 2008 compared to an increase of $17.4 million or 9% in 2007.

- Revenues for 2008 increased by $3.6 million or 3.5% compared to a decrease in 2007 of $18.8 million or 15%, while expenses (excluding dividend) increased by $13.6 million or 16.7% in 2008 compared to a decrease of $18.5 million or 18% in 2007.

- In 2006 the Regulatory Commission of Alaska (RCA) issued Order No 2 in Docket U-06-89 (2) concerning the use of the funds received in settlement of the 2005 gas underlift which resulted in recognizing a regulatory liability in the amount of $23.8 million to be used for future natural gas purchases. The deferred credit consisted of the 2005 settlement of $23 million (final adjusted settlement) plus interest of $0.8 million. The Order also agreed with the Utility's proposal to loan the electric fund the gas underlift proceeds to construct a new generating unit (Unit) with the condition that as the funds were repaid, the loan amount plus interest will be restricted for future natural gas purchases. As of December 3 1,2008 and December 3 1,2007, the regulatory liability account has a balance of $26 million and $25 million, respectively.

- In 2008 and 2007, the Utility paid a dividend and gross receipts tax of $6.4 million and 7.4 million respectively, to the Municipality based on prior year revenues confined after audit. The dividend consists of a revenue distribution to general government of 5% of the Utility's gross revenues excluding restricted revenues or $5.2 million in 2008 and $6 million in 2007. In addition, payment of a gross receipts tax considered supplemental Municipal Utility Service Assessment (MUSA) was made to the Municipality at 1.25% times actual gross operating revenues or $1.2 million in 2008 and $1.4 million in 2007. In addition to these MUSA payments, the Utility paid MUSA on its net plant in service of $3.1 million in 2008 and $2.3 million in 2007. The impact MUSA payments will have on the General Government Operating budget needs to be closely reviewed in light of the new tax cap iniatiative.

- In 2006, the Utility loaned the Municipality's Real Estate Services fund $3.7 million for the acquisition of real property described as tract 8, Muldoon Estates Subdivision per Assembly Ordinance (AO) 2006-149(S). The terms of the inter-fund loan require repayment within a period “not to exceed five (5) years" and annual interest "based upon the Cash Pool Earnings rate plus 50 basis points". The balance of the loan as of

December 3 I, 2008 is $4.1 million.

- In 2007, the Utility filed its 2006 Petroleum Production Tax (PPT) with the State of Alaska, Department of Revenue Tax Division (Division). The Utility paid $1.1 million in installment payments for the applicable period and believed it was entitled to a refund of overpayments, plus interest, in the amount of $1 .1 million. The Utility received a refund of $1. 1 million, which was passed on to third party gas customers based on their proportionate share of purchases. The Division stated that interest was not applicable in the interim period.

- In 2008, the Utility entered into a participation agreement with Chugach Electric Adation, Inc. (CEA) to proceed with the joint development, construction, and operation of the Southcentral Power Project.

- In 2007, the United States Minerals Management Service (MMS) conducted an audit of the Utility's royalty valuation of its "own-use" gas from the Beluga River Unit Gas Field (BRU) for the period January 1,2003 though December 2006. The MMS concluded that years 2003 through 2005 were in compliance. Begining January 1, 2006 when the Utility's gas purchase contracts with Chevron Texaco and Conoco Phillips expired, the Utility began supplying all its internal gas needs from the BRU gas reserves. In the absence of these contracts, the Utility based its royalty valuation on the annual "transfer price" that the RCA established for the Utility. The MMS deemed that this was not an appropriate value for paying royalty. Under protest, the Utility paid the MMS determined under- paid royalty of $2 million. An agreement was later reached between the MMS and the Utility that the appropriate royalty value for the Utility's internally used non-am's-length gas consumption beginning January 1, 2006 should be based on the Utility's sales price to CEA. This valuation method is consistent with 30 CFR 206152 (c), and results in a recalculated royalty of $1.7 million.

- In 2007, the Utility petitioned the RCA to change the methodology used to adjust the gas transfer price and record proceeds from the sales of gas, net of royalties, as a deferred credit. In May 2007, the RCA approved the Utility's petition and allowed the transfer price to be implemented.

Additional Issues:

- Capital Expenditures were not consistent with budgeted levels and a detailed review of management/policy direction needs to be examined:
    - Cap-ex for 2008 : expenditures of $43 million compared to a budget of $56 million
    - Cap-ex for 2009: expenditures of $8 million thru April compared to the annual budget of $132 million

- The Cost of Power is a quarterly revision by the Regulatory Commission of Alaska (RCA) and is basically a direct pass-through to the consumer on the monthly bill.

- Should money be budgeted out of customer revenue for *charitable contributions* from ML&P? Or should it be a voluntary customer program like AWWU's Coins Can Count Program
  www.awwu.biz/website/Customer_Service/CoinsCanCount/CoinsCanCount.pdf
- Policy call to reduce/eliminate Economy Energy Sales has dramatically impacted the net income, consumers' rates and utility operations.
- The Gross receipts tax + property value of MUSA combined equate to approximately $4.2 million a year. The question is open on how this portion of MUSA will be accounted for under the tax cap calculation – potential for General Government tax calculation impact.
- Cash Investment Report needs to be carefully evaluated – the net loss this past year because of the " type of investments" equated to almost $5 million

  - Overall the portfolio reflects an appropriate desire for safety and capital preservation. While these attributes probably make sense in light of presumably large shorter horizon funding needs, the elephant in the room is the portfolio's extremely low yield, particularly when considering the inflationary implications of our Federal Reserve's unprecedented expansionary monetary policy. If there is a reasonable expectation that some portion of this portfolio will not be needed for a longer time frame (i.e., over the next 3 to 5 years), it would make sense to invest at least a low single-digit percentage of the portfolio in equities with a commodity bent to preserve its purchasing power.
  - Question that needs to be addressed by the Fund Manager: On page 4, the report assesses the relative return of the new, enhanced investing strategy by comparing the actual returns under the new investment approach (established June 1, 2007) with a benchmark that purportedly reflects the prior investment strategy of rolling shorter-duration Agency Discount Notes. However, the chosen benchmark was the Merrill Lynch 90-day T-Bill Index, which would be expected to yield somewhat lower returns than Agency Discount Notes. Agency Discount Notes trade at a yield spread above Treasury Bills, and there were periods over the assessed timeframe when that spread was very significant and would have demonstrated higher returns for a more appropriately chosen benchmark.

REGULATORY OVERVIEW:

ML&P automatically receives a fuel adjustment every quarter from the RCA- referred to as the Cost of Power Adjustment (COPA). The COPA adjustment is intended to appropriately capture any changes in the cost of fuel used to generate electricity. Base Rate increases are not as frequent.

ML&P has not gone in for a Base Rate change since October 2003(based on a 2002 Test Year). It is anticipated that ML&P will file a revenue requirements study using a 2008 test year in the latter part of 2009.

Discussions with staff indicated the actual rate increase request is not fully known at this time, but could be in the 8 – 10% range.

POLICY QUESTIONS and CONCERNS:
There are several key strategic opportunities for the transition team to consider and address in the three/six year horizon:

- What is the backup plan and direction the Mayor will want to take if Chugach Electric Association (CEA) fails to get State assistance and asks MOA/ML&P for help? If CEA gets *some help* it will most likely take the form of higher TIER from the Regulatory Commission of Alaska (RCA) and MOA/ML&P using its Railbelt Energy Fund share to help the overall financial situation.

- Until fully vetted unbundled costs are developed and made public for ML&P – the operational efficiencies or lack thereof between ML&P and with the neighboring Utilities can never be fully understood or properly planned for.

- Will there be a need or Policy consideration of **ML&P's expansion of service area** to the Municipal boundaries so benefits can be shared with all within the Municipality rather than the select ML&P ratepayers? From a service territory perspective- CEA members would constitute the *majority* members of a combined entity. It is also important to note that the gas field was acquired with Revenue Bonds and as such, the debt is borne by the ML&P ratepayers NOT the overall Municipality, as is the case with GO bonding.

- After determining the policy direction with regard to the relationship between ML&P and CEA, the focus will have to become more inclusive with regard to MEA. Again, because a significant portion of MEA is within the Municipal boundaries.

- The costly Navigant report fell extremely short of real/tangible benefits. There is still a question if ML&P gains any real benefits and cost savings by the 30% share participation.
    - ML&P has determined that the benefits of participation in the South Anchorage Power Project are more detrimental than beneficial and are looking to *Sell* their 30% interest to Matanuska Electric Association (MEA) or Homer Electric Association (HEA).

- Fully Unbundled costs (Generation, Transmission, Distribution, gas supply) are a mandatory step for ML&P. ML&P does not have publically available unbundled costs – again the Navigant report fell short in the analysis and never provided the underlying financial benchmarking data to fully analyze the operational efficiencies of ML&P and Chugach Electric existing and proposed generation. Therefore, there is no way to compare proposed new joint plant to capital and operations costs of other such plants in the country. We know there will be fuel savings from the more efficient new generators contemplated, but are there other alternatives yielding even more savings to utility customers?

- What are the **private sector opportunities** with respect to the Utilities:
  - It's been assumed that only ML&P-Chugach would be allowed to build the proposed new joint generation. Many state regulatory commissions (and the province of British Columbia for example) would never allow an incumbent utility to build or operate a new generation facility without a fair and impartial third-party-administered solicitation open to all qualified providers to determine if the utility's proposal is in fact, the lowest cost alternative and the one most beneficial to utility customers. Here in the southern Railbelt, that means, without doing this, you don't really know whether another utility or independent power producer would have a better project yielding lower costs and more value to ratepayers now and in the future. It is not too late to do such for the new generation. At least then we would know what the right price would be and the incumbents (CEA and ML&P) would have to be competitive.

  - Finally, it might be more viable for the neighboring electric cooperatives to consider sale of electric distribution business or the subsequent aggregation of distribution. Since ML&P is in the enviable position of having combined distribution, generation and gas supply ownership for their Utility, it may make sense to look at the aggregation of consumers within the Municipality for the greater benefit under the guise of "combination should help accelerate expansion of gas into the service territory." Some of the options that could be considered between the utilities would focus on the privatization of certain components of service, joint new generation options, etc.

Consolidation/Aggregation:

All of the aforementioned issues are based on Southcentral's need for consolidation and aggregation of contractual gas supply. Summary of advantages:

- Coordinated power supply
- Mutually advantageous agreements utilizing tax exempt bonds for financing such projects
- Aggregated gas supply contracts; i.e. open-season discussions and gas supply alternatives analysis for Southcentral

Economy Energy Sales:

While the increase in revenue associated with economy energy sales is offset by a reduction in revenue associated with lowering the COPA, increased economy energy sales create economic value to the Municipality of Anchorage in three ways:

1. The cash margins from economy energy sales + domestic sales under lower COPA are higher than cash margins from domestic sales under higher COPA + little or no economy energy sales
2. Higher cash margins should enable ML&P to build cash and balance sheet equity faster than it would have otherwise and reduce the amount of indebtedness required for any capital improvement program - reducing the leverage ratio and perceived financial risk which could in turn result in lower finance costs at the time of issuing debt. At least up until the equity percentage of capitalization is up to the hypothetical capital structure used in the next rate case, which is slated for this coming year. The effect on total cost of finance may be modest as changes in the debt/equity ratio may be offset by changes in the cost of debt/cost of equity - at least around the nominal debt/equity ranges we are encountering now.
3. Most importantly for any policy decision --- Economy Energy Sales allows ML&P to lower rates to its ratepayers. Fairbanks gains from buying less expensive power. Anchorage gains from having lower cost electricity (c/kWh) with the reduced COPA.

Gas Supply:
Without an aggregated approach between ML&P, CEA and Enstar, the Producer companies (Conoco, Marathon and Chevron) remain in a position to divide and harvest the utilities. With an aggregated model, the gas & electric utilities have more bargaining power with the Cook Inlet gas producers. This same aggregated approach also applies to figuring out Cook Inlet gas storage and figuring out LNG imports/ANS North Slope Gas to Southcentral, which will hopefully lead to getting gas producers to come to the table with decent terms.

Greater Railbelt Energy and Transmission Corporation (GRETC)
This is a State initiative and very much in the early stages of development. Determination of the risks and opportunities should be closely monitored before the start of the next legislative session.

Recommendations for Immediate Consideration:

- Highly recommend an independent review of the regulatory, legal, financial and cost impacts to ML&P.

- Unbundle financials to enable more public and direct comparisons of efficiency and effectiveness by line of business, consistent with utility industry standards.

- Benchmark performance by function to ensure that each of the enterprises is operating and delivering value to consumers favorable when compared to top North American performers for its peer class.

- Institute independent audit of ML&P top line revenue to ascertain why management allowed valuable economy energy sales to decline rather than take corrective action ahead of time.

- Investigate initiation of a well designed incentive pay system to encourage productivity and innovation. As an example, executive base salaries could be reduced by say 10% and create opportunity for general managers and their immediate management level team to earn up to 20% of base in "at-risk" pay based on achieving measurable improvements in value delivered to customers. Comparable to migrating utilities toward more business like practice. However, the determination of at-risk pay metrics need to be done independent of the utility management so that compensation doesn't go up without any significant increase in performance above trend line.

Anchorage Water & Wastewater Utility

Anchorage Water & Wastewater Utility
Transition Summary Report

Key Issues:

- MUSA Decision was an attempt to shift approximately $6 million/year in municipal government costs from taxpayers to AWWU customers. It would not necessarily lower taxes because this action removed these costs from the tax cap and would allow a tax rise to fund new municipal spending. The RCA rejected this cost shifting, and the Superior Court agreed. The Alaska Supreme Court has overturned the RCA disallowance and it's still possible there could be a $30-$40 million refund to AWWU customers required.

- AWWU set up as separate authority in 2005. Phases 1&2 of the transition complete; Phase 3 in progress.
    - Should the separate authority concept be completed as planned?
    - Title 31 setting up the authority is silent on the purpose of the authority. Clarification and guidelines are needed. How is the Utility to be managed and for whose benefit:
        - General MOA taxpayers/owners of AWWU?
        - Customers of AWWU?
        - Others or a mix?

      Current Mission Statements:
      The mission of ML&P is to provide service with competitive, safe, reliable, energy.

Excellence through Innovation - Anchorage Water & Wastewater Utility supporting the public health, safety and economic interests of the community by providing quality Water and Wastewater services in a responsible, efficient and sustainable manner.

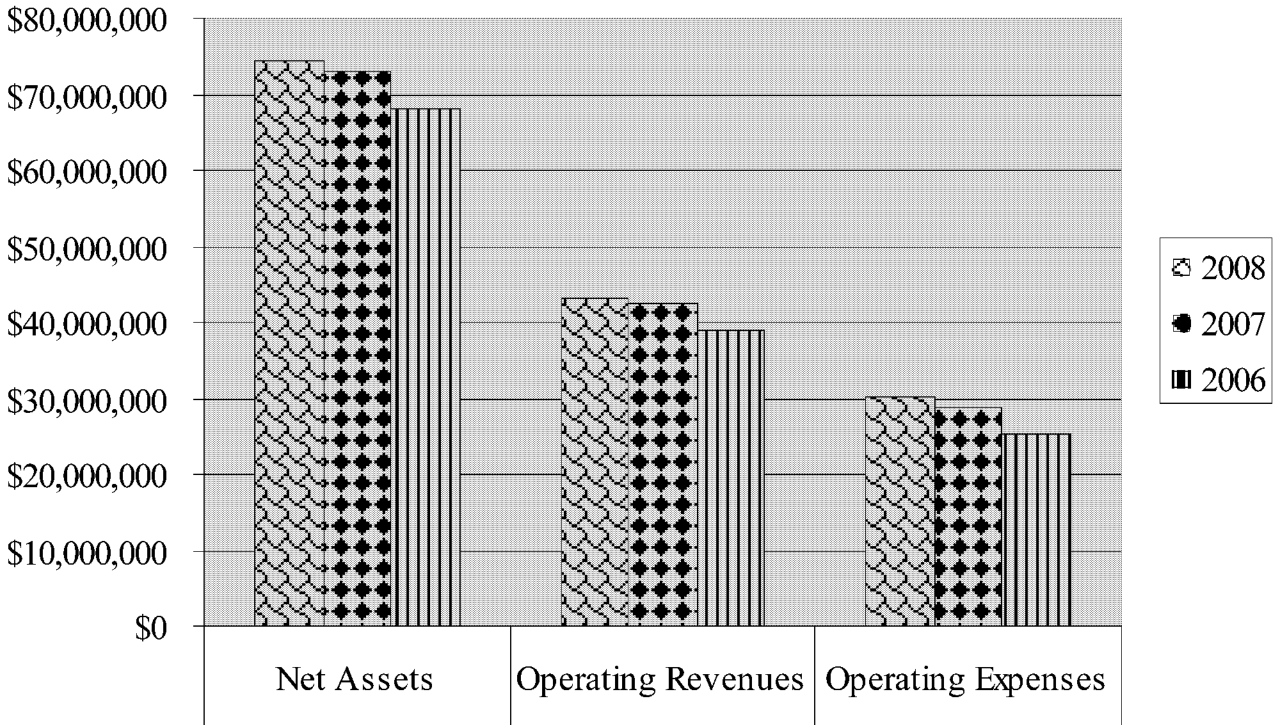
No matter how well intended current authority boards and managers may be, organizations drift, different individuals will leave and be replaced, mission statements are easy to change.

- Lines of responsibility are not clear-cut. AWWU general manager reports to both the AWWU Board and the Mayor.
- There would be increased risk with an independent authority made even more independent by removing more of the Mayor and Assembly's oversight responsibility.
- Better to develop a modern regulatory and organizational framework with a clear purpose, management objectives, transparency and performance reporting designed to be self executing as much as possible.
- This will not be successful without also evaluating RCA regulation of AWWU. The issues are very similar to those at ML&P.
- Recommend that the administration seek the best possible regulatory and public utility management advice to design a long term solution that will deliver the best possible value for utility owners and customers.

- AWWU is to be complemented for already completing extensive comparative performance benchmarking of its activities. This information will be an important input to development of the regulatory and organizational framework discussed above.

