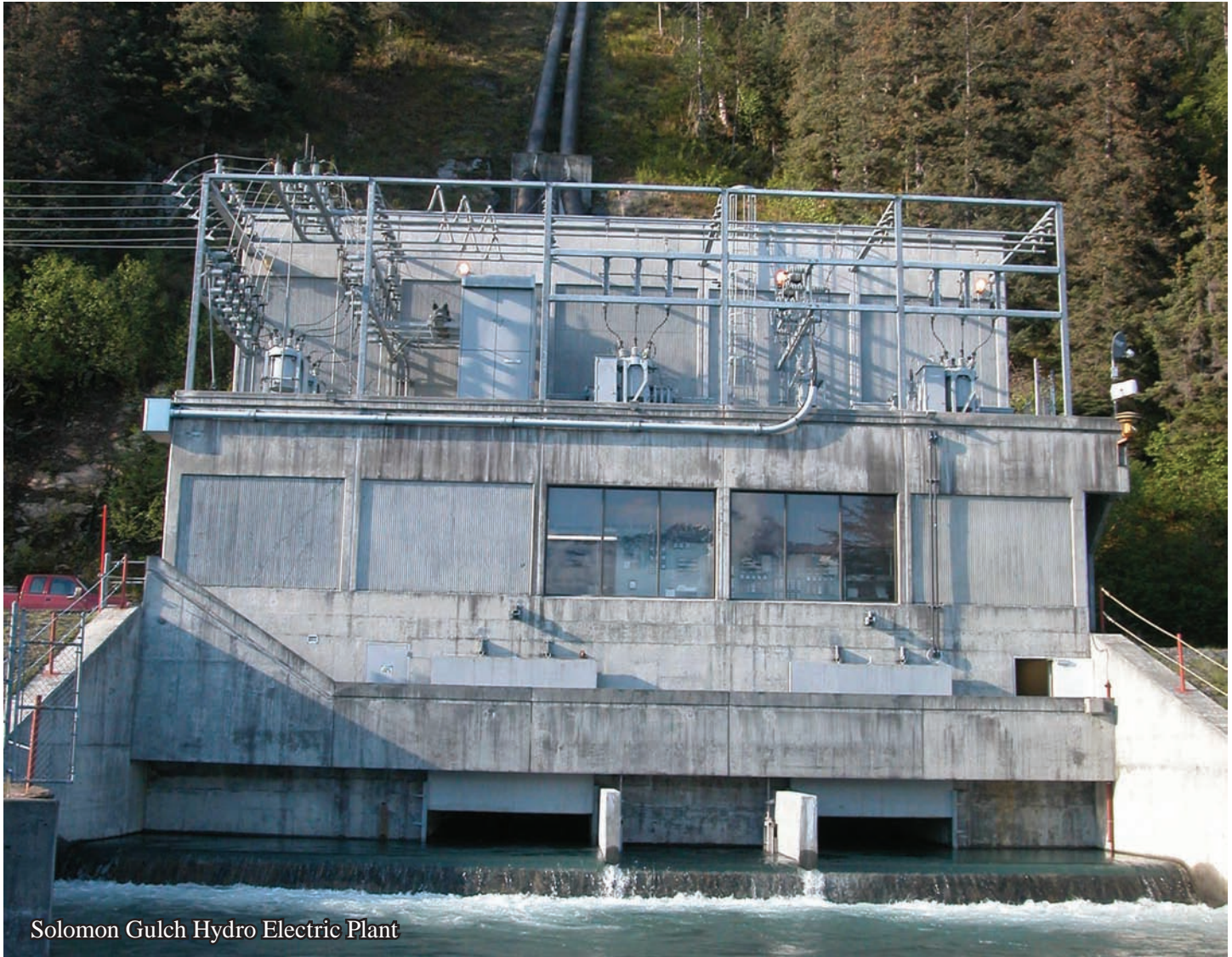


CVEA to Acquire Solomon Gulch from Four Dam Pool Power Agency



Solomon Gulch Hydro Electric Plant

The Four Dam Pool Power Agency (FDPPA), owner of four Alaska hydroelectric facilities, is finalizing the sale of the two projects that serve cooperative members of the Agency.

Solomon Gulch which serves the Copper Basin and Valdez, and Terror Lake which serves Kodiak Island, will be sold to Copper Valley Electric Association and Kodiak Electric Association, respectively. The FDPPA will retain ownership

of the Swan Lake facility which serves Ketchikan, and the Tye Lake facility which serves the cities of Wrangell and Petersburg. The surviving Agency will be renamed the Southeast Alaska Power Agency.

The transaction is expected to close in early 2009.

