Chugach Electric Association
**Powering Alaska's Future**

# Annual Report 2002

# Chugach Electric Association

Contents



## Corporate mission

Through superior service, safely provide reliable and competitively priced energy.

## Corporate vision

Powering Alaska's future.

## Incorporation

Chugach Electric Association was incorporated in Alaska, March 1, 1948, with funding under the Rural Electrification Act of 1936, as amended. In 1991 Chugach refinanced and paid off its federal debt, leaving the REA program. Chugach remains a cooperative, and ranks among the largest of the nearly 1,000 electric cooperatives in the nation.

## Personnel policy

It is a policy of Chugach Electric Association, Inc., to recruit, hire, train, compensate, and promote persons without regard to race, color, religion, national origin, sex, marital status, pregnancy, parenthood, disability, veterans status, age or any other classification protected by applicable federal, state, or local law.

## Chugach snapshot

Chugach provides retail service to approximately two-thirds of the homes and businesses in the Municipality of Anchorage and wholesale and economy energy sales to other utilities throughout Alaska's Railbelt region from Fairbanks to Homer.

**On the cover:**
A 15-kilovolt **Epoxilator** with an automatic conductor deadend is easier to use, lightweight, **stronger** and more durable than the old-style porcelain and bolt-on type. In addition, they can be **installed faster**.

# 2002 Year in Review

**In 2002** Chugach continued to provide safe, reliable, inexpensive electrical energy to its members. However, we also faced many challenges along the way, many of which will continue into 2003 and beyond.

Chugach's general rate case before the Regulatory Commission of Alaska (RCA) continued throughout 2002. This case really began in 1995, but the major phase commenced in July of 2001. The expected decision was rendered in early-2003 with a surprise substantial reduction in our revenues ordered by the RCA. Chugach filed and the RCA granted a motion for a stay of the order. Chugach filed a request for reconsideration Feb. 28, 2003, and expects the resolution process to continue deep into 2003.

Chugach held its Annual Membership Meeting April 25, and 165 members registered for the event. Fourteen percent of the 59,606 members of record voted in the election, in which H.A. "Red" Boucher, Samuel W. Cason and Patricia B. "Pat" Jasper were elected to 3-year terms on the board. Members did not approve a proposed bylaw change. The Board also announced the selection of Evan J. (Joe) Griffith as the new general manager, replacing retiring General Manager Eugene N. Bjornstad.

Chugach continued the process to relicense the Cooper Lake hydroelectric project. The Federal Energy Regulatory Commission issued the original operating license for the project in 1957. The existing license will expire on April 30, 2007, and Chugach must file an application for a new license on or before April 30, 2005. The nearly 20-megawatt power plant was commissioned in 1961 and overhauled and upgraded in 2001.

Chugach completed a number of major generation maintenance projects during the year. These included major maintenance on a Bernice Lake gas turbine (Unit No. 4) and two Beluga gas turbines (Unit Nos. 3 and 5). Beluga Unit No. 8, a waste-heat powered steam plant, also received a major overhaul, the first since 1994.

August saw an RCA decision rejecting Matanuska Electric Association's application to amend Chugach's certificate to allow them to take over Chugach's retail customers and associated infrastructure.

In September Chugach began replacing failing underground cable in the Talus West Subdivision and completed the project in October as multiple outages hastened the plans to replace the cable.

The Southern Intertie — a project that will result in a second transmission link between Anchorage and the Kenai Peninsula when completed — continues to move ahead. Three federal agencies have evaluated routes and decided on what is known as the TESORO route. A "decision date" in mid-2003 will determine which of the six Railbelt electric utilities will continue to participate in the project.

Heavy rainfall on the Kenai Peninsula brought additional water to Bradley and Cooper lakes, resulting in more clean, low-cost energy being available. While the rainfall provided for extra energy, it also washed out a portion of the road leading to the Cooper Lake Power Plant, and 4-wheel drive vehicles were necessary to provide access until repairs were completed.

As fuel prices and purchased power costs rose and fell, so did Chugach's fuel surcharge. In January the fuel surcharge was 2.29 cents per kilowatt-hour. By the end of the year the surcharge was down to 1.75 cents per kwh.

Late in the year, the RCA approved a line extension settlement agreement that reduces line extension credit amounts and limits some up-front credits. The agreement takes effect Jan. 1, 2003.

# General Manager & President Report

Joe Griffith, General Manager
Bruce Davison, President

**Chugach is** a multi-faceted, member-owned electric utility that consists of much more than the basic business of providing energy to its members. While 2002 was no different than other challenging years, it was also a year of many changes, with staff and the board working more closely together than ever before to provide the basics that members want … reliability, a fair price and excellent service.

To better serve its members, Chugach reorganized into four business units.

Energy Supply is responsible for making the energy we provide. This task includes the care and feeding of the facilities that make the power. They also must ensure an adequate power supply in the future.

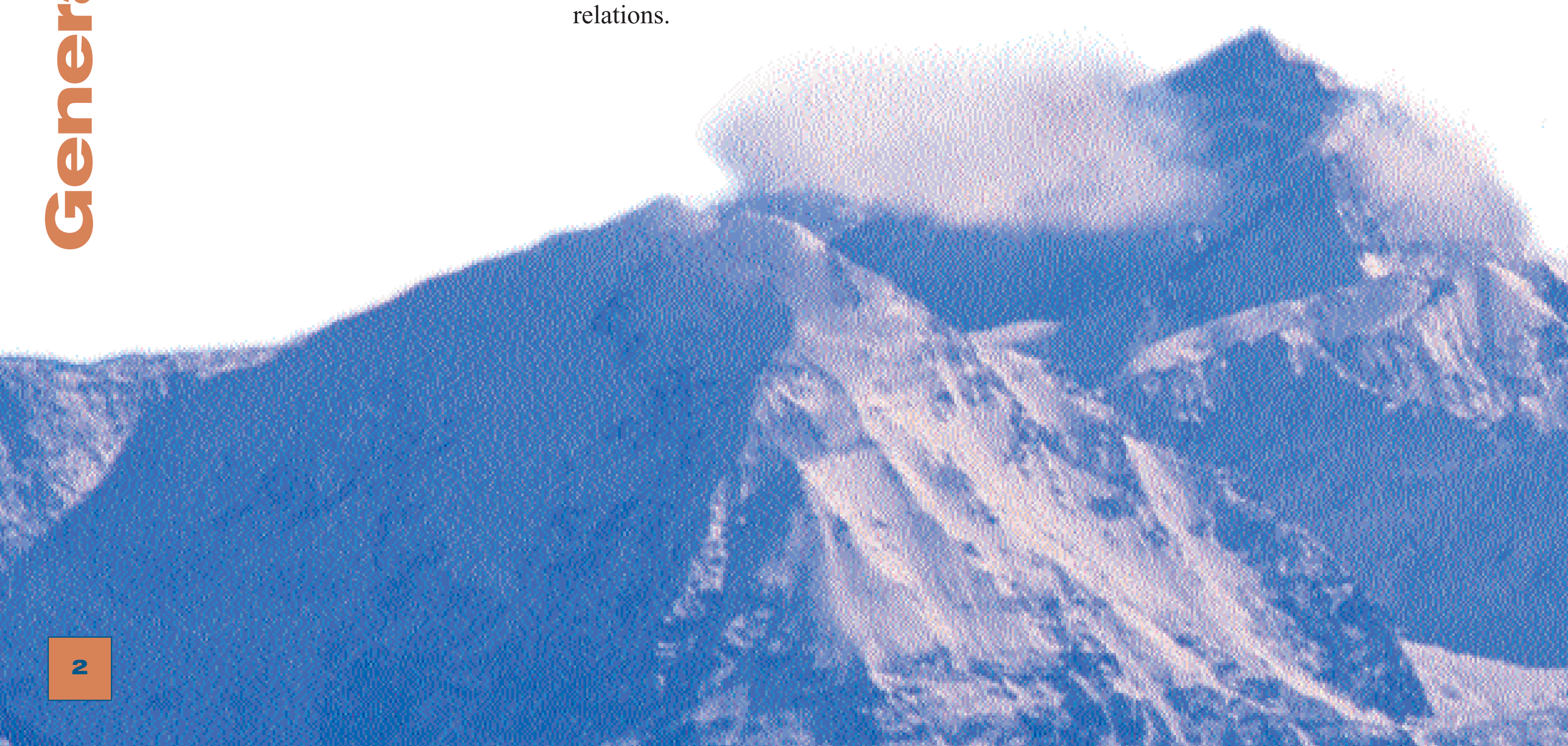
Power Delivery sends safe, reliable power to the doors of retail and wholesale consumers. They also operate and maintain the transmission and distribution facilities.

Administration provides support services to staff and our members. They also are in charge of safety, rates, environmental matters, information technology, purchasing and public relations.

And finally Chugach's Chief Financial Officer and staff are responsible for the financial health of the cooperative.

Power outages are always the principal challenge that face Chugach and its members. In 2002 the number of actual outage hours per customer decreased. Much of that decrease can be attributed to an aggressive tree-trimming program in our rights of way. However, trees from outside of Chugach's rights of way can also impact customers.

Chugach filed a general rate case with the Regulatory Commission of Alaska during July 2001. Chugach's efforts on the case continued throughout the next 18 months, and included a long hearing in November and December of 2002. Chugach had requested a base rate increase of 5.7 percent, our first requested increase to retail customers since 1994 and wholesale customers since 1996. Although the Commission hearing concluded in December, adjudication of the final outstanding issues is anticipated to last well into 2003. All of Chugach's wholesale customers and the Public Advocacy Section of the Commission were intervening parties in the rate case.



The Southern Intertie project, that will result in a second transmission link between Anchorage and the Kenai Peninsula, continues to move ahead. Three federal agencies have evaluated routes and decided to authorize what is known as the TESORO route. They have issued Records of Decision to memorialize this result after studying the Environmental Impact Statement. In mid-2003, after conducting further cost studies, each of the six Railbelt electric utilities will decide whether to continue to participate in the project.

Chugach continued to meet financial challenges and obligations. In 2002, Chugach refinanced $180 million in bonds and showed a significant savings in interest expense. We also continued to retire capital credits. While we have remained financially healthy, a recent order by the RCA could have an impact on how we do business with our members and in the financial arena in the future.

Earlier in the year the board voted to accept an offer from the International Brotherhood of Electrical Workers and extend the three collective bargaining unit agreements through June 2006. The board voted to accept the proposal after determining that it would be cost-effective and in the best interest of Chugach and its members.

Since we are the largest electric utility in Alaska, the Board determined that we should work toward a greater presence in both the community and in Juneau. In November the board established the Government & External Affairs Committee. This committee is charged with taking a proactive role in educating and communicating Association issues. Chugach took steps toward that goal by hosting a legislative reception, offering Beluga Power Plant tours, and making presentations about Chugach and utility issues to a variety of groups.

While the majority of the business revolves around safely providing reliable, competitively-priced energy to our members, there is also a commitment to the community in which we live. In 2002 we established a Contribution Committee to review requests for donations from organizations, agencies and individuals. To see a list of some of the organizations contributed to by Chugach and its employees, please turn to the inside of the back cover of our 2002 annual report.

Chugach still has world-class reliability and an exceptional workforce dedicated to doing an excellent job. We assure you that your Association will meet its mission which is "through superior service, safely provide reliable and competitively-priced energy." The Board and Chugach's staff and employees are committed to continuing our best efforts for you.

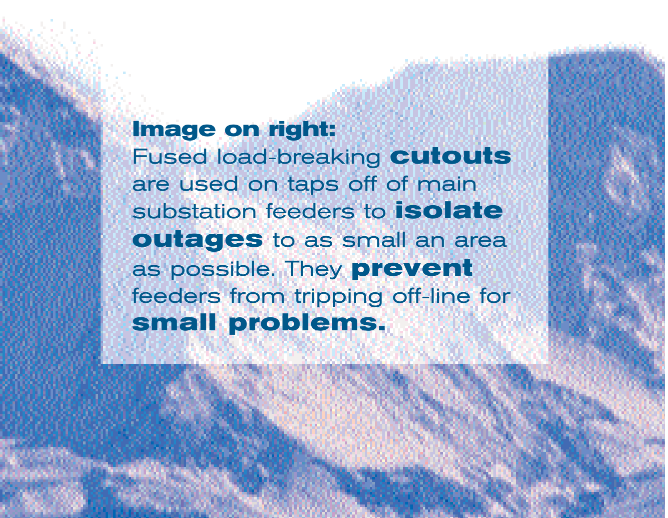


**Image on right:**
Fused load-breaking **cutouts** are used on taps off of main substation feeders to **isolate outages** to as small an area as possible. They **prevent** feeders from tripping off-line for **small problems.**

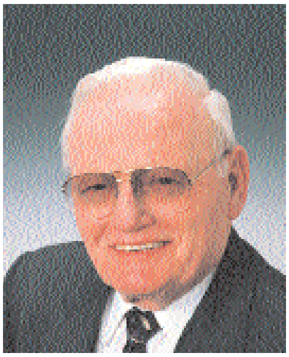
# 2002 Board of Directors

President Bruce E. Davison is an attorney and professional engineer. He was appointed to the board in June 1997 to fill a vacancy, elected to the board in 1998 and re-elected in 2001. Davison also chairs the board's Operations Committee.

Vice President Dave Cottrell is the Managing Partner/President of Mikunda, Cottrell & Co., CPAs & Consultants. He was elected to the board in 2001.

Secretary Chris Birch is a civil engineer and Director of Engineering, Planning and Environment for the Ted Stevens Anchorage International Airport. He was appointed to the board in 1996 to fill a vacancy, elected to the board in 1997 and re-elected in 2000.

Treasurer Jeff Lipscomb is a project management consultant with JWL Engineering. He was elected to the board in 2000. Lipscomb also chairs the board's Finance and Audit committees.



Director H.A. "Red" Boucher is a communications consultant who owns H.A. "Red" Boucher & Associates. He was elected to the board in 1999 and re-elected in 2002. Boucher chairs the board's Technology Committee and the Government & External Affairs Committee.

Director Sam Cason is a self-employed attorney. He was elected to a 3-year term on the board in 2002.

Director Patricia Jasper is a small-business owner and a former computer programmer and systems analyst. She was first elected to the board in 1995, and elected to a 3-year term in 1996 and again in 1999 and 2002.

**Administration** is responsible for Chugach's administrative functions, including purchasing, environmental issues, information services, major accounts, member services, safety and industrial health, regulatory affairs and pricing, and public relations.

Among other things, Administration has:

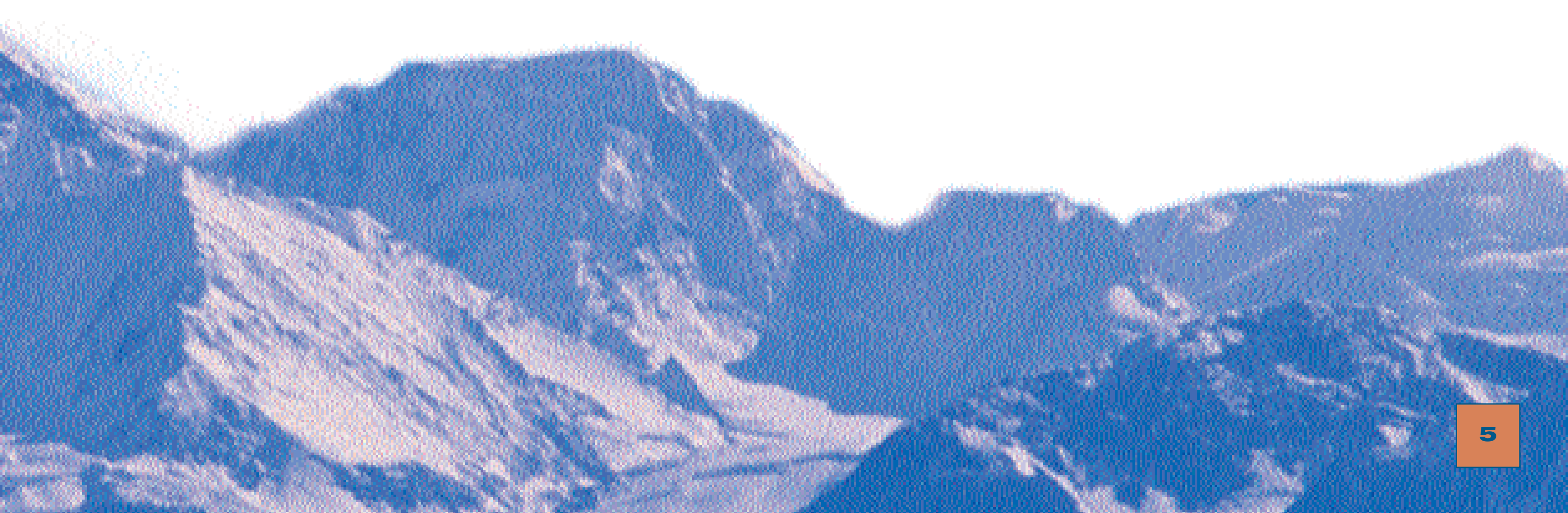
- Allocated and sent notices for nearly $5.5 million in retail and wholesale capital credits for 2001.
- Received 143,896 calls through the Member Services Department during normal operations, of which 113,390 were answered within 30 seconds.
- Submitted testimony and supporting exhibits and other documentation as necessary for Chugach's rate case proposal based upon a 2000 Test Year.
- Dramatically increased the number of NetPay payments from 5,913 in 2001 to 22,962 in 2002.
- Installed an ATM for member convenience.
- Performed Chugach's electrical safety demonstration for more than 2,100 children and adults.
- Developed a substation safety ad to promote safety to children.

Chugach performed emergency response training for all supervisors and provided a variety of safety training for employees.

In December, Chugach retired nearly $2.8 million in retail capital credits. Chugach mailed capital credits checks or gave credit on accounts to nearly 30,000 members of record from 1985.


Chugach developed an interactive display on making and moving electricity for the BP Energy Center.

Chugach collected water samples during a stream study on Krause Creek near Beluga as part of a review process for its non-domestic wastewater discharge permit for the Beluga Power Plant.



# Power Delivery


Chugach's re-certification as a Tree Line USA utility includes recognition for its right of way vegetation management program.

The new H2Oasis is one of the more interesting new projects in Chugach's service area. The H2Oasis is an indoor water park and is scheduled to open in 2003. It includes a wave pool, a children's lagoon complete with a pirate ship and a 150-foot long enclosed body slide.

Chugach relocated major electric lines along Dowling Road between the Old Seward Highway and Lake Otis Boulevard in conjunction with a State of Alaska construction project. Road construction is scheduled to start in the spring of 2003.

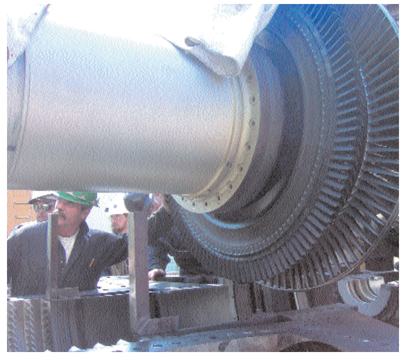
**Power Delivery** is responsible for delivering safe, reliable power to the doors of Chugach's retail and wholesale consumers. Delivering power is a complex business using electronic controls and communications, power dispatching and metering. In addition, power delivery includes operating and maintaining facilities as well as designing and building new infrastructure that delivers the power to the homes and businesses that Chugach serves. Among other things, in 2002, Power Delivery:

- Installed 1,992 new residential services in an average of 2.18 days per service. Chugach's customer service target is 5 business days for connecting a residential service.
- Completed a key electric line linking the University and Dowling substations that is part of a larger plan to improve capacity to South Anchorage.
- Completed environmental studies for the Southern Intertie that will provide a second transmission link from Anchorage to the Kenai Peninsula. The benefits of this link include reducing fuel costs as the system can be operated more efficiently.
- Upgraded a transmission line along Northwood Drive between International Airport Road and 84th Avenue to allow for load growth in South Anchorage.
- Achieved revenues of nearly $1 million for Chugach from selling spare capacity on Chugach's microwave system, leasing joint space on poles, charging joint-use utilities for sharing a common trench and performing warranty work for vehicle and equipment manufacturers.
- Extended the life of 5.6 miles of underground cable by using cable injection technology in neighborhoods that included Dimond Estate Trailer Court, Talus West, Strawberry Meadows and Bancroft subdivisions.
- Began design work on a transmission loop that will link the International Substation to a new bulk substation in South Anchorage and to Chugach's University Substation. This link will provide additional reliability and the capability of handling additional load growth in South Anchorage.
- Installed automated switching devices for the domestic terminals at Ted Stevens International Airport in December to improve reliability to the Airport facility.

**The Energy Supply Division** is responsible for operating and generating the power at the power plants Chugach owns. In addition, it oversees Chugach's responsibilities in other power projects, including the Eklutna Power Plant, the Bradley Lake Hydroelectric Project, and the Chugach-owned 1-megawatt fuel cell project located at the U.S. Postal Service bulk mail facility near the Ted Stevens International Airport. Energy Supply, at the request of Chugach's members, continues to investigate alternative generation resources, including micro-turbines and wind generation.

Among other things, in 2002 Energy Supply:

- Completed a major overhaul of Beluga Unit No. 3 in March.
- Proceeded with the Federal Energy Regulatory Commission process to relicense the Cooper Lake hydroelectric project including holding open public and governmental agency information meetings.
- Completed a major overhaul of Bernice Lake Unit No. 4 in June.
- Completed a major overhaul in August of Beluga Unit No. 8, the steam unit that is fueled by waste heat produced by Unit Nos. 6 and 7.
- Replaced damaged turbine blades discovered during an annual inspection on Beluga Unit No. 7.
- Completed a hot-gas-path inspection on Beluga Unit No. 5 in December.
- Performed annual unit inspections on Cooper Lake Unit Nos. 1 and 2, International Unit Nos. 1, 2 and 3, Bernice Lake Unit No. 3 and Beluga Unit Nos. 1, 2, 6 and 7.
- Developed input data for business plans for the wind generation sites that are being evaluated in the decision process.
- Achieved significantly lower emissions of nitrogen oxides for Beluga Unit Nos. 6 and 7, a decrease that is attributable to upgrading the units.



As part of the major overhaul of Bernice Lake Unit No. 4, Chugach removed the rotor and sent it to Beluga so the blades could be coated. The $1.4 million overhaul started in April and was completed in July.

Chugach continues to investigate alternative generation sources, including wind generation. Chugach has met with representatives of the environmental community to ask for their input on a possible future wind generation project.

Chugach replaced components on the first-stage nozzle on Beluga Unit No. 5 as part of a major maintenance project.

**Chugach uses various generation resources** to ensure reliable, affordable power. Chugach has 527.08 megawatts of installed capacity as detailed. The unit ratings shown are nominal ratings taken at 30 degrees Fahrenheit. Chugach also takes power from the state-owned Bradley Lake hydroelectric project near Homer. In addition, Chugach owns and operates a 1-megawatt fuel cell that is the primary source of power for the U.S. Postal Service at the Anchorage Mail Processing Center.

### Beluga

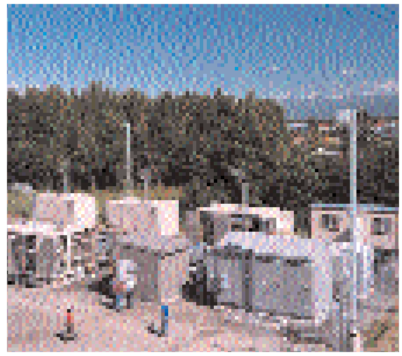
- Located on the west side of Cook Inlet near Tyonek
- Combustion turbines 1–3, and 5-7 fueled by natural gas
- Unit 8 is a steam turbine

| Units | Commissioned | Power Rating (megawatts) |
|---|---|---|
| No. 1 | 1968 | 19.6 |
| No. 2 | 1968 | 19.6 |
| No. 3 | 1972 | 64.8 |
| No. 5 | 1975 | 68.7 |
| No. 6 | 1975 | 75.1 |
| No. 7 | 1978 | 80.1 |
| No. 8 | 1981 | 53.0 |
| | Total | 380.9 |

### Cooper Lake

- Located near Cooper Landing on the Kenai Peninsula
- Hydro-turbines

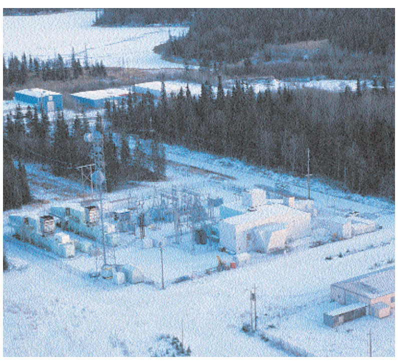
| Units | Commissioned | Power Rating (megawatts) |
|---|---|---|
| No. 1 | 1960 | 9.6 |
| No. 2 | 1960 | 9.6 |
| | Total | 19.2 |



### Fuel cell project

- Located at the U.S. Postal Service Anchorage mail processing center

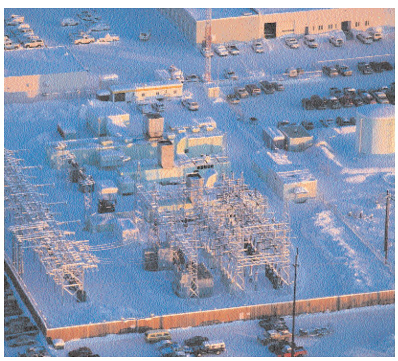
| Commissioned | Power Rating (megawatts) |
|---|---|
| 2000 | 1.0 |
| | Total 1.0 |



### Bernice Lake

- Located near Nikiski on the Kenai Peninsula
- Natural gas combustion turbines

| Units | Commissioned | Power Rating (megawatts) |
|---|---|---|
| No. 2 | 1971 | 19.0 |
| No. 3 | 1978 | 26.0 |
| No. 4 | 1981 | 22.5 |
| | Total | 67.5 |



### International

- Located off International Airport Road in Anchorage
- Natural gas combustion turbines

| Units | Commissioned | Power Rating (megawatts) |
|---|---|---|
| No. 1 | 1964 | 14.1 |
| No. 2 | 1965 | 14.1 |
| No. 3 | 1969 | 18.5 |
| | Total | 46.7 |

### Eklutna

- Former federal hydroelectric project along the Knik River
- Jointly owned with Anchorage Municipal Light & Power and Matanuska Electric Association
- Chugach's share is 30%, 11.7 Mw maximum

| Units | Commissioned | Power Rating (megawatts) |
|---|---|---|
| No. 1 | 1955 | 23.5 |
| No. 2 | 1955 | 23.5 |
| | | Total 47.0 |

# Key Comparisons

**Services at year-end**

| | |
|---|---|
| 2000 | 71,776 |
| 2001 | 73,239 |
| 2002 | 74,632 |

**Total revenue**

| | |
|---|---|
| 2000 | $160.8 Million |
| 2001 | $180.2 Million |
| 2002 | $173.4 Million |

**Kilowatt-hours sold**

| | |
|---|---|
| 2000 | 2.41 Billion kwh |
| 2001 | 2.27 Billion kwh |
| 2002 | 2.39 Billion kwh |

**Expenses**

| | |
|---|---|
| 2000 | $151.1 Million |
| 2001 | $174.7 Million |
| 2002 | $175.4 Million |

**Retail kwh**

| | |
|---|---|
| 2000 | 1.09 Billion kwh |
| 2001 | 1.11 Billion kwh |
| 2002 | 1.14 Billion kwh |

**Margins**

| | |
|---|---|
| 2000 | $9.7 Million |
| 2001 | $5.5 Million |
| 2002 | ($2 Million) |

**Wholesale kwh**

| | |
|---|---|
| 2000 | 1.05 Billion kwh |
| 2001 | 1.16 Billion kwh |
| 2002 | 1.13 Billion kwh |

**Cost per residential kwh in December (based on a 700 kwh average)***

| | |
|---|---|
| 2000 | 9.9197 cents/kwh |
| 2001 | 11.5059 cents/kwh |
| 2002 | 10.7047 cents/kwh |

**Economy energy kwh**

| | |
|---|---|
| 2000 | 267.9 Million kwh |
| 2001 | 81.9 Million kwh |
| 2002 | 125.8 Million kwh |

**Cost of 700 kwh of residential service in December***

| | |
|---|---|
| 2000 | $69.44 |
| 2001 | $80.54 |
| 2002 | $74.93 |

*Includes customer and energy charges, fuel surcharge and regulatory cost charge.

## Outage Statistics

Chugach averaged 2.45 outage hours per customer in 2002, down from 2.91 hours in 2001. The 5-year average for customer outage hours increased to 2.27 hours in 2002 from 2.05 hours in 2001.

**Image on right:**
About 90 percent of Chugach's residential electric meters are read using **AMR** (Automated Meter Reading) technology, which makes the process **more efficient** than when all reading was performed manually.

# Treasurer Report

Jeff Lipscomb, Treasurer

**In 2002, power production increased** and power production costs decreased as compared to 2001. Normally Chugach would have viewed this as a good year. Chugach produces power for its members that includes both its retail customers and other electric utilities who are its wholesale customers. The rate case Chugach filed with the Regulatory Commission of Alaska (RCA), in 2001 made several requests, including adjustments to wholesale and retail tariffs to more equitably distribute costs. After granting an interim rate increase of about 4 percent in October 2001, the RCA ruled in January 2003 that Chugach must refund all of the interim rate increase, lower its previously approved rates and make detrimental changes in the relationship of wholesale and retail costs distribution. As a result, in 2002, wholesale customers accounted for over 52 percent of the power produced by Chugach but only 35 percent of Chugach's revenue. In addition, wholesale customers stand to receive approximately $5 million in refunds while Chugach residential members would receive less than $500,000.

Some other profound impacts of the RCA order to Chugach include:

- Eliminating capital credit distributions to members in 2003.
- Requiring $7.1 million in refunds.
- Placing Chugach on "credit watch with negative implications."
- Recording a $2 million loss in 2002.

Chugach has filed a petition with the RCA requesting reconsideration of some of these decisions and the substantial adverse financial impact of the rate order.

As I mentioned above, the good news is costs were being managed well and in many cases lowered. As part of the $180 million bond refinancing completed in 2002, Chugach was able to place $60 million of its debt in a variable interest rate instrument that averaged a very attractive 1.9 percent for the year. The savings in interest expense was significant and illustrates how our sound debt management practices emphasize financial health and low cost. We converted to a new bond indenture early in 2003 that provides even greater debt management flexibility and reduces reporting requirements.

As a response to high-profile business failures, the federal government enacted the Sarbanes-Oxley Act of 2002, which tightened accounting and reporting controls and responsibilities for many companies. Chugach's Finance Committee (also acting as the Audit Committee) reviewed the Act's requirements and met with Chugach's outside auditors and legal counsel to ensure Chugach's compliance with the Act.

Total revenues in 2002, including non-operating margins, were $173.4 million, down from $180.2 million in 2001. Operating expenses were $175.4 million, up slightly from $174.7 million in 2001. The net result is a loss of $2.0 million. The 2002 revenues and expenses include the effects of the RCA rate order.

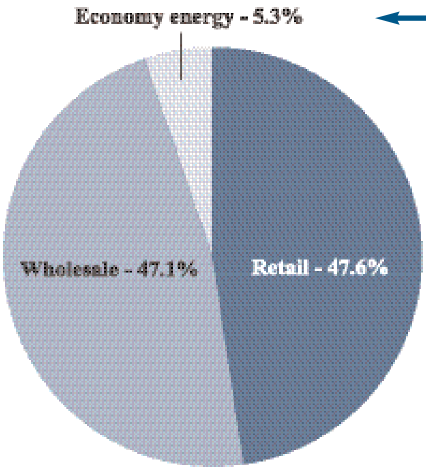
Balancing the need to build equity and continue rotating capital credits to members, the Board of Directors, following a recommendation from the Finance Committee, authorized the retirement of $2.8 million in retail capital credits in 2002. The Board of Directors also adopted a new policy on capital credits distributions that will allow former members to obtain an early discounted distribution. We expect to hear a favorable ruling from the Internal Revenue Service on this plan in 2003.

2003 will present continuing challenges as Chugach works through the reconsideration process associated with the adverse RCA rate order.

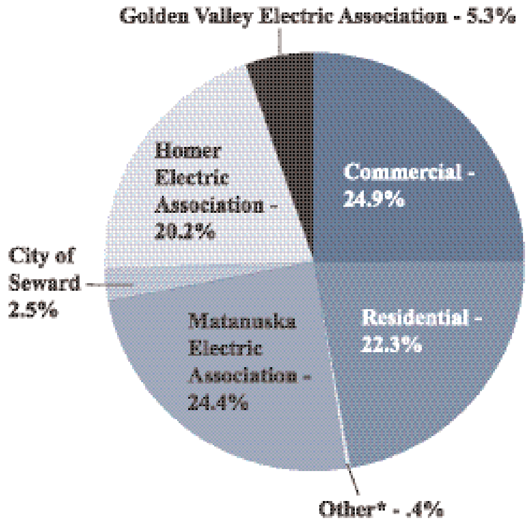
# Power Sales at a Glance

## By Kilowatt-hours, Total: 2,393,755,524

**Overview:**



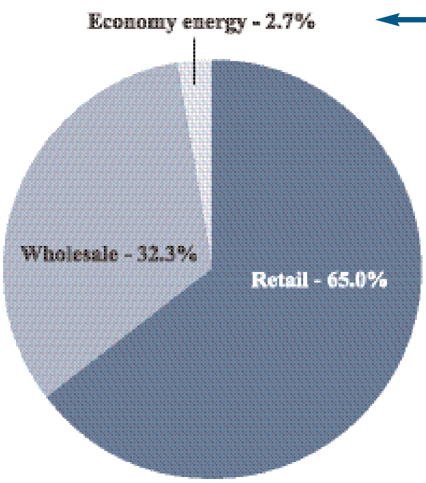

**Detail:**



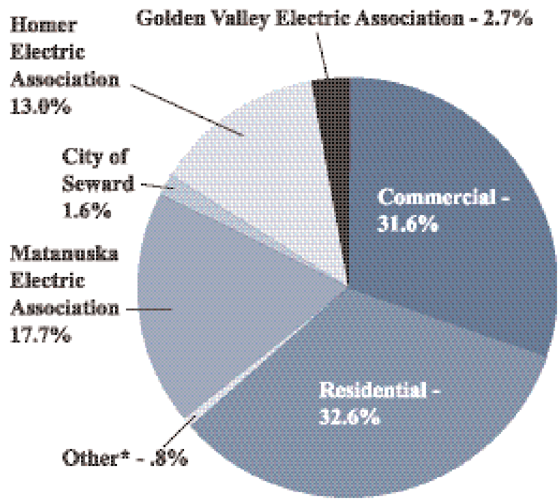

*Streetlighting and Fuel Cell

## By Operating Revenues, Total: $169,413,145

**Overview:**




**Detail:**




Note: Amounts may not total 100% due to rounding.

*Streetlighting and Fuel Cell

**Image on right:**
Meter Technicians, Linemen, Substation Technicians and others use **fluke test meters** in the field. Modern test equipment is always **improving** the **quality** of our service.

**KPMG**
**701 West Eighth Avenue**
**Suite 600**
**Anchorage, AK 99501**

## Independent Auditors' Report

The Board of Directors
Chugach Electric Association, Inc.

We have audited the accompanying balance sheets of Chugach Electric Association, Inc. (Chugach) as of December 31, 2002 and 2001, and the related statements of revenues, expenses and patronage capital and cash flows for each of the years in the three-year period ended December 31, 2002. These financial statements are the responsibility of the Chugach's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Chugach Electric Association, Inc. as of December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

March 11, 2003
Anchorage, Alaska

## December 31, 2002 and 2001

| ASSETS | 2002 | 2001 |
|---|---|---|
| Utility plant (notes 2, 6, 12 and 13): | | |
| Electric plant in service | $730,439,297 | $714,317,863 |
| Construction work in progress | 20,224,302 | 28,887,008 |
| | 750,663,599 | 743,204,871 |
| Less accumulated depreciation | 279,958,912 | 261,353,177 |
| Net utility plant | 470,704,687 | 481,851,694 |
| Other property and investments, at cost: | | |
| Nonutility property | 3,550 | 3,550 |
| Investments in associated organizations (note 3) | 10,963,715 | 10,485,186 |
| | 10,967,265 | 10,488,736 |
| Current assets: | | |
| Cash and cash equivalents, including repurchase agreements of $8,007,424 in 2002 and $5,520,275 in 2001 | 7,284,292 | 3,814,767 |
| Cash-restricted construction funds | 598,864 | 517,871 |
| Special deposits | 222,163 | 222,163 |
| Accounts receivable, less provision for doubtful accounts of $313,545 in 2002 and $318,757 in 2001 | 26,410,264 | 22,302,400 |
| Fuel cost recovery | 0 | 3,591,963 |
| Materials and supplies | 23,747,590 | 22,822,003 |
| Prepayments | 1,953,350 | 627,544 |
| Other current assets | 336,798 | 335,753 |
| Total current assets | 60,553,321 | 54,234,464 |
| Deferred charges (notes 9 and 14) | 27,989,601 | 28,706,293 |
| | $570,214,874 | $575,281,187 |

| LIABILITIES & EQUITIES | 2002 | 2001 |
|---|---|---|
| Equities and margins (note 5): | | |
| Memberships | $ 1,108,243 | $ 1,059,098 |
| Patronage capital (note 4) | 120,148,502 | 125,184,374 |
| Other (note 5) | 6,221,150 | 5,565,234 |
| | 127,477,895 | 131,808,706 |
| Long-term obligations, excluding current installments (notes 6, 7 and 17): | | |
| 2001 Series A Bonds payable | 150,000,000 | 150,000,000 |
| 2002 Series A Bonds payable | 120,000,000 | 0 |
| 2002 Series B Bonds payable | 55,700,000 | 0 |
| First Mortgage (1991 Series A) Bonds payable | 0 | 149,310,000 |
| National Bank for Cooperatives Promissory Notes payable | 64,134,179 | 65,000,000 |
| | 389,834,179 | 364,310,000 |
| Current liabilities: | | |
| Current installments of long-term obligations (notes 6 and 7) | 5,165,821 | 10,409,945 |
| Short-term obligations (note 6) | 6,081,250 | 11,000,000 |
| Accounts payable | 7,719,974 | 11,012,905 |
| Provision for rate refund (note 17) | 7,050,000 | 0 |
| Consumer deposits | 1,826,265 | 1,603,691 |
| Fuel cost payable | 363,862 | 0 |
| Accrued interest | 6,381,106 | 7,378,058 |
| Salaries, wages and benefits | 4,977,594 | 4,844,819 |
| Fuel | 7,095,402 | 11,565,117 |
| Other current liabilities | 2,027,938 | 1,900,155 |
| Total current liabilities | 48,689,212 | 59,714,690 |
| Deferred credits (note 11) | 4,213,588 | 19,447,791 |
| | $570,214,874 | $575,281,187 |

See accompanying notes to financial statements.

# Statements of Revenues, Expenses and Patronage Capital

## Years ended December 31, 2002, 2001 and 2000

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Operating revenues (note 17) | $171,944,918 | $178,595,214 | $158,541,114 |
| Operating expenses: | | | |
| Fuel | 46,822,943 | 56,130,437 | 42,504,396 |
| Other power production | 13,500,103 | 12,397,465 | 10,221,978 |
| Purchased power | 18,750,936 | 14,717,318 | 9,152,248 |
| Transmission | 3,930,902 | 3,545,707 | 3,828,630 |
| Distribution | 10,869,335 | 10,417,736 | 9,774,860 |
| Consumer accounts | 5,594,572 | 5,121,394 | 5,275,455 |
| Sales expense | 0 | 495,523 | 1,112,804 |
| Administrative, general and other | 22,251,895 | 19,574,476 | 21,343,393 |
| Depreciation | 27,649,250 | 25,096,665 | 23,216,509 |
| Total operating expenses | 149,369,936 | 147,496,721 | 126,430,273 |
| Interest expense: | | | |
| On long-term obligations | 26,161,891 | 27,128,662 | 24,987,033 |
| Charged to construction – credit | (418,078) | (1,063,643) | (2,178,425) |
| On short-term obligations | 298,930 | 1,164,495 | 1,909,682 |
| Net interest expense | 26,042,743 | 27,229,514 | 24,718,290 |
| Net operating margins | (3,467,761) | 3,868,979 | 7,392,551 |
| Nonoperating margins: | | | |
| Interest income | 774,814 | 679,640 | 703,807 |
| Other | 897,761 | 1,236,907 | 1,615,161 |
| Property loss | (220,964) | (246,390) | (31,741) |
| Assignable margins | (2,016,150) | 5,539,136 | 9,679,778 |
| Patronage capital at beginning of year | 125,184,374 | 122,925,253 | 117,335,481 |
| Retirement of capital credits and estate payments (note 4) | (3,019,722) | (3,280,015) | (4,090,006) |
| Patronage capital at end of year | $120,148,502 | $125,184,374 | $122,925,253 |

See accompanying notes to financial statements.

# Statements of Cash Flows

## Years ended December 31, 2002, 2001 and 2000

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| **Operating activities:** | | | |
| Assignable margins | $(2,016,150) | $5,539,136 | $9,679,778 |
| Adjustments to reconcile assignable margins to net cash provided by operating activities: | | | |
| Provision for rate refund | 7,050,000 | 0 | 0 |
| Depreciation and amortization | 33,472,159 | 30,265,821 | 27,575,408 |
| Capitalization of interest | (491,349) | (1,370,319) | (340,838) |
| Property (gains) losses, net | (220,964) | (246,390) | (31,741) |
| Other | 1,568 | (19,169) | (1,155) |
| Changes in assets and liabilities: | | | |
| (Increase) decrease in assets: | | | |
| Special deposits | 0 | (10,000) | (29,999) |
| Accounts receivable | (4,107,864) | (3,101,488) | (1,469,918) |
| Fuel cost recovery | 3,591,963 | (676,230) | (2,734,978) |
| Prepayments | (1,325,806) | 127,732 | 106,671 |
| Materials and supplies | (925,587) | (7,464,805) | 1,822,938 |
| Deferred charges | (4,479,028) | (13,761,107) | (1,231,531) |
| Other assets | (1,044) | (3,507) | 9,456 |
| Increase (decrease) in liabilities: | | | |
| Accounts payable | (3,292,931) | 1,519,030 | (14,976) |
| Fuel payable | 363,862 | 0 | 0 |
| Accrued interest | (996,952) | 1,516,668 | (204,724) |
| Deferred credits | (14,580,533) | (1,584,906) | (3,638,491) |
| Consumer deposits | 222,574 | 279,478 | 264,536 |
| Other liabilities | (4,209,158) | 4,134,563 | 3,213,198 |
| Net cash provided by operating activities | 8,054,760 | 15,144,507 | 32,973,634 |
| **Investing activities:** | | | |
| Extension and replacement of plant | (16,417,119) | (36,408,253) | (46,730,043) |
| Increase in investments in associated organizations | (480,097) | (608,864) | (909,137) |
| Net cash used in investing activities | (16,897,216) | (37,017,117) | (47,639,180) |
| **Financing activities:** | | | |
| Net transfer of restricted construction funds | (80,993) | (139,023) | 159,556 |
| Proceeds from short-term borrowings, net | 0 | (29,000,000) | 40,000,000 |
| Proceeds from long-term obligations | 180,000,000 | 150,000,000 | 0 |
| Repayments of long-term obligations | (164,638,695) | (93,930,350) | (24,872,405) |
| Memberships and donations received | 705,061 | 734,245 | 700,923 |
| Retirement of patronage capital | (3,019,722) | (3,280,015) | (4,090,006) |
| Net receipts (refunds) of consumer advances for construction | (653,670) | (392,642) | 352,610 |
| Net cash provided by financing activities | 12,311,981 | 23,992,215 | 12,250,678 |
| Net change in cash and cash equivalents | 3,469,525 | 2,119,605 | (2,414,868) |
| Cash and cash equivalents at beginning of year | $3,814,767 | $1,695,162 | $4,110,030 |
| Cash and cash equivalents at end of year | $7,284,292 | $3,814,767 | $1,695,162 |
| Supplemental disclosure of cash flow information | | | |
| Interest expense paid, net of amounts capitalized | $27,039,695 | $25,712,846 | $24,917,014 |

See accompanying notes to financial statements.

Notes to Financial Statements

# December 31, 2002 and 2001

(1) **Description of Business and Summary of Significant Accounting Policies**

*Description of Business*

Chugach Electric Association, Inc., (Chugach) is the largest electric utility in Alaska. Chugach is engaged in the generation, transmission and distribution of electricity to directly served retail customers in the Anchorage and upper Kenai Peninsula areas. Through an interconnected regional electrical system, Chugach's power flows throughout Alaska's Railbelt, a 400-mile-long area stretching from the coastline of the southern Kenai Peninsula to the interior of the state, including Alaska's largest cities, Anchorage and Fairbanks.

Chugach also supplies much of the power requirements of three wholesale customers, Matanuska Electric Association (MEA), Homer Electric Association (Homer) and the City of Seward (Seward). Chugach's members are the consumers of the electricity sold.

Chugach operates on a not-for-profit basis and, accordingly, seeks only to generate revenues sufficient to pay operating and maintenance costs, the cost of purchased power, capital expenditures, depreciation, and principal and interest on all indebtedness and to provide for reasonable margins and reserves. Chugach is subject to the regulatory authority of the Regulatory Commission of Alaska (RCA).

*Management Estimates*

In preparing the financial statements, management of Chugach is required to make estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the reporting period. Critical estimates include the provision for rate refund and allowance for doubtful accounts. Actual results could differ from those estimates.

*Regulation*

The accounting records of Chugach conform to the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC). Chugach meets the criteria, and accordingly, follows the accounting and reporting requirements of Statement of Financial Accounting Standards 71, *Accounting for the Effects of Certain Types of Regulation (SFAS 71).* Revenues in excess of current period costs (net operating margins and non-operating margins) in any year are designated on Chugach's statement of revenues and expenses as assignable margins. These excess amounts (i.e. assignable margins) are considered capital furnished by the members, and are credited to their accounts and held by Chugach until such future time as they are retired and returned without interest. Retained assignable margins are designated on Chugach's balance sheet as patronage capital. This patronage capital constitutes the principal equity of Chugach.

*Reclassifications*

Certain reclassifications, which have no affect on assignable margins, have been made to the 2000 and 2001 financial statements to conform to the 2002 presentation.

*Plant Additions and Retirements*

Additions to electric plant in service are recorded at original cost of contracted services, direct labor and materials, indirect overhead charges and capitalized interest. For property replaced or retired, the average unit cost of the property unit, plus removal cost, less salvage, is charged to accumulated provision for depreciation. The cost of replacement is added to electric plant. Renewals and betterments are capitalized, while maintenance and repairs are charged to expense as incurred.

*Operating Revenues*

Operating revenues are based on billing rates authorized by the RCA, which are applied to customers' usage of electricity. Included in operating revenue are billings rendered to customers adjusted for differences in meter read dates from year to year. Chugach's tariffs include provisions for the flow through of gas costs according to existing gas supply contracts. Chugach recorded potential refunds of approximately $7.1 million as described in note 17, "*Subsequent Events – Regulation.*"

Chugach entered into a settlement agreement with MEA and Homer in 1996. The settlement agreement was designed to resolve a number of ratemaking disputes and assure MEA and Homer that their base rates would be no higher than those based on 1995 costs and would be reduced (and refunds given) if Chugach's 1996, 1997 or 1998 test year costs to serve their needs were significantly reduced. The Agreement required Chugach to make filings of Chugach's cost of service to facilitate determination of any refunds owed under the settlement agreement.

Calculations based on 1996 costs indicated that a rate reduction was required and that a refund was owed for the previous periods. Early in 2000, refunds of $86,132 were issued to Homer and $1,809,801 to MEA that represented uncontested amounts owed consistent with the 1996 test year filing. In June 2000, the RCA issued its final order approving the 1996 test year cost of service. As a result of this order, additional refunds were issued to MEA and Homer in the amounts of $332,157 and $503,272, respectively, on July 25, 2000. Consistent with the Settlement Agreement, these refunds were based on demand and energy purchases retroactive to January 1, 1997.