FINANCIAL Overview
Water Utility

- Net Capital Assets increased by $18,120,000, or 4% in 2008 and $18,780,000, or 5% in 2007.
- Net Assets increased by $1,460,000, or 2% in 2008 and $4,880,000, or 7% in 2007.
- Operating Revenues increased by $430,000, or 1% in 2008 and $3,810,000, or 10% in 2007.
- Operating Expenses increased by $1,230,000, or 4% in 2008 and $3,420,000, or 13% in 2007.



	Net Assets	Operating Revenues	Operating Expenses
2008	$74,516,359	$43,056,888	$30,069,656
2007	$73,053,101	$42,626,470	$28,836,456
2006	$68,170,029	$38,813,948	$25,419,903

Overview of the Financial Report

The Utility reports as an enterprise fund of the Municipality of Anchorage (MOA). A Board of Directors (Board) consisting of seven members governs the Utility. The Board recommends tariff rates, fees, and charges imposed by the Utility for its products and services to the Assembly for approval. The Utility is economically regulated by the Regulatory Commission of Alaska (RCA).

Analysis of the Financial Statements

In 2008, the Utility's total assets increased by $2.1 million. Net capital assets increased by $18.1 million due to new plant additions.
Major additions to plant in service in 2008 were Transmission and Distribution plant:

- Anchorage Water Loop IV $19.2 million
- G & H Alley Upgrade $1.9 million
- 19th Avenue Upgrade $1.3 million

General plant:

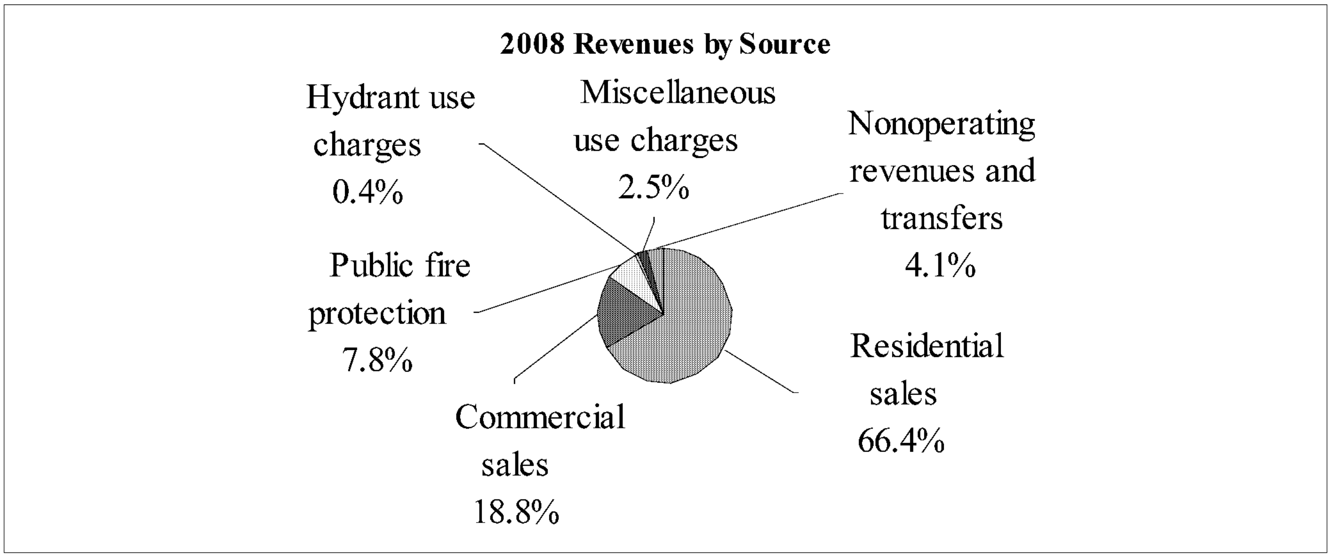
- Structures and improvements $1.8 million
- Information Technology upgrades for $3.6 million

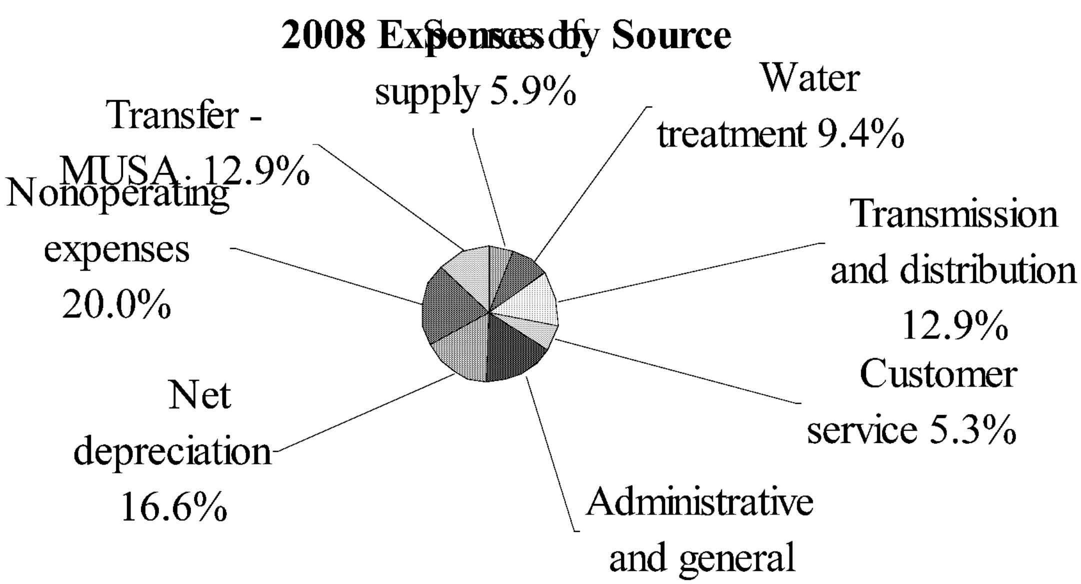
Current and other assets decreased by $16.2 million in 2008 primarily due a $14.9 million reduction in cash and investments restricted for capital construction. Restricted cash and investments from the proceeds of bonds issued in 2007 were used to fund capital construction in 2008.

There was no significant change in total liabilities from 2007 to 2008. Net debt outstanding increased $4.4 million due to additional low interest State of Alaska Loans of $9.2 million offset by debt principal payments. Current and other liabilities decreased $3.7 million primarily due to a decrease in construction accounts payable.

Net Assets
Net assets increased $1.5 million during 2008. Operating revenues increased by $.4 million due to modest customer growth of approximately .3%. Non-operating revenues decreased by $1.1 million due to lower returns on investments caused by poor market conditions in 2008. Special items of $1.3 million resulted from net pension obligations and net OPEB obligations written off in 2008.

Operating Expenses:
Operating expenses increased by $1.2 million from 2007. The increase was due primarily to a $.7 million increase in depreciation expense associated with increased plant in service. Additional contributing factors were increases in labor costs from negotiated labor agreements and increases in fuel, chemical and utility costs.



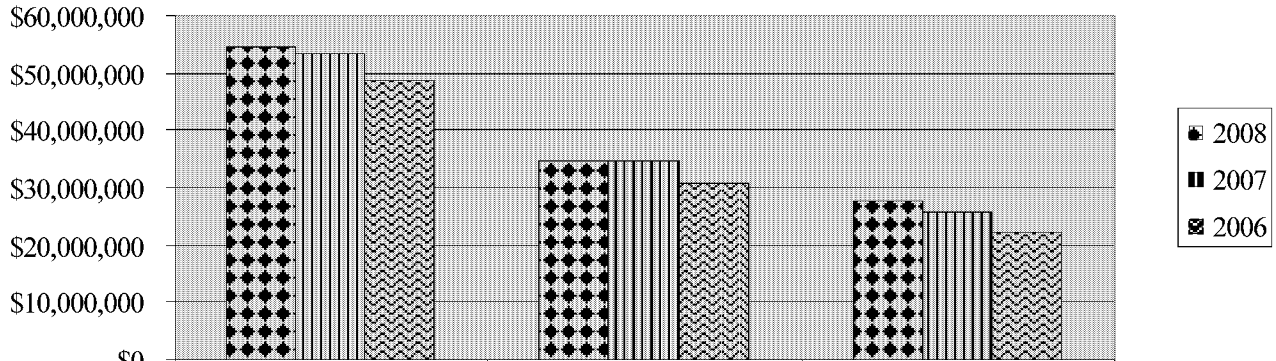


WASTEWATER UTILITY FINANCIAL HIGHLIGHTS:

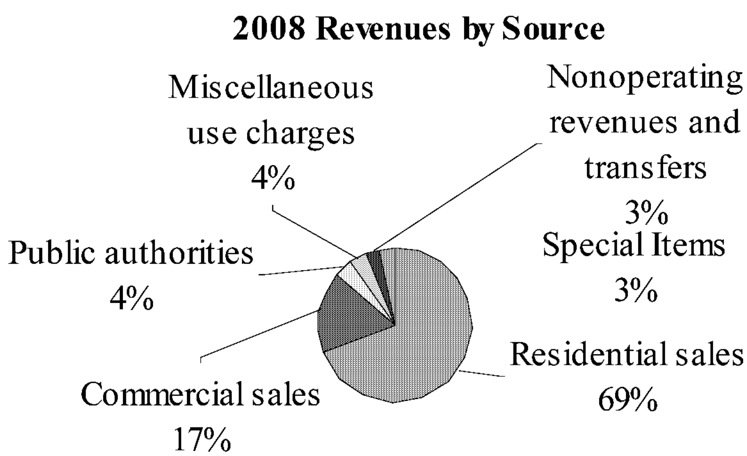
Financial Highlights

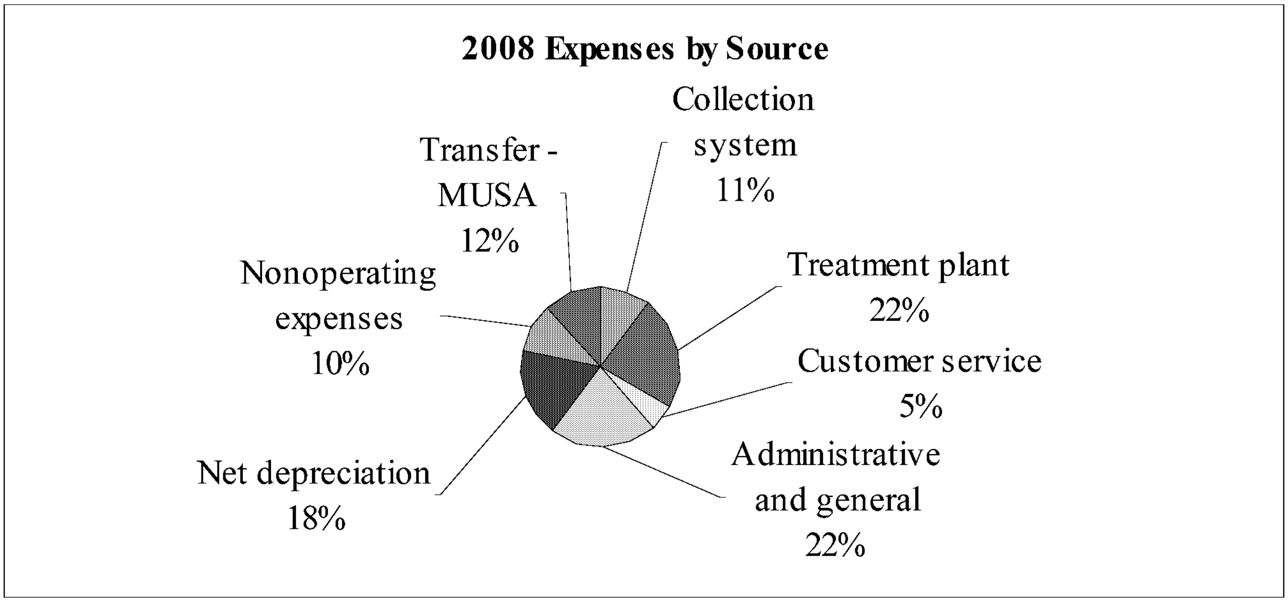
- Net Capital Assets increased by $11,860,000, or 4% in 2008 and $11,880,000, or 4% in 2007.
- Net Assets increased by $1,410,000, or 3% in 2008 and $4,330,000, or 9% in 2007.

- Operating Revenues increased by $24,000, or 0.1% in 2008 and $3,610,000, or 12% in 2007.
- Operating Expenses increased by $1,980,000, or 7% in 2008 and $3,510,000, or 16% in 2007.



	Net Assets	Operating Revenues	Operating Expenses
2008	$54,629,358	$34,581,135	$27,624,265
2007	$53,222,110	$34,557,313	$25,646,320
2006	$48,887,147	$30,947,804	$22,140,232





MUSA DISCUSSION:

History:
From 1976 to 1987 MUSA was calculated on both contributed plant (donated or paid for with grants) and non-contributed plant (Utility paid for). In 1988 the Municipality changed the MUSA ordinance to be based on only non-contributed plant and a gross receipts tax. The APUC (predecessor of the RCA) allowed the MUSA on non-contributed plant in rates, but deemed the gross receipts tax to be a dividend and thus not allowed in rates. In 2003 the Municipality again changed MUSA to include contributed plant in the calculation, as it had been from 1976 to 1987. In 2004, AWWU filed a revenue requirement study requesting a rate increase, including the MUSA on contributed plant in its rate calculation. The RCA denied the portion of the rate increase associated with the MUSA on contributed plant. The RCA concluded that because there was no increase in services, the increase in MUSA had the characteristics of a dividend to the Municipality.

AWWU appealed the decision to the Superior Court, which upheld the RCA decision in June of 2007. AWWU then appealed the decision to the Alaska Supreme Court.

On May 8, 2009, the Supreme Court issued an opinion on the case. The Supreme Court opinion stated "Because RCA: (1) unreasonably believed that its decision was controlled by 1989 APUC precedents; (2) unreasonably failed to consider applicable tax law and evidence on whether private utilities pay property taxes on contributed plant; and (3) unreasonably concluded without sufficient factual findings that the proposed 2003 MUSA payment had the characteristics of a dividend, we hold RCA's denial of AWWU's rate request lacked a reasonable basis." The Supreme Court reversed the Superior Court decision and remanded for RCA to conduct further proceedings and make a determination on the merits of the reasonableness of AWWU's proposed rate increase.

On May 18, AWWU filed a Motion for Clarification with the Supreme Court. The motion seeks guidance from the Court on the scope of the remand and the Court's intention with respect to the reasonableness issue to be considered by the RCA. Specifically, the motion requests that on remand reasonableness may be established by showing tax equity exists if private and publicly-owned utilities contribute to the cost of government on substantially the same basis.

On May 28, the Attorney General's office filed a limited opposition to AWWU's motion for clarification with the Supreme Court. The AG's office agrees that clarification is needed, however, they do not agree that reasonableness may be established by showing tax equity. The AG asserts that reasonableness should be determined under affiliated transactions statutory requirements, requiring a cost based assessment.

Current Status:
The Supreme Court opinion is a win for the MOA and AWWU in that they found that the RCA's denial of AWWU's rate request lacked a reasonable basis. ***Caution here: Maybe it's a win for the MOA, but it may not be a win for AWWU consumers, and MOA taxpayers?*** It does not however, completely settle the MUSA issue. What the Supreme Court ruled on was whether or not the RCA decision denying MUSA on contributed plant in rates had a reasonable basis. They found that the RCA decision did not have a reasonable basis for the reasons listed above; therefore the RCA needs to conduct further proceedings and make a determination on the reasonableness of AWWU's rate increase.

Currently, AWWU is waiting on the Supreme Court to act on the Motion for Clarification. At this point, AWWU does not yet know what the scope of "further proceedings" at the RCA will entail or what the timeline for those proceedings and any decision will be.

Currently the estimated potential refund liability for MUSA as of December 31, 2008 is between $24.5 million without interest, up to $30.3 million including interest. That potential liability is expected to be $30.6 million without interest to $40.6 million including interest by the end of 2009.

AWWU Authority discussion
In a candid discussion with AWWU General Manager, Mark Premo, I asked him what the three "most positive aspects" of the Authority would be from a management perspective and the three things he would most likely change. This discussion is contained below:
Three most positive aspects of the Authority Board per the GM:

1. The Authority was created to ensure that the City's investment is maximized, while providing sound governance of AWWU by focusing expert resources on: a) financial integrity; b) system integrity; and, c) customer interests, upon this critical public health and human safety service. To this end, in the past 18 months the Authority has

provided positive guidance to Utility staff in all three areas. Prior to Authority formation, direct interaction with policy makers was limited due to other demands on their time; and the policy makers, as a general rule, were not fully versed in the management of a utility.

2. As an Enterprise fund, AWWU is expected to operate much like a private business. The creation of an Authority form of governance helps establish business-driven principles and converts AWWU's oversight into one more consistent with industry-wide best management practices, while demanding accountability of staff not before seen as an operating department of the MOA.
3. The form of governance created by Title 31 allows for a group of dedicated experts to quickly focus on one issue at a time. An example would be the Long Range Financial Plan, which addresses the competing interests of capital expenditures, system integrity and distributions to the Owner (MOA).

Three things the GM would change:

1. The intent of Title 31 was to make a good utility even better, with the implementation of a more efficient type of governance for AWWU; and, to provide a model for the implementation of best practices in a Municipal environment, through an Independent Operating Authority. Presently, there appears to be discussion about this intent by MOA policy makers – this makes it extremely difficult to run and manage the Utility's operation (mixed signals). The MOA policy makers need to decide if an Operating Authority is how they want the Utility to operate or not. Simply put, let the Utility run as Title 31 is structured to operate, and facilitate the transfer of management authority to the Utility as presented in the transition plan, Phases1/2 (Phase 3 has yet to be finalized); or, make the Utility a department as it was previously. I'm concerned that Title 31 is/will be compromised – and the worst thing that could happen is attempting to run the Utility halfway between an operating Authority and a MOA department. In such a case, nothing gets accomplished. To answer your question directly: make us an Operating Authority or a MOA department – halfway in-between is counterproductive.

