

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-Q**

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**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2004

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

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Commission file number 33-42125

**CHUGACH ELECTRIC ASSOCIATION, INC.**

Incorporated pursuant to the Laws of Alaska State

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Internal Revenue Service – Employer Identification No. 92-0014224

5601 Minnesota Drive, Anchorage, AK 99518  
(907) 563-7494

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act)

Yes  No

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of the latest practicable date.

CLASS

OUTSTANDING AT NOVEMBER 1, 2004

NONE

NONE

DRAFT

**CAUTION REGARDING FORWARD-LOOKING STATEMENTS**

**PART I FINANCIAL INFORMATION**

<b><i>Item 1.</i></b>	Financial Statements (Unaudited)	2
	Balance Sheets, September 30, 2004 and December 31, 2003	3
	Statements of Revenues, Expenses and Patronage Capital, Three and Nine Months Ended September 30, 2004 and 2003	5
	Statements of Cash Flows, Nine Months Ended September 30, 2004 and 2003	6
	Notes to Financial Statements	7
<b><i>Item 2.</i></b>	Management's Discussion and Analysis of Results of Operations and Financial Condition	11
<b><i>Item 3.</i></b>	Quantitative and Qualitative Disclosures About Market Risk	17
<b><i>Item 4.</i></b>	Controls and Procedures	18

**PART II OTHER INFORMATION**

<b><i>Item 1.</i></b>	Legal Proceedings	18
<b><i>Item 2.</i></b>	Unregistered Sales of Equity Securities and Use of Proceeds	20
<b><i>Item 3.</i></b>	Defaults Upon Senior Securities	20
<b><i>Item 4.</i></b>	Submission of Matters to a Vote of Security Holders	20
<b><i>Item 5.</i></b>	Other Information	20
<b><i>Item 6.</i></b>	Exhibits	20
	Signatures	21
	Exhibits	22

## **CAUTION REGARDING FORWARD-LOOKING STATEMENTS**

*Statements in this report that do not relate to historical facts, including statements relating to future plans, events or performance, are forward-looking statements that involve risks and uncertainties. Actual results, events or performance may differ materially. Readers are cautioned not to place undue reliance on these forward-looking statements, that speak only as of the date of this report and the accuracy of which is subject to inherent uncertainty. Chugach Electric Association, Inