

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE


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MEMORANDUM

TO: Members of the Legislative Budget and Audit Committee

FROM: Pat Davidson, CPA 
Legislative Auditor

DATE: July 16, 2008

RE: Alaska Industrial Development and Export Authority – Selected Snettisham Hydroelectric Project Issues

The following information is provided in response to your request that our division conduct a limited review of the Alaska Industrial Development and Export Authority's (AIDEA) involvement with the Snettisham Hydroelectric Project. The specific areas of review were the Renewal & Replacement (R&R) Fund and insurance coverage as it relates to Snettisham transmission lines. This letter summarizes our review. The review was very limited and does not constitute an audit. Our limited review focused primarily on determining whether AIDEA appears to have fulfilled their responsibilities in these areas.

AIDEA's primary responsibility in the Snettisham Hydroelectric Project is to the holders of revenue bonds AIDEA issued for the purchase of the project. AIDEA's roles and responsibilities are primarily those one would typically associate with an agency financing the purchase of a project, not its operation. There is no cost to AIDEA for the financing, operation, maintenance, or capital improvement of the Snettisham Hydroelectric Project. All costs and expenses are borne or reimbursed by the operator, Alaska Electric Light and Power Company.

Nothing came to our attention during our limited review that would indicate that AIDEA has not fulfilled their responsibilities as they relate to the Snettisham Hydroelectric Project R&R Fund or insurance requirements for the transmission lines.

The following provides background information, describes the purpose, operating methodology, and use of the R&R Fund, and addresses transmission line insurance.

Background Information

Snettisham Project Description

The Snettisham Hydroelectric Project (project) is a 78,210kw hydroelectric project located 28 air miles south of Juneau. The project consists of two reservoirs, a small flashboard dam, power tunnels, underground generating plant, switchyard, 44 miles of transmission line, and substation. It provides approximately 80% of the Juneau-Douglas area electric needs.

Project Development and Ownership

The U.S. Congress authorized development of the project in 1962 and appropriated funds for construction to the U.S. Army Corps of Engineers in 1966. Construction of the first phase (Long Lake) began in 1967, with the project coming on line in 1973. Once construction was completed the U.S. Department of Energy, Alaska Power Administration became responsible for the operation, maintenance and sale of power from the project. By 1984, electrical demand in Juneau was such that Congress appropriated money for the second phase of the project (Crater Lake). Operation of the Crater Lake phase began in 1990.

In the mid 1980's the federal government began exploring the merits of divesting its power marketing agencies located throughout the country. In Alaska, this divestiture was approached through a series of public reports and consultations, the result of which was a formal invitation for proposals by the Alaska Power Administration in the spring of 1987. The state and federal governments entered into a Snettisham Purchase Agreement in February 1989. In 1995, the U.S. Congress authorized and directed the sale of Snettisham to the Alaska Industrial Development & Export Authority (AIDEA) through passage of the Alaska Power Administration Asset Sale and Termination Act. During May 1996, the Alaska State Legislature authorized AIDEA to purchase Snettisham.

AIDEA Purchase and Party Responsibilities

AIDEA's acquisition of the Snettisham project was completed in 1998. It was financed through the sale of tax-exempt revenue bonds. The legislature authorized the issuance of up to \$100 million in revenue bonds for this purpose in 1996. The purchase price for the project was \$81.9 million. The AIDEA Snettisham Power Revenue Bond Resolution and Official Statement delineate roles and responsibilities related to the sale and operation of Snettisham. As an integral component of the purchase and bond issuance, AIDEA entered into several agreements with the Alaska Electric Light and Power Company (AEL&P) and its affiliate the Snettisham Electric Company¹. These include a Power Sales Agreement with AEL&P, the Operations and Maintenance (O&M) Agreement with AEL&P, and a Snettisham Option Agreement with Snettisham Electric Company.

Power Sales Agreement (PSA) - Under terms of the PSA, AIDEA agreed to pay the costs of acquiring the Snettisham Project, the cost to design, procure, and install a second set of

¹ AEL&P and the Snettisham Electric Company are both wholly owned subsidiaries of the Alaska Energy and Resources Company.

four submarine transmission cables, and the cost of an initial \$1.8 million deposit to the Renewal & Replacement fund (R&R Fund). AEL&P acquired all of the capability of the project to generate and transmit electric energy. The PSA also provided AEL&P with the right to purchase any additional capability of the project if it was ever expanded, provided that they pay for any additional debt service and operation and maintenance expenses related to the expansion. In return for these rights, AEL&P obligated itself to certain requirements. Key obligations of AEL&P involve paying annual Project Costs including debt service on all bonds associated with the project, all of AIDEA's administrative costs, and the annual contributions to the R&R Fund. AEL&P must provide insurance as required by the O&M agreement, provide replacement power when power from the Snettisham Project is not available, and make additional payments to AIDEA as may be necessary for annual Snettisham Project revenues to AIDEA to meet the debt service coverage requirements required in the Bond Resolution.

Snettisham Option Agreement - The PSA includes as a separate exhibit the Snettisham Option Agreement. This agreement gives the Snettisham Electric Company the option to buy the Snettisham Project from AIDEA. The option period is any time after August 2003 and before the end of the PSA in December 2038. The option has not been exercised, though AIDEA believes that the option will eventually be exercised and the project's ownership will pass to this entity.

Operations and Maintenance (O&M) Agreement - The O&M Agreement between AIDEA and AEL&P requires AEL&P to operate and maintain the entire Snettisham Project and to pay for the cost of this operation. AIDEA has the right to review and negotiate changes to AEL&P's annual operating budget. The O&M Agreement also delineates AEL&P's insurance responsibilities. Provisions are included that allow requirements for expected insurance coverages to be waived if certain conditions exist. AIDEA and the State Division of Risk Management may waive a specific insurance requirement if it will not materially affect the State's risk or if the insurance coverage in question is not available under reasonable terms and conditions.

Renewal & Replacement (R&R) Fund

In accordance with requirements of the AIDEA Bond Resolution and the Snettisham Project PSA and O&M Agreements, an R&R Fund was established and is maintained with the bond Trustee. The R&R Fund was created for the purpose of paying or reimbursing the cost of Project Repairs and associated engineering, construction and administrative costs, that would normally be treated as capital costs. The initial R&R Fund contribution for 1998 was \$1.8 million. This was provided, as required, by AIDEA from initial bond proceeds. The minimum R&R Fund balance is \$500,000. According to AIDEA, AEL&P has been submitting annual R&R contributions to the bond trustee for deposit into this fund as required by the PSA. In 1999, their first year contribution was \$685,279. This amount increased at an annual rate of 3% for the next three years.

In 2001, and every three years thereafter, an independent consultant is required to review the R&R Fund and recommend adjustments to the amount of the annual contributions. AEL&P has chosen to obtain this review on an annual basis. The independent consultant's most recent R&R

fund report of November 2007 constituted the ninth annual assessment. In all instances, AIDEA and AEL&P have agreed to annual R&R Fund contribution adjustments in line with those recommended by the independent consultant. Based on historical usage and forecasted anticipated needs, recommended annual contributions delineated in the November 2007 report are as follows:

<u>Year</u>	<u>R&R Expenditure Forecast</u>	<u>Annual Contribution</u>	<u>End of Year Fund Balance</u>
2008	\$1,847,076	\$1,445,766	\$2,494,718
2009	\$ 950,623	\$1,489,139	\$3,133,023
2010	\$2,034,561	\$1,533,813	\$2,757,596

Anticipated R&R Fund costs, interest earnings, and required annual contributions are projected out until the year 2037. Consultant recommended annual contributions are designed to ensure a sufficient balance in the fund to cover all anticipated costs through 2037.

Amounts in the R&R fund are applied to the cost of budgeted capital items for project repairs, pursuant to requisition requests made by AEL&P and approved by AIDEA. Certain transmission line related R&R costs are budgeted and are included in the consultant's R&R Fund analyses and projections. However, repair costs of the nature and magnitude resulting from the recent avalanche damage are not normal anticipated costs considered during the consultants R&R Fund projections.

According to AIDEA staff, the balance of the R&R Fund at the time of the April 16, 2008 avalanche is estimated to have been \$3,465,286. To date, only one disbursement of \$519,181 has been made to cover avalanche related repair costs. AIDEA anticipates this disbursement of R&R funds will be repaid with a portion of the proceeds from a long-term loan they will be making to AEL&P. A loan for up to \$8 million was recently approved by the AIDEA Board of Directors for use by AEL&P in financing the avalanche repairs. AIDEA's Snettisham Project manager estimates that the total cost of avalanche related repairs will be in the range of \$5.3 to \$6.0 million.

Overall, the purpose, operating methodology, and use of the R&R Fund seem well understood by involved parties. Its use and periodic evaluation appears consistent with requirements of the identified governing documents.

Transmission Line Insurance

Raytheon Engineers & Constructors were contracted to complete the Facility Evaluation and Risk Assessment for AIDEA and AEL&P just prior to AIDEA's acquisition of the Snettisham Project in 1998. According to their assessment, the Snettisham Project has relatively low risk exposure compared to other hydroelectric projects in Alaska. They stated that this was due to the fact that there is only a small dam and most of the major transmission line problems likely to occur had already occurred and been corrected for. They also noted that it is difficult, if not impossible, and very expensive to buy insurance coverage for the transmission lines and submarine cables.

According to the Snettisham Power Revenue Bond Resolution, AIDEA is required, as long as they own the Snettisham Project, to cause it to be insured against such risks and in such amounts as is customary in connection with the operation of facilities of comparable type and size as may reasonably and economically be obtained or secured. What is “customary” and what may be “reasonably and economically obtained or secured” is to be determined by an independent insurance consultant at least every five years.

The first independent insurance consultant review after AIDEA’s acquisition was required in 2003. The assessment was completed and the independent insurance consultants report issued on August 28, 2003. In this report, transmission and distribution lines are listed as uninsured property because they are generally not insurable at any reasonable cost. The next required independent insurance consultant review is to take place in 2008. According to AIDEA staff, AEL&P has already selected an approved consultant. Related on-site reviews are slated to occur in July 2008.

According to the State Division of Risk Management director, Snettisham Project property is not included under any State self-insurance coverage. The overall coverages maintained by AEL&P in accordance with the O&M Agreement are deemed adequate. He also noted that coverage for transmission lines would only be required if it was customary for facilities of this nature and could be obtained at reasonable cost. He said it is not customary and not considered generally available. There was never an expectation that insurance would be available to cover the Snettisham transmission lines. He also pointed out that to his knowledge no state owned power project, including the Bradley Lake Hydroelectric Project and the Alaska Intertie has ever had transmission lines included under any State self-insurance coverage or through any other policy coverage.

It is the position of AIDEA, Department of Law, and State Risk Management staff that a waiver of insurance coverage is not required in relation to Snettisham Project overhead transmission lines. Waivers are only necessary when insurance coverage is customary and expected but not available at reasonable cost or terms. Transmission line coverage is not considered customary and there was never an expectation that coverage could be obtained at reasonable cost or terms. Per our review of governing documents, agreements, consultant reports, and research regarding availability of insurance coverage, we concur with this assessment.

If you have any questions, please contact me at 465-3830.