2. The General Manager should serve at the Board's pleasure, not the Mayor's. The General Manager has two independent bosses; as long as both bosses are on the same page it works. However, if a difference of opinion were to exist between the Mayor and the Board, the General Manger would be in a no-win position.

3. The GM would recommend expanding the Board from seven members to nine members. The Board discussed this and voted not to approve my recommendation. For the Board to be a functional, non-political governance Board, using committees to carry the workload, nine members is a better number to spread the workload out so Board Directors do not burn-out on Board related activities.

There are 3 main options under an "Authority" for the various administrative functions (i.e. Personnel, Purchasing, OEO, A/P, Accounting, IT, OMB, Finance, Internal Audit, Reprographics, etc.) when the MOA establishes independent authorities:

1. Establish and transfer all functions to each new authority.

    - This is the basic model that has been done in the past for the Parking Authority, ATU, AWWU. The application of Municipal Code(s) has varied some on each of these authorities.

2. Maintain all existing administrative functions within General Government and transfer only the management oversight to the authority.

    - This would generally mean that the Authority Board would take on the day to day management oversight of the existing department, provide management guidance, and functionally fill the role of the Municipal Manager, Mayor, and Assembly. The Authority would probably operate within all existing Codes and Ordinances, but could be modified based upon actual need.

3. Establish a separate Central Services Section to provide all administrative functions for the Utilities and Enterprise Activities, i.e. AWWU, MLP, Port, Airport, Solid Waste Services.

    - This model would minimize the sheer number of duplicated services that would otherwise be required for (multiple) independent authorities. It would, however, break the chain between General Government and the Enterprise Activities and allow the two distinct activities to operate independent of each other. General Government would maintain whatever level of administrative services they need, and the Enterprise Activities would separately staff and maintain their level of administrative services. This option may help in eliminating the noise that occurs whenever General Government has monetary problems. In the last couple of economic down turns, the Utilities also shared in the service reductions even though they themselves did not have an economic problem. The caution that needs to be exercised here is potential impact to the ratepayer given the economic downturn we are facing. Whether or not all of the existing Municipal Codes would apply to the separate enterprise entity would be an obvious discussion.

4. Some combination of 1, 2, or 3 above.

OTHER COMMENTS ON THE AUTHORITY STRUCTURE:

- Board approves department managers - This obviously defuses the authority of the GM. It seems that the GM should be free to choose his team and not having a board get involved in such personnel decisions below the level of GM. It's hard to imagine a situation where a board does not formally agree with a department manager that the GM wants. It would only occur with a board that does not have confidence in the GM, in which case the GM should be fired anyway.

- Authority Boards - Title 31& 32 state that "One member shall be a municipal employee". This needs to be clarified - that this employee is the Mayor's representative, or is an ex officio. The mayor/assembly should not be able to appoint just any municipal employee to a five-year term on these boards that extends beyond the term of a mayor.

There is an unusual relationship between the authority structure of these utilities and the Municipality. If a major financial, regulatory or environmental issue was to arise, the authority would be the entity tasked with dealing with and resolving the problem. But, the rate payers and the citizens of the Municipality would hold the Mayor/Municipality responsible. This raises a question about both the need and effectiveness of the authority structure. If a utility were to be sold similar to the ATU example, the fully private entity assumes ownership and operates under a shareholder/Board structure with responsibility to the SEC and full accountability to shareholders and a board of directors.

The concern of unnecessary duplication of supervision is only one area where an Authority structure may fall short. There needs to be careful consideration of who exactly is ultimately responsible for the successful operation and management of the Utility and when the answer is the Municipality, an intermediary can send mixed signals to both the public and GM without the accompanying accountability that is expected from an entity with oversight over a utility providing essential services to Municipal citizens.

Issues

ENERGY

ENERGY

Submitted by Judy Brady, Steve Pratt, Dan Coffey, Bill Popp, Tony Izzo, Arden Page, Joe Griffith, Bob Stinson, and Dave Harbour

BACKGROUND

Cook Inlet natural gas deliverability is in rapid decline. The Division of Oil & Gas reported a 2009 winter deliverability decrease of 19% relative to 2007 peak demand, and a 42% decline relative to the peak of 1999[59]. "Deliverability" is most often defined as the measure of natural gas that can be delivered on a daily basis.[60 61]

The consequence of deliverability declining below peak demand is serious at best, and potentially catastrophic for 50% of Alaska's population. Since electric generation depends on gas supply, a gas deliverability shortfall during the coldest and darkest times of the year, bringing rolling brownouts and loss of space heating, could have extremely serious life and safety impacts on Anchorage and Southcentral Alaska residents.

Gas deliverability affects space heating and power supply capabilities in the Municipality of Anchorage and the Mat-Su and Kenai Boroughs. Matanuska Electric Association (MEA) depends on Chugach Electric Association (CEA) for its gas supply, as does Homer Electric Association (HEA) and Seward Electric (Seward has local back up generation that is significantly more expensive than buying power from Chugach Electric). Lack of gas for Chugach Electric, therefore, has serious consequences for all of Southcentral Alaska.

Natural gas distribution systems rely on maintaining pressure to meet consumer needs for continuous service. Should the gas distribution system lose pressure, even for a brief period, Anchorage could be faced with a shutdown of the entire system for safety purposes. It would likely take weeks or months to reestablish service to consumers[62]. Aside from the obvious health and safety concerns, the economic impact to homes and businesses faced with frozen pipes and no heat for an extended period would be massive and felt statewide.

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This report focuses on the greatest priority: effectively confronting Anchorage's energy crisis. A broader view is then presented of Anchorage's energy challenges as it fulfills its responsibility as Alaska's headquarters city.