The RCA issued an order for the 1997 test year that did not reduce wholesale rates or require refunds under the Settlement Agreement. Chugach submitted its 1998 test year revenue requirement filing to the RCA in February 2001. According to an order issued by the RCA on March 15, 2002, no rate reduction or refunds were required based on Chugach's 1998 test year costs. Parties had until April 1, 2002, to file a request for reconsideration and until April 15, 2002, to file an appeal. Neither were filed by any party regarding this order. No additional test years remain to be reviewed under the Settlement Agreement.

In 1998 a power sales agreement was negotiated between Chugach and Seward. The contract was approved by the RCA on June 14, 1999 for a three-year term, which expired on September 11, 2001. The parties negotiated and executed an Amendment, extending the term of the contract to January 31, 2006, which was approved by the RCA July 9, 2001. The RCA's approval required a revision to the contract to include an option to re-negotiate the terms of the contract if rates are adjusted by the 2000 Test Year general rate case. Seward has three choices within sixty days of the final order. The choices are to continue the contract using the rate methodology adopted in the case, negotiate a new contract or give notice of termination effective twelve months from the effective date of the final order of the RCA.

In October 1998 Marathon Oil Company, one of Chugach's natural gas suppliers, notified Chugach that it had reached a settlement with the State of Alaska regarding additional excise and royalty taxes for the period 1989 through 1998. In accordance with the purchase contract, Chugach would be responsible for these additional taxes. The RCA approved Chugach's plan to recover this over 12 months through the Fuel Surcharge mechanism except for the retail portion in the amount of $436,778 that, in accordance with Chugach's request, was written off at December 31, 1998. Recovery of this expense in rates continued from April 1, 1999, through April 1, 2000. Despite RCA approval and subsequent re-confirmation by the RCA, MEA had refused to pay the portion of its monthly bill it considered to be recovery of the Marathon tax. On December 20, 2000, by the Superior Court for the State of Alaska, MEA was ordered to pay the unpaid tax liability and associated litigation costs. MEA appealed that order to the Alaska Supreme Court. On November 15, 2002, the Alaska Supreme Court affirmed the decision of the Superior Court for the State of Alaska. Chugach invoiced MEA for the unpaid tax liability and associated litigation costs, as well as interest on the unpaid balance. On January 8, 2003, Chugach received payment.

# December 31, 2002 and 2001

*Investments in Associated Organizations*

Investments in associated organizations represent capital requirements as part of financing arrangements. These investments are non-marketable and accounted for at cost.

*Deferred Charges and Credits*

Deferred charges, representing regulatory assets, are amortized to operating expense over the period allowed for rate-making purposes. In accordance with SFAS 71, Chugach's financial statements reflect regulatory assets and liabilities. Continued accounting under SFAS 71 required certain criteria be met. Management believes Chugach's operations currently satisfy these criteria. However, if events or circumstances should change so the criteria are not met, the write off of regulatory assets and liabilities could have a material effect on the financial position and results of operations.

Deferred credits, representing regulatory liabilities, are amortized to operating expense over the period allowed for rate-making purposes. It also includes nonrefundable contributions in aid of construction, which are credited to the associated cost of construction of property units. Refundable contributions in aid of construction are held in deferred credits pending their return or other disposition.

*Depreciation and Amortization*

Depreciation and amortization rates have been applied on a straight-line basis and at December 31, 2002 are as follows:

Annual Depreciation Rate Ranges

| | |
|---|---|
| Steam production plant | 2.55% - 2.80% |
| Hydraulic production plant | 0.04% - 1.56% |
| Other production plant | 2.67% - 7.62% |
| Transmission plant | 1.50% - 4.24% |
| Distribution plant | 2.13% - 9.22% |
| General plant | 2.21% - 20.40% |
| Other | 2.35% - 2.75% |

Chugach uses remaining life rates set forth in the most recently approved depreciation study. In 2000 an update of the Depreciation Study was completed utilizing Electric Plant in Service balances as of December 31, 1999. Depreciation rates developed in that study were implemented effective January 1, 2002, in accordance with the RCA's Order No. 26, "Order Determining Revenue Requirement and Rate Design Issues and Requiring Filings" in Docket U-01-108, "In the Matter of the Tariff Revision, Designated as TA226-8, Filed by CHUGACH ELECTRIC ASSOCIATION, INC." (Order U-01-108(26) or the Order)

*Capitalized Interest*

Allowance for funds used during construction (AFUDC) and interest charged to construction (IDC) - credit are the estimated costs during the period of construction of equity and borrowed funds used for construction purposes. Chugach capitalized such funds at the weighted average rate (adjusted monthly) of 4.7% during 2002, 7.5% during 2001 and 7.9% during 2000.

*Cash and Cash Equivalents*

For purposes of the statement of cash flows, Chugach considers all highly liquid debt instruments with a maturity of three months or less upon acquisition by Chugach (excluding restricted cash and investments) to be cash equivalents.

*Materials and Supplies*

Materials and supplies are stated at the lower of average cost or market.

*Fair Value of Financial Instruments*

SFAS 107, *Disclosures About the Fair Value of Financial Instruments*, requires disclosure of the fair value of certain on and off balance sheet financial instruments for which it is practicable to estimate that value. The following methods are used to estimate the fair value of financial instruments:

Cash and cash equivalents and restricted cash - the carrying amount approximates fair value because of the short maturity of those instruments.

Investments in associated organizations - the carrying amount approximates fair value because of limited marketability and the nature of the investments.

Consumer deposits - the carrying amount approximates fair value because of the short refunding term.

Long-term obligations - the fair value is estimated based on the quoted market price for same or similar issues (note 7).

Treasury rate lock agreements – the fair value is estimated based on discounted cash flow using current rates.

*Financial Instruments and Hedging*

Chugach used U.S. Treasury forward rate lock agreements to hedge expected interest rates on the February 2002 debt re-financings. Chugach accounted for the agreements under SFAS 80 and 71 through December 31, 2000, and SFAS 133, 138 and 71 subsequent to that date. Chugach adopted SFAS 133 on January 1, 2001. Accordingly, the unrealized gain or loss was not recorded and was treated as a regulatory asset upon settlement (note 6). This accounting treatment was approved by the RCA in Order U-01-108(26). See note 17, "*Subsequent Events – Regulation.*"

*Income Taxes*

Chugach is exempt from federal income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code, except for unrelated business income. For the years ended December 31, 2002, 2001 and 2000 Chugach received no unrelated business income.

# December 31, 2002 and 2001

*Environmental Remediation Costs*

Chugach accrues for losses and establishes a liability associated with environmental remediation obligations when such losses are probable and can be reasonably estimated. Such accruals are adjusted as further information develops or circumstances change. Estimates of future costs for environmental remediation obligations are not discounted to their present value. However, various remediation costs may be recoverable through rates and accounted for as a regulatory asset.

2) **Utility Plant Summary**

Major classes of electric plant as of December 31 are as follows:

| | 2002 | 2001 |
|---|---|---|
| Electric plant in service: | | |
| Steam production plant | $60,392,869 | $60,392,869 |
| Hydraulic production plant | 17,904,105 | 8,125,226 |
| Other production plant | 103,046,773 | 94,207,814 |
| Transmission plant | 208,103,602 | 206,972,504 |
| Distribution plant | 188,775,770 | 177,457,788 |
| General plant | 52,273,770 | 46,757,035 |
| Unclassified electric plant in service* | 91,346,892 | 111,809,111 |
| Equipment under capital lease | 56,323 | 56,323 |
| Other | 8,539,193 | 8,539,193 |
| Total electric plant in service | 730,439,297 | 714,317,863 |
| Construction work in progress | 20,224,302 | 28,887,008 |
| Total electric plant in service and construction work in progress | $750,663,599 | $743,204,871 |

* Unclassified electric plant in service consists of complete unclassified of general plant, generation, transmission and distribution projects

Depreciation of unclassified electric plant in service has been included in functional plant depreciation accounts in accordance with the anticipated eventual classification of the plant investment.

(3) **Investments in Associated Organizations**

Investments in associated organizations, which are non-marketable and accounted for at cost, include the following at December 31:

| | 2002 | 2001 |
|---|---|---|
| National Rural Utilities Cooperative Finance Corporation (NRUCFC) | $6,095,980 | $6,095,980 |
| National Bank for Cooperatives (CoBank) | 4,703,331 | 4,216,115 |
| NRUCFC capital term certificates | 44,631 | 45,616 |
| Other | 119,773 | 127,475 |
| | $10,963,715 | $10,485,186 |

The Farm Credit Administration, CoBank's federal regulators, requires minimum capital adequacy standards for all Farm Credit System institutions. CoBank's loan agreements require, as a condition of the extension of credit, that an equity ownership position be established by all borrowers. Chugach's investment in NRUCFC similarly was required by Chugach's financing arrangements with NRUCFC.

(4) **Patronage Capital**

Chugach has an approved capital credit retirement program, which is contained in the Chugach business plan. This establishes, in general, a plan to return the capital credits of wholesale and retail customers based on the members' proportionate contribution to Chugach's assignable margins on an approximately 15-year rotation. At December 31, 2002, Chugach had assigned $122,164,652 of patronage capital (net of capital credit retirements). Approval of actual capital credit retirements is at the discretion of Chugach's Board of Directors.

In November 2000, the Board of Directors authorized the retirement of $3,750,000 of retail patronage for 1984 and 1985.

In November 2001, the Board of Directors authorized the retirement of $3,000,000 of retail patronage for 1985.

In November 2002, the Board of Directors authorized the retirement of $2,769,568 of retail patronage for 1985.

Estate payments in the amount of $250,154, $280,015 and $340,006 were made in 2002, 2001 and 2000, respectively.

Following is a five-year summary of anticipated capital credit retirements:

| Year ending December 31 | Total |
|---|---|
| 2003 | $0 |
| 2004 | 405,000 |
| 2005 | 1,260,000 |
| 2006 | 400,000 |
| 2007 | 1,600,000 |

# December 31, 2002 and 2001

**(5) Other Equities**

A summary of other equities at December 31 follows:

| | 2002 | 2001 |
|---|---|---|
| Non-operating margins, prior to 1967 | $23,625 | $23,625 |
| Donated capital | 183,807 | 183,907 |
| Unredeemed capital credit retirement | 6,013,718 | 5,357,702 |
| | $6,221,150 | $5,565,234 |

**(6) Debt**

| Long-term obligations at December 31 are as follows: | 2002 | 2001 |
|---|---|---|
| 2002 Series A Bond of 6.20%, maturing in 2012, with interest payable semi-annually February 1 and August 1: | $120,000,000 | $0 |
| 2002 Series B Bond of a rate set for 28-day auction periods, maturing in 2012, with interest payable monthly and principal due annually | 60,000,000 | 0 |
| 2001 Series A Bond of 6.55%, maturing in 2011, with interest payable semi-annually March 15 and September 15: | 150,000,000 | 150,000,000 |
| First mortgage (1991 Series A) Bond of 8.08%, that matured in 2002 and 9.14% that would have matured in 2022, with interest that was payable semi-annually March 15 and September 15: | | |
| 8.08% | 0 | 5,232,000 |
| 9.14% (refinanced in 2002 by the 2002 Series A and Series B Bond, maturing in 2012) | 0 | 149,310,000 |
| CoBank 8.95% bond that matured in 2002, with interest that was payable monthly and principal that was due semi-annually | 0 | 177,945 |
| CoBank 7.76% note maturing in 2005, with interest payable monthly | 10,000,000 | 10,000,000 |
| CoBank 5.60% note maturing in 2022, with interest payable monthly and principal due annually beginning in 2003 | 45,000,000 | 45,000,000 |
| CoBank 5.60% note, with principal due in 2007 and 2012, and with interest payable monthly | 10,000,000 | 15,000,000 |
| Total long-term obligations | 395,000,000 | 374,719,945 |
| Less current installments | 5,165,821 | 10,409,945 |
| Long-term obligations, excluding current installments | $389,834,179 | $364,310,000 |

*Covenants*

Chugach is required to comply with all covenants set forth in the Amended and Restated Indenture, dated April 1, 2001, which became effective January 22, 2003, and the covenants contained in the Master Loan Agreement between Chugach and CoBank dated December 27, 2002.

*Security*

Substantially all assets were pledged as collateral for the long-term obligations until retirement of the 1991 Series A Bonds and subsequent institution of the Amended and Restated Indenture. On January 22, 2003, the Bonds became general unsecured and unsubordinated obligations. Under the Amended and Restated Indenture, Chugach is prohibited from creating or permitting to exist any mortgage, lien, pledge, security interest or encumbrance on Chugach's properties and assets (other than those arising by operation of law) to secure the repayment of borrowed money or the obligation to pay the deferred purchase price of property unless Chugach equally and ratably secure all bonds subject to the Amended and Restated Indenture, except that Chugach may incur secured indebtedness in an amount not to exceed $5 million or enter into sale and leaseback or similar agreements.

*Rate*

The Amended and Restated Indenture requires Chugach, subject to any necessary regulatory approval, to establish and collect rates reasonably expected to yield margins for interest equal to at least 1.10 times total interest expense. The CoBank Master Loan Agreement also requires Chugach to establish and collect rates reasonably expected to yield margins for interest equal to at least 1.10 times interest expense. As described in note 17, "*Subsequent Events – Regulation,*" Chugach received a waiver of the rate covenant from CoBank. Margins for interest generally consist of Chugach's assignable margins plus total interest expense. Chugach's analysis of the financial impact of Order U-01-108(26) from the RCA is still preliminary, however, upon recording the adjustments set forth in Order U-01-108(26), Chugach's margins for interest would fall below 1.10 times interest charges. If there occurs any material change in the circumstances contemplated at the time rates were most recently reviewed, the Amended and Restated Indenture requires Chugach to seek appropriate adjustments to those rates so that they would generate revenues reasonable expected to yield margins for interest equal to at least 1.10 times interest charges. In order to maintain Chugach's compliance with this covenant, Chugach is taking the actions described in note 17, "*Subsequent Events – Regulation.*"

*Distribution to Members*

The Amended and Restated Indenture prohibits Chugach from making any distribution of patronage capital to Chugach's customers if an event of default under the Amended and Restated Indenture exists. Otherwise, Chugach may make distributions to Chugach's members in each year equal to the lesser of 5% of Chugach's patronage capital or 50% of assignable margins for the prior fiscal year. This restriction does not apply if, after the distribution, Chugach's aggregate equities and margins as of the end of the immediately preceding fiscal quarter are equal to at least 30% of Chugach's total liabilities and equities and margins.

# December 31, 2002 and 2001

*Maturities of Long-term Obligations*

Long-term obligations at December 31, 2002, mature as follows:

| Year ending December 31 | Sinking Fund Requirements 2001 Series A Bonds | Sinking Fund Requirements 2002 Series A Bonds | Sinking Fund Requirements 2002 Series B Bonds | Principal maturities CoBank Mortgage bonds | Total |
|---|---|---|---|---|---|
| 2003 | $0 | $0 | $4,300,000 | $865,821 | $5,165,821 |
| 2004 | 0 | 0 | 4,600,000 | 945,000 | 5,545,000 |
| 2005 | 0 | 0 | 4,900,000 | 11,031,393 | 15,931,393 |
| 2006 | 0 | 0 | 5,200,000 | 1,125,687 | 6,325,687 |
| 2007 | 0 | 0 | 5,500,000 | 6,228,569 | 11,728,569 |
| Thereafter | 150,000,000 | 120,000,000 | 35,500,000 | 44,803,530 | 350,303,530 |
| | $150,000,000 | $120,000,000 | $60,000,000 | $65,000,000 | $395,000,000 |

*Short-term obligations*

Chugach had an annual line of credit of $35,000,000 available in 2001 and 2002 with CoBank. On December 27, 2002, Chugach chose to reduce the available line of credit to $20,000,000. The CoBank line of credit expires July 31, 2003. At December 31, 2002, there was $6.1 million outstanding on this line of credit, which carried an interest rate of 3.17%. At December 31, 2001, there was $11 million outstanding on this line of credit, which carried an interest rate of 3.75%. In addition, Chugach had an annual line of credit of $50,000,000 available at December 31, 2002 and 2001 with NRUCFC. At December 31, 2002 and 2001, there was no outstanding balance on this line of credit. The NRUCFC line of credit expires October 15, 2007.

*Refinancing*

On February 1, 2002, Chugach issued $120,000,000 of 2002 Series A Bond and $60,000,000 of 2002 Series B Bond for the purpose of redeeming $149.3 million in principal amount of the 1991 Series A Bond due 2022, to pay the redemption premium on the 1991 Series A Bond due 2022 in the amount of $13.6 million and for general working capital. The 2002 Series A Bond will mature on February 1, 2012, and bears interest at 6.20% per annum. Interest is payable semi-annually on February 1 and August 1 of each year commencing on August 1, 2002. Chugach may not redeem the 2002 Series A Bond prior to maturity.

The 2002 Series B Bond (the "Auction Rate Bond") will mature on February 1, 2012. The Auction Rate Bond bore interest from the date of original delivery to and through February 27, 2002, at a rate established by the underwriter prior to their date of delivery and thereafter bore interest at the rate set for 28-day auction periods. The initial auction took place on February 27, 2002. The applicable interest rate for any 28-day auction period is the term rate established by the auction agent based on the terms of the auction. The Auction Rate Bond may be converted, in Chugach's discretion, to a daily, seven-day, 35-day, three-month or a semi-annual period or a flexible auction period. The Auction Rate Bond is subject to optional and mandatory redemption and to mandatory tender for purchase prior to maturity in the manner and at the times described herein. Bankers Trust Company is the auction agent and J.P. Morgan Securities Inc., acted as the initial broker-dealer for the Auction Rate Bond.

Payment of the 2002 Series A Bond and the Auction Rate Bond (collectively the "Bonds") are unsecured obligations, ranking equally with Chugach's other unsecured and unsubordinated obligations. In addition, Chugach is limited in Chugach's ability to secure obligations for borrowed money or the deferred purchase price of property unless Chugach equally and ratably secures Chugach's outstanding indebtedness subject to the Amended and Restated Indenture governing the Bonds.

On April 17, 2001, Chugach issued $150,000,000 of 2001 Series A Bond, for the purpose of retiring indebtedness outstanding under existing lines of credit and outstanding bonds, for capital expenditures and for general working capital. The lines of credit had an aggregate outstanding principal balance of $55,000,000, as of April 17, 2001, were renewable annually and bore interest at variable annual rates ranging from 7.55% to 7.80% at April 17, 2001. The variable-rate bonds retired had an aggregate outstanding principal balance of $72,500,000, as of April 17, 2001, would have matured in 2002 and bore interest at a variable rate that was 7.55% on April 17, 2001.

The 2001 Series A Bond will mature on March 15, 2011, and bears interest at 6.55% per annum. Interest is payable semi-annually on March 15 and September 15 of each year commencing on September 15, 2001. The 2001 Series A Bond is an unsecured obligation, ranking equally with Chugach's other unsecured and unsubordinated obligations. In addition, Chugach is limited in Chugach's ability to secure obligations for borrowed money or the deferred purchase price of property unless Chugach equally and ratably secures Chugach's outstanding indebtedness subject to the Amended and Restated Indenture governing the Bonds.

On September 19, 1991, Chugach issued $314,000,000 of First Mortgage Bond, 1991 Series A (Bond), for purposes of repaying existing debt to the Federal Financing Bank and the Rural Electrification Administration (now Rural Utilities Services). Pursuant to Section 311 of the Rural Electrification Act, Chugach was permitted to prepay the REA debt at a discounted rate of approximately 9%, resulting in a discount of approximately $45,000,000 (note 11).

The bond that matured in 2002 (1991 Series A 2002 Bond) was subject to annual sinking fund redemption at 100% of the principal amount thereof, which commenced March 15, 1993. The bond that would have matured in 2022 (1991 Series A 2022 Bond) was subject to annual sinking fund redemption at 100% of the principal amount thereof commencing March 15, 2003. The Series A 2002 Bond was not subject to optional redemption. The Series A 2022 Bond was redeemable at the option of Chugach on any interest payment date at an initial redemption price commencing in 2002 of 109.140 of the principal amount thereof declining ratably to par on March 15, 2012. The Bond was secured by a first lien on substantially all of Chugach's assets. The Indenture prohibited outstanding short-term indebtedness (other than trade payables) in excess of 15% of Chugach's net utility plant and limited certain cash investments to specific securities.

In March 2000, Chugach reacquired $8,500,000 of the 1991 Series A 2022 Bond at a premium of 104.00. Total transaction cost, including accrued interest and premium, were $9,215,502.

In April 2000, Chugach reacquired $10,000,000 of the 1991 Series A 2022 Bond at a premium of 108.875. Total transaction costs, including accrued interest and premium, were $10,953,511.

In May 2001, Chugach reacquired $10,000,000 of its 1991 Series A 2022 Bond at a premium of 111.00. Total transaction costs, including accrued interest and premium, were $11,242,178.

In December 2001, Chugach reacquired $5,000,000 of its 1991 Series A 2022 Bond at a premium of 111.00. Total transaction costs, including accrued interest and premium, were $5,661,711.

The premiums paid are reflected as a regulatory asset and amortized over the life of the corresponding debt.

# December 31, 2002 and 2001

*Treasury Rate Lock Agreements*

On March 17, 1999, Chugach entered into a U.S.Treasury rate lock transaction with Lehman Brothers Financial Products Inc., (Lehman Brothers) for the purpose of taking advantage of favorable market interest rates in anticipation of refinancing Chugach's Series A Bond due 2022 on their optional call date (March 15, 2002). On May 11, 2001, Chugach terminated the $18.7 million 30-year U.S. Treasury portion of the Treasury Rate Lock Agreement in receipt of payment of $10,000 by Lehman. On December 7, 2001, Chugach terminated 50%, or $98.0 million, of the 10-year U.S. Treasury portion of the U.S. Treasury Rate Lock Agreement for a settlement payment of $4 million to Lehman Brothers. Chugach settled the remaining 50% of the 10-year U.S. Treasury portion of the Treasury Rate Lock Agreement for $3 million on December 19, 2001. On January 14, 2002, Chugach entered into an 18-day rate lock agreement with JP Morgan on the 2002 refinancing. Chugach terminated the rate lock on February 1, 2002, which generated a payment to Chugach of $1.2 million. The settlement payments were accounted for as regulatory assets and amortized over the life of the corresponding debt, which was authorized by the RCA in Order U-01-108(26). As of December 31, 2001, the aggregate principal amount of the Series A Bond due 2022 was $149,310,000. That principal amount was refinanced by the 2002 Series A and Series B Bonds in February 2002.

**(7) Fair Value of Long-Term Obligations**

The estimated fair values (in thousands) of the long-term obligations included in the financial statements at December 31 are as follows:

| | 2002 | | 2001 | |
|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Long-term obligations (including current installments) | $395,000 | $425,279 | $374,720 | $390,320 |

Fair value estimates are dependent upon subjective assumptions and involve significant uncertainties resulting in variability in estimates with changes in assumptions.

**(8) Employee Benefits**

Employee benefits for substantially all employees are provided through the Alaska Electrical Trust and Alaska Hotel, Restaurant and Camp Employees Health and Welfare Trust Funds (union employees) and the National Rural Electric Cooperative Association (NRECA) Retirement and Security Program (nonunion employees). Chugach makes annual contributions to the plans equal to the amounts accrued for pension expense. For the union plans, Chugach pays a contractual hourly amount per union employee, which is based on total plan costs for all employees of all employers participating in the plan. In these master, multiple-employer plans, the accumulated benefits and plan assets are not determined or allocated separately to the individual employer. Costs for union plans were approximately $2,253,000 in 2002, $1,990,000 in 2001 and $2,017,000 in 2000. In 2002, 2001 and 2000, Chugach contributed $1,401,000, $1,397,000 and $1,057,000, respectively, to the NRECA plan.

**(9) Deferred Charges**

Deferred charges, net of amortization, consisted of the following at December 31:

| | 2002 | 2001 |
|---|---|---|
| Debt issuance and reacquisition costs | $14,155,863 | $15,649,174 |
| Refurbishment of transmission equipment | 234,568 | 243,828 |
| Computer software and conversion | 5,666,620 | 8,161,890 |
| Studies | 1,952,074 | 1,776,576 |
| Business venture studies | 601,217 | 531,416 |
| Fuel supply negotiations | 329,901 | 348,986 |
| Major overhaul of steam generating unit | 2,701,076 | 17,092 |
| Environmental matters and other | 154,205 | 272,899 |
| Other regulatory deferred charges | 2,194,077 | 1,704,432 |
| | $27,989,601 | $28,706,293 |

**(10) Employee Representation**

Approximately 72% of Chugach's employees are represented by the International Brotherhood of Electrical Workers (IBEW). The various IBEW contracts expire on June 30, 2006.

**(11) Deferred Credits**

Deferred credits at December 31 consisted of the following:

| | 2002 | 2001 |
|---|---|---|
| Regulatory liability – unammortized gain on reacquired debt | $0 | $15,629,104 |
| Refundable consumer advances for construction | 2,817,614 | 2,163,944 |
| Estimated initial installation costs for transformers and meters | 364,766 | 447,378 |
| Post retirement benefit obligation | 405,700 | 405,700 |
| New business venture | 30,256 | 30,256 |
| Other | 595,252 | 771,409 |
| | $4,213,588 | $19,447,791 |

In conjunction with the 1991 refinancing described in note 6, Chugach had recognized a gain of approximately $45,000,000. The Alaska Public Utilities Commission (APUC), required Chugach to pass through the gain to consumers in the form of reduced rates over a period equal to the life of the bonds using the effective interest method; consequently, the gain has been deferred for financial reporting purposes as required by SFAS 71. Approximately $188,082 of the deferred gain was amortized in 2002 prior to the 2002 refinancing. The balance of the gain was extinguished with the transactions associated with the 2002 refinancing. Approximately $1,231,000 of the deferred gain was amortized in 2001. Approximately $1,553,000 of the deferred gain was amortized in 2000.

# December 31, 2002 and 2001

**(12) Bradley Lake Hydroelectric Project**

Chugach is a participant in the Bradley Lake hydroelectric project (Bradley Lake). Bradley Lake was built and financed by the Alaska Energy Authority (AEA) through State of Alaska grants and $166,000,000 of revenue bonds. Chugach and other participating utilities have entered into take-or-pay power sales agreements under which shares of the project capacity have been purchased and the participants have agreed to pay a like percentage of annual costs of the project (including ownership, operation and maintenance costs, debt service costs and amounts required to maintain established reserves). Under these take-or-pay power sales agreements, the participants have agreed to pay all project costs from the date of commercial operation even if no energy is produced. Chugach has a 30.4% share of the project's capacity. The share of debt service exclusive of interest, for which Chugach has guaranteed, is approximately $44,000,000. Under a worst-case scenario, Chugach could be faced with annual expenditures of approximately $4.1 million as a result of Chugach's Bradley Lake take-or-pay obligations. Management believes that such expenditures, if any, would be recoverable through the fuel surcharge ratemaking process. Upon the default of a Bradley Lake participant, and subject to certain other conditions, AEA, through Alaska Industrial Development and Export Authority, is entitled to increase each participant's share of costs pro rata, to the extent necessary to compensate for the failure of another participant to pay its share, provided that no participant's percentage share is increased by more than 25%.

On April 4, 2000, AEA issued $47,710,000 of Power Revenue Refunding Bonds, Fourth Series, for the purpose of refunding $46,235,000 of the Second Series Bonds. The refunded Second Series Bonds were called on July 1, 2000. The refunding resulted in aggregate debt service payments over the next twenty-two years in a total amount approximately $6,400,000 less than the debt service payment, which would be due on the refunded bonds. There was an economic gain of approximately $3,500,000.

The following represents information with respect to Bradley Lake at June 30, 2002 (the most recent date for which information is available). Chugach's share of expenses was $4,343,562 in 2002, $3,929,614 in 2001 and $3,696,829 in 2000 and is included in purchased power in the accompanying financial statements.

| (In thousands) | Total | Proportionate Share |
|---|---|---|
| Plant in service | $ 307,016 | $ 93,333 |
| Accumulated depreciation | (74,503) | (22,649) |
| Interest expense | 9,235 | 2,807 |

Other electric plant in service represents Chugach's share of a Bradley Lake transmission line financed internally and Chugach's share of the Eklutna hydroelectric project, purchased in 1997 (note 13).

**(13) Eklutna Hydroelectric Project**

During October 1997, the ownership of the Eklutna hydroelectric project formally transferred from the Alaska Power Administration to the participating utilities. This group, including their corresponding interest in the project, consists of Chugach (30%), MEA (16.7%) and AML&P (53.3%).

Other electric plant in service includes $1,957,742 representing Chugach's share of the Eklutna Hydroelectric Plant. This balance will be amortized over the estimated life of the facility. During the transition phase and after the transfer of ownership, Chugach, MEA and AML&P have jointly operated the facility. Each participant contributes their proportionate share for operation, maintenance and capital improvement costs to the plant, as well as to the transmission line between Anchorage and the plant. Under net billing arrangements, Chugach then reimburses MEA for their share of the costs.

**(14) Commitments and Contingencies**

*Contingencies*

Chugach is a participant in various legal actions, rate disputes, personnel matters and claims both for and against Chugach's interests. Management believes the outcome of any such matters, other than the final outcome of Order U-01-108(26) described in note (17) "Subsequent Events-Regulation," will not materially impact Chugach's financial condition, results of operations or liquidity.

*Long-Term Fuel Supply Contracts*

Chugach has entered into long-term fuel supply contracts from various producers at market terms. The current contracts will expire at the end of the currently committed volumes or the contract expiration dates of 2015 and 2025.

*Significant Customers*

Chugach is the principal supplier of power under long-term wholesale power contracts with MEA and HEA. These contracts represented $58.7 million or 34.1% of operating revenues in 2002, $57.7 million or 32.3% in 2001 and $45.2 million or 28.5% in 2000. These contracts will expire in 2014.

*Cooper Lake Hydroelectric Plant*

Chugach discovered polychlorinated biphenyls (PCBs) in paint, caulk and grease at the Cooper Lake Hydroelectric plant during initial phases of a turbine overhaul. A FERC approved plan, prepared in consultation with the Environmental Protection Agency (EPA), was implemented to remediate the PCBs in the plant. As a condition of its approval of the license amendment for the overhaul project, FERC required Chugach to also investigate the presence of PCBs in Kenai Lake. A sampling plan was developed by Chugach in consultation with state and federal agencies and approved by FERC. In 2000, Chugach sampled sediments and fish collected from Kenai Lake and other waters. While low levels of PCBs were found in some sediment samples taken near the plant, no pathway from sediment to fish was established. While the levels of PCBs in fish from Kenai Lake were similar to levels found in fish from other lakes within the region, Chugach conducted additional sampling and analysis of fish in Kenai Lake and other waters and filed Chugach's final report dated April 1, 2002 with FERC, which analyzed the results of the sampling. Based on these analyses, Chugach concluded that no further PCB sampling and analysis in Kenai Lake was necessary. In a letter dated June 13, 2002, FERC informed Chugach that its review of the report supported Chugach's conclusions and agreed Chugach was not required to conduct further PCB sampling and analysis in Kenai Lake. In its recent order in Chugach's general rate case, Order U-01-108(26), the RCA permitted the costs associated with the overhaul and the PCB remediation to be recovered through rates. Consequently, management believes the costs of the PCB remediation and studies will have no material impact on Chugach's financial condition or results of operations. Chugach will be filing a request in 2003 with the RCA to allow Chugach to record the costs Chugach incurred to investigate the presence of PCBs in Kenai Lake to be recovered through rates.

## December 31, 2002 and 2001

*Legal Proceedings*

Matanuska Electric Association, Inc., v. Chugach Electric Association, Inc., Superior Court Case No. 3AN-99-8152 Civil

This action is a claim for a breach of the Tripartite Agreement, which is the contract governing the parties' relationship for a 25-year period from 1989 through 2014 and governing Chugach's sale of power to MEA during that time. MEA asserted Chugach breached that contract by failing to provide information, by failing to properly manage Chugach's long-term debt, and by failing to bring Chugach's base rate action to a Joint Committee before presenting it to the RCA. The committee is defined in the power sales contract and consists of one MEA and two Chugach board members. All of MEA's claims have been dismissed. On April 29, 2002, MEA appealed the Superior Court's decisions relating to Chugach's financial management and Chugach's failure to bring Chugach's base rate action to the joint committee before filing with the RCA to the Alaska Supreme Court. Management is uncertain as to the outcome but will vigorously defend the appeal.

Chugach has certain additional litigation matters and pending claims that arise in the ordinary course of Chugach's business. In the opinion of management, no individual matter or the matters in the aggregate is likely to have a material adverse effect on Chugach's results of operations, financial condition or liquidity.

*Regulatory Cost Charge*

In 1992 the State of Alaska Legislature passed legislation authorizing the Department of Revenue to collect a regulatory cost charge from utilities in order to fund the governing regulatory commission, which was the APUC in 1992 and is currently the RCA. The tax is assessed on all retail consumers and is based on kilowatt-hour (kWh) consumption. The Regulatory Cost Charge has decreased since its inception (November 1992) from an initial rate of $.000626 per kWh to the current rate of $.000318, effective October 1, 2002.

### (15) Segment Reporting

Chugach had divided its operations into two reportable segments: Energy and Internet service. The energy segment derives its revenues from sales of electricity to residential, commercial and wholesale customers, while the Internet segment derived its revenues from provision of residential and commercial internet services and products. The reporting segments follow the same accounting policies used for Chugach's financial statements and described in the summary of significant accounting policies. Management evaluates a segment's performance based upon profit or loss from operations. Jointly used assets are allocated by percentage of reportable segment usage and centrally incurred costs are allocated using factors developed by Chugach, which are patterned upon usage. As of March 6, 2001, with an effective date of March 20, 2001, Chugach sold the bulk of Chugach's internet service provider assets related to dial-up services (excluding DSL services) to GCI Communication Corporation. The aggregate purchase price was $759,049 at closing, plus an additional amount of $70,075, which was based on number of subscriber accounts retained during the ninety-day transition period following closing. These transactions resulted in a loss of $258,073. The following is a tabulation of business segment information for the years ended December 31:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| **Operating Revenues** | | | |
| Internet | $0 | $196,051 | $1,170,448 |
| Energy | 171,944,918 | 178,399,163 | 157,370,666 |
| Total operating revenues | 171,944,918 | 178,595,214 | 158,541,114 |
| **Assignable Margins** | | | |
| Internet | 0 | (165,273) | (1,505,518) |
| Energy | (2,016,150) | 5,704,409 | 11,185,296 |
| Total assignable margins | (2,016,150) | 5,539,136 | 9,679,778 |
| **Assets** | | | |
| Internet | 0 | 0 | 550,275 |
| Energy | 570,214,874 | 575,281,187 | 539,195,705 |
| Total assets | 570,214,874 | 575,281,187 | 539,745,980 |
| **Capital Expenditures** | | | |
| Internet | 0 | 0 | 163,565 |
| Energy | 16,417,119 | 36,408,253 | 46,566,478 |
| Total capital expenditures | 16,417,119 | 36,408,253 | 46,730,043 |

### (16) Quarterly Results of Operations (unaudited)

| | 2002 Quarter Ended | | | |
|---|---|---|---|---|
| | Dec. 31* | Sept. 30 | June 30 | March 31 |
| Operating Revenue | $39,015,326 | $41,523,323 | $42,837,727 | $48,568,542 |
| Operating Expense | 39,742,069 | 35,548,872 | 36,589,007 | 37,489,988 |
| Net Interest | 6,013,016 | 5,994,890 | 6,039,051 | 7,995,786 |
| Net Operating Margins | (6,739,759) | (20,439) | 209,669 | 3,082,768 |
| Non-Operating Margins | 735,253 | 94,646 | 122,622 | 499,090 |
| Assignable Margins | $(6,004,506) | $74,207 | $332,291 | $3,581,858 |

| | 2001 Quarter Ended | | | |
|---|---|---|---|---|
| | Dec. 31 | Sept. 30 | June 30 | March 31 |
| Operating Revenue | $52,194,258 | $42,186,684 | $39,018,695 | $45,195,577 |
| Operating Expense | 43,744,371 | 35,591,202 | 32,788,603 | 35,372,545 |
| Net Interest | 6,820,907 | 6,680,125 | 7,037,810 | 6,690,671 |
| Net Operating Margins | 1,628,979 | (84,643) | (807,718) | 3,132,361 |
| Non-Operating Margins | 931,967 | 126,903 | 222,619 | 388,668 |
| Assignable Margins | $2,560,946 | $42,260 | ($585,099) | $3,521,029 |

*The reduction to operating revenue described in note 17 "*Subsequent Events – Regulation*" was recorded in the 2002 quarter ended December 31.

# December 31, 2002 and 2001

**(17) Subsequent Events**

*Refinancing*

The indenture initially governing the outstanding bonds of Chugach, 2001 Series A, 2002 Series A and 2002 Series B, provided that the bonds were secured by a mortgage on substantially all of Chugach's assets so long as any amounts remained outstanding to CoBank on bonds issued under the indenture. Upon the retirement of the bonds issued to CoBank, Chugach's outstanding bonds became subject to an Amended and Restated Indenture pursuant to which the bonds became unsecured obligations of Chugach.

Chugach and CoBank have entered into a Master Loan Agreement dated as of December 27, 2002, pursuant to which CoBank and Chugach replaced the bonds issued to CoBank with unsecured promissory notes not governed by the indenture. CoBank returned the old CoBank bonds to Chugach on January 22, 2003. Accordingly, under the terms of the Amended and Restated Indenture, all of Chugach's outstanding bonds became unsecured obligations of Chugach as of January 22, 2003.

*Regulation*

Chugach filed a general rate case on July 10, 2001, based on the 2000 test year, requesting a permanent base rate increase of 6.5%, and an interim base rate increase of 4.0%. On September 5, 2001, the RCA granted a 1.6% interim increase effective September 14, 2001. Chugach filed a petition for reconsideration and on October 25, 2001, the RCA approved an interim base rate increase of 3.97%. The additional rate increase was implemented on November 1, 2001. The interim rate increase was based on a normalized (adjusted for recurring expenses) test year and a system ratemaking Times Interest Earned Ratio (TIER) of 1.35. In this filing for permanent rates, Chugach proposed that margins be calculated using a rate base/rate of return methodology rather than the TIER methodology previously used.

As anticipated in Chugach's July 2001 original filing, on April 15, 2002, Chugach submitted a filing with the RCA to update certain known and measurable costs and savings that had occurred outside the 2000 Test Year. In the updated filing, Chugach reduced its base rate increase request from 6.5% to 5.7%, or approximately $0.9 million in the revenue requirement on a system basis. The revised filing also reflected an increase in depreciation expense of approximately $1.5 million due to the completion of the Beluga Unit 7 re-powering project and a reduction in annualized interest expense, due to Chugach's recent refinancing efforts, of $2.4 million. In this revised filing, Chugach continued to request $11.9 million in margins. As a result of reduced interest costs, this would yield an equivalent system TIER of 1.47.

Three intervenors filed pre-filed testimony with the RCA in July 2002 opposing various aspects of Chugach's proposal. Chugach filed its reply testimony with the RCA on October 1, 2002. The hearing to resolve the outstanding issues associated with the 2000 test year rate case took place in November and December of 2002, concluding on December 13, 2002.

On February 6, 2003, Chugach received Order U-01-108(26) from the RCA, which among other things included the following.

Chugach will be required to use TIER in calculating return levels. Chugach's system overall TIER was revised downward from 1.35 to 1.30, a difference that would reduce margins by approximately $1.3 million based on the 2000 test year and that would also have similar impacts in subsequent years.

Chugach will be required to treat AFUDC/IDC as a reduction to long-term interest expense, which reduces the revenue requirement by approximately $1.2 million.

The RCA reduced Chugach's normalized interest rate of 3.8% to 2%, which equates to a revenue requirement reduction of approximately $1.1 million.

Chugach's overall Depreciation Study was approved, although the RCA did require approximately $0.7 million in downward adjustments, which will not affect margins in future years.

Chugach's analysis of the financial impact of the Order is still preliminary. There are several outstanding questions regarding interpretation of the Order that have not yet been clarified. However, based upon this preliminary analysis, the Order would require a refund of revenues collected in 2001 of approximately $1.1 million of revenues collected in 2002 of approximately $6.0 million, which amounts were recorded as a reduction to operating revenues in 2002. The ultimate amount, which may be refunded, may change based upon RCA's reconsideration of the Order and Chugach cannot predict the outcome of reconsideration of the issues inherent in the Order.

The Order would also require a reduction in estimated 2003 revenues of approximately $6.0 million. Chugach has calculated, that based on the budgeted revenues and expenditures, under Order 26, Chugach may have insufficient margins to yield margins for interest equal to at least a 1.10 in 2003.

The CoBank Master Loan Agreement requires Chugach to establish and collect rates reasonably expected to yield margins for interest equal to at least 1.10 times interest expense. CoBank waived the rate covenant as of December 31, 2002, and reduced the rate covenant for 2003 from 1.10 to 1.08. Chugach believes that they will achieve compliance with the covenant as revised. The Amended and Restated Indenture also requires Chugach, subject to any necessary regulatory approval, to establish and collect rates reasonably expected to yield margins for interest equal to at least 1.10 times total interest expense. If there occurs any material change in the circumstances contemplated at the time rates were most recently reviewed, the Amended and Restated Indenture requires Chugach to seek appropriate adjustments to those rates so that they would generate revenues reasonable expected to yield margins for interest equal to at least 1.10 times interest charges, subject to any necessary regulatory approval or determination.

In order to maintain Chugach's compliance with these covenants, Chugach is taking the actions described below.

On February 13, 2003, Chugach filed a Motion with the RCA asking the RCA to stay the effect of its Order until after the RCA considers Chugach's Petition for Reconsideration of Order 26.

On February 18, 2003, the RCA granted, in part, Chugach's motion for stay. Specifically, the RCA stayed, until further order of the RCA, Ordering Paragraph 1 of Order U-01-108(26) which states, "Chugach's rates will be established on the basis of the 2000 test year revenue requirement recomputed in accordance with our decisions set out in the body of this Order." The RCA stayed the two Ordering paragraphs of the Order that would have required Chugach to put the new rates into effect. The RCA also allowed a one-week extension until February 28, 2003 to comply with ordering paragraphs 2 and 3, which require Chugach to recalculate its revenue requirement and cost-of-service studies reflecting the impact of Order U-01-108(26) on Chugach's rates. The RCA also extended the time to file Petitions for Reconsideration of Order U-01-108(26) one week to February 28, 2003. Chugach filed the Petition for Reconsideration with the RCA on February 28, 2003. The Public Advocacy Section (PAS), also filed a Petition for Reconsideration that, in part, seeks to remove, from depreciation expense that the RCA allowed, certain depreciation associated with Beluga Units 6 and 7 because the plant was added outside the 2000 Test Year upon which the rates were based. The RCA issued an Order on March 4, 2003, extending the time for filing responses to petitions for reconsideration from March 10 to March 14, 2003, and determined that the period for ruling on the petitions for reconsideration should be extended from March 31 to April 15, 2003. Management is uncertain as to the outcome but will vigorously defend its position. Under Alaska law, Chugach's financial covenants in the Amended and Restated Indenture are valid and enforceable, and rates set by the RCA must be adequate to meet those covenants. If the RCA does not modify the Order to allow Chugach to charge rates reasonably expected to yield margins for interest equal to at least 1.10 times interest expense, Chugach intends to bring action to enforce that provision of the Alaska state law described above.

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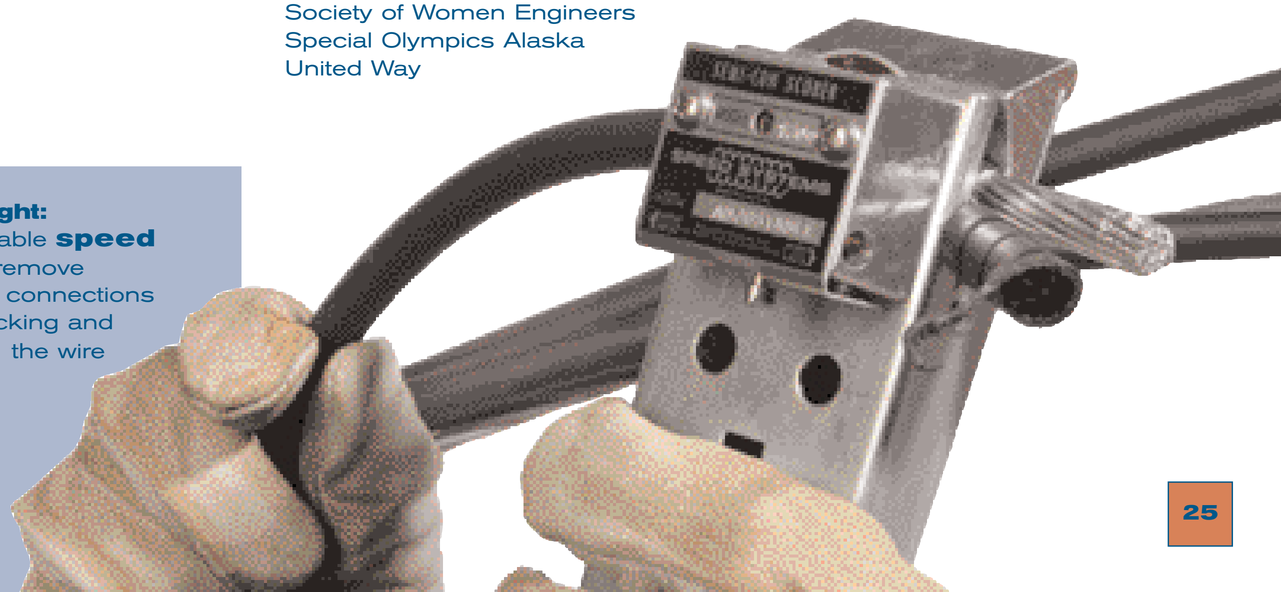
## Community Involvement

Chugach and its employees are committed to being involved in the community through donating and by volunteering. Some of the organizations Chugach and its employees have had the opportunity to work with in 2002 include:

Alaska Community Forest Council
Alaska Pacific University/SIFE
Alaska Youth & Parent Foundation
Anchorage Concert Association
Anchorage Home Builders Assoc.
Anchorage Literacy Project
Anchorage Rescue Mission
Anchorage Youth Court
Anchorage Youth Symphony
AWAIC
Bean's Café
Booth Memorial Home
Boy Scouts of America
Brother Francis Shelter
Chamber of Commerce City Wide Clean Up
Christmas Shoe Boxes for Children Project
Clare House
Cook Inlet Tribal Council
Covenant House Alaska
Crime Stoppers of Anchorage
Family Care Court
Food Bank of Alaska
Habitat for Humanity
Hope Community Resources
Junior Achievement
Mabel T. Caverly Senior Center
Mother Lawrence Foundation
National Multiple Sclerosis Society
Neighbor to Neighbor Fund
Partners in Justice
Resource Development Council
Safe Harbor Inn
Salvation Army
Society of Women Engineers
Special Olympics Alaska
United Way

Chugach provided a grant to the Alaska Community Forest Council for a project at the Balto Seppala Park. The council promotes tree care locally and statewide.

**Image on right:**
Secondary cable **speed strippers** remove insulation for connections **without** nicking and **damaging** the wire strands.



# Railbelt System

Chugach power flows to nearly three-fourths of Alaska's population. Chugach serves nearly 75,000 metered retail locations in a service territory extending from Anchorage to the Northern Kenai Peninsula, and from Whittier on Prince William Sound to Tyonek on the west side of Cook Inlet. Chugach regularly provides power for Alaskans from Homer to Fairbanks through wholesale and economy energy sales to Homer Electric Association, the City of Seward, Matanuska Electric Association and Golden Valley Electric Association. On occasion, Chugach sells to or buys energy from Anchorage Municipal Light & Power.

Chugach has 527.08 megawatts of installed generation capacity at five power plants and one fuel cell plant. Chugach operates 2,026 miles of energized line, made up of 402 miles of transmission line, 929 miles of overhead distribution line and 695 miles of underground distribution line.

Chugach's 2002 system peak load of 415.41 megawatts occurred between 6 and 7 p.m. on Dec. 30. Power sales for the year totaled 2.39 billion kilowatt-hours. Chugach finished 2002 with total revenues of $173.4 million, expenses of $175.4 million and margins of $(2.0) million.