The Four Dam Pool Initial Project has been in existence since the early 1980s, when the state of Alaska constructed or acquired the four hydro-

electric facilities. The Alaska Legislature provided that the four projects would be treated as one project that would be operated and managed jointly and that would share risks and charge an equal wholesale power rate to each of the five member utilities. This arrangement was memorialized in a 45-year Long Term Power Sales Agreement (PSA) signed in October 1985.

In 2000, following many years of

discussions between the utilities and the state regarding purchasing the assets, the Alaska Legislature passed legislation authorizing the formation of joint action agencies, a new entity under Alaska law specifically designed to enable the utilities to purchase the Four Dam Pool assets from the state.

Following enactment of the law substantial due diligence was performed in support of the transaction. During this period Kodiak announced their strong desire to own Terror Lake and the utilities passed a resolution stating their intent to pursue breaking up the pool no later than 2012.

In 2002, the state-owned assets were sold to the Four Dam Pool Power Agency. The 1985 PSA which set forth provisions for risk sharing, pooling of costs and charging postage stamp wholesale power rates for all members remained in effect under FDPPA ownership.

In 2006, Kodiak proposed once again to break up the pool and offered to purchase the Terror Lake project for \$38 million. These additional resources combined with those of the Four Dam Pool resulted in negotiations which lead to approval by the FDPPA Board of Directors and the respective Boards of Copper Valley and Kodiak to a Purchase and Sale Agreement, whereby CVEA would purchase Solomon Gulch and Kodiak Electric would purchase Terror Lake.

Under the terms of the agreement CVEA will become the owner of the 12-megawatt Solomon Gulch hydroelectric facility and the 106 miles of transmission line connecting the communities of Valdez and Glennallen.

As part of the transaction CVEA will no longer purchase power from the FDPPA but instead will roll the costs of operating and maintaining Solomon Gulch and the transmission system into its rate structure.

In addition, costs previously included in the FDPPA rate will now be paid directly by CVEA such as the cost of project management, insurance, regulatory and environmental

compliance, renewals and replacements, and administrative costs.

Also, as part of the transaction, CVEA will assume all ownership risks pertaining to mechanical, electrical, structural and technological obsolescence, regulatory changes, and natural events including avalanches.

In exchange for assuming the risks and burdens of owning the Solomon Gulch Project, CVEA, will receive at closing, \$15 million to be placed in reserve to fund these future risks of ownership and needed system improvements.

Notwithstanding the future ownership responsibilities the Management and Board of CVEA are confident that the transaction will result in future economic benefits to CVEA consumers.

Even though the FDPPA organization is composed of tax exempt cooperatives and nontaxable municipal utilities the transaction presented some formidable tax obstacles. "We have had questions about the tax impact of owning Solomon Gulch since the 1999 discussions leading up to the FDPPA purchase of the projects," said Robert Wilkinson, "and those questions have only recently been answered."

Under the Internal Revenue Code municipal electric utilities are treated as "government" entities, while electric cooperatives are treated like private entities. Under the Code public assets may not be transferred to private ownership at below fair market value.

To do otherwise could result in CVEA receiving taxable income for the value of the cash received and the value of the facilities received.

To address this issue CVEA sought and obtained, from the Internal Revenue Service, a Private Letter Ruling which said that the value of the cash and assets received could be deducted from income as long as that value was accounted for as patronage sourced income.

To comply with the private letter ruling, the co-op will have to include both the cash and fair market value of the Solomon Gulch assets as part

of its taxable income received in the year of transaction, but may allocate that value to members as non refundable patronage capital and take a tax return deduction in an equal amount. This accounting and tax treatment avoids paying income taxes on the receipt of cash and the plant itself.

The transaction does have other tax consequences. CVEA is tax exempt under Section 501 c (12) of the Internal Revenue Code which says that as long as CVEA receives more than 85% of its revenue from its members it remains tax exempt.

In 2009 the purchase of Solomon Gulch will cause CVEA to fail this test and to lose its tax exempt status because the value of the compensation received is considered by the IRS to be nonmember income.

While the value of the assets and cash can be deducted from taxable income, interest income cannot, and accordingly CVEA will pay some income tax on investment earnings in 2009.

"Individual utility ownership of the projects has been discussed since at least 1995," says Wilkinson. "The projects were built for the benefit of the communities they serve and it always made sense to return ownership to those communities."

With Kodiak's financing in place and Copper Valley's tax issues addressed, it now appears that the cooperatives are positioned to take ownership of their respective projects.

The cities of Ketchikan, Wrangell, and Petersburg must now seek approval from their governing bodies and many other details must be accomplished before the transaction closes, hopefully in early 2009.