FINDINGS

1. **The need for reliable, affordable energy delivery--heat, light and power--to residents is a high priority issue for the Municipality of Anchorage[63].**

2. **There is widespread consensus that the Municipality of Anchorage faces the possibility of a gas deliverability disruption this coming winter and for the next several winters.**

3. **Energy disruptions this coming winter, and in future winters, due to diminishing gas supply and deliverability, have the likelihood of serious consequences. The implications for the residents are, at best, seriously inconvenient, and at worst, catastrophic.**

4. **The immediate problem for Anchorage is this: Alaska's energy delivery systems are isolated from other states - we are not interconnected to the national power grid or nationwide network of natural gas pipelines.**

5. **The need is "now" and the solutions are "future". Anchorage has an immediate energy deliverability problem and solutions will take from 3 to 15 years to implement.**

6. **Energy solutions from "big ticket" billion dollar projects, like a gas pipeline from the North Slope or hydro electric dams, are at least 10 to 15 years into the future.**

7. **Shorter term solutions such as gas storage facilities (to store gas produced in the summer for use during peak cold periods in winter), imported LNG, new, more efficient equipment, and new supplies from exploration in Cook Inlet are, at best, 3 to 5 years out.**

8. **Solutions will require staggering amounts of investment, amounts that will be borne by Anchorage residents.**

9. **While federal agencies estimate significant quantities of additional gas reserves exist in Cook Inlet, no new large discoveries have been made for decades. Cook Inlet exploration and development faces high costs, geologic risks, and regulatory uncertainty in an isolated, low demand market.**

[63] When we use the term "Anchorage", or "Municipality of Anchorage" in this energy report, we are mindful of the similar challenges facing all of Southcentral Alaska, and, to a degree, Interior Alaska, with which Southcentral shares electricity and natural gas resources.

10. **Long term gas supply contracts are necessary to provide certainty to residents, producers, and utilities.**

11. **The RCA has not approved a long term gas supply contract since 2001. The RCA's repeated rejection of negotiated agreements has created uncertainty for residents, consumers, and producers. This is a crucial issue that must be resolved.**

12. **All of the proposed short and long term solutions are complicated by technical, competitive, legal, economic, financial, policy and political issues. These issues have discouraged or deadlocked decision making – to the detriment of the residents of Anchorage and Southcentral Alaska.**

13. **While there is widespread public awareness and concern about rising energy costs, there is limited public awareness of the increasing seriousness of the energy supply and deliverability issues.**

14. **While the power/gas supply responsibility of the Municipality is largely executed through Municipal Light & Power's (ML&P's) service area, Mayor Sullivan can and should play an activist role on behalf of the Municipality's residents in this impending Southcentral energy deliverability crisis.**

SHORT TERM RECOMMENDATIONS
July 1 to November 30, 2009

The goals are to: 1. ensure the safety of all residents through preparedness for energy disruptions; 2. engage the public in community conservation as the Municipality's best immediate action to avoid rolling brownouts/ blackouts or system failure; 3. assign a high priority focus on energy issues at the executive branch level; and, 4.coordinate with responsible parties to encourage additional solutions to avoid disruptions.

I. Immediately access/implement emergency response to life/ safety threats from gas supply disruptions

To ensure public safety if there is a "perfect storm"- a long cold spell combined with an equipment failure - there must be an immediate, efficient, coordinated response.

1. **Access the Municipality of Anchorage's current Emergency Operations Plan (EOP) for an energy disruption event. By date certain, direct that there is a meaningful contingency plan, coordinated with all utilities and producers, for response to a large-scale winter interruption in energy supply.**

2. **Direct the Office of Emergency Management to coordinate an exercise to test the adequacy of the coordinated response plans with utilities, the school district, military, hospitals and all other key parties.**

3. **Ensure there is a coordinated communication plan among the members of the command team and with the public.**

II. Coordinate a city-wide energy conservation plan.

There is strong consensus that a city wide energy conservation program, with emphasis on peak user times in cold weather, is the most effective measure the Municipality itself can take to prevent rolling brown outs, black outs when the system is under stress. If this is our best shot we should take it. Individual utilities and conservation groups have and are advocating conservation; this recommendation is aimed at coordinating an all-city buy in.

1. **Coordinate an energetic city wide energy conservation plan, with emphasis on cutting back use during cold snaps. Engage citizens, municipal, state and federal agency personnel, utilities, producers, churches, schools, hospitals, business, civic, conservation groups, radio stations, newspapers.**

2. **Direct the municipal departments to review their conservation plans with the goal of decreased energy use by November; coordinate with federal and state agencies, building owners, realtors, and other key groups to participate.**

3. **Begin an on-going dialogue with the public now to raise awareness, without panic, on the issues, the challenges, the solutions. Consider implementing and publicizing a "Power Alert" program wherein during peak use periods the Mayor could call on citizens to minimize their use of natural gas and electricity.**

III. Appoint a senior staff person, reporting to the Mayor, to be responsible advising the Mayor on energy issues and challenges.

Decisions made in the next two to three years by utilities, gas producers, regulators, the assembly, state agencies, public authorities and the legislature will determine much of the energy picture of Southcentral for years to come. The Municipality of Anchorage must have an individual to focus entirely on energy issues and proposals, coordinate and communicate with key players, and to provide accurate and timely information on energy issues affecting Anchorage.

INTERMEDIATE RECOMMENDATIONS
1 to 10 YEARS

The goal is for the Municipality of Anchorage and Southcentral to be assured of reliable, affordable energy. The strategies include: (1) urging responsible parties to implement intermediate plans for assured energy deliverability within the next 3 years; (2) to press for decisions about, and implementation of, long term solutions that will assure the Municipality and Southcentral of future reliable, affordable energy.

I. Work with gas producers, utilities and private parties to encourage and support solutions for energy deliverability.

II. Work with the State of Alaska, the legislature, and private parties to ensure uninterrupted delivery of natural gas and electrical power to Southcentral Alaska.

III. Support public and private plans for renewable energy options.

IV. Consider plans that unify and/or coordinate Chugach and ML&P operations to provide more operational efficiency and more efficient deployment of capital.

V. Direct the Municipal Attorney to review all Regulatory Commission of Alaska open dockets to identify those which could affect Anchorage's citizens. Make such a review a permanent responsibility of the Municipal Attorney. Actively intervene in all Commission dockets where the interests of citizens could be affected, especially those regarding energy issues.

VI. Support local, state and federal legislation that provides for economic stability/growth in Southcentral Alaska, including oil and gas leasing both on and offshore, and value-added industries.

VII. Participate in the Tri-Borough Commission to ensure continuing coordination among Anchorage/Mat Su/Kenai on energy issues.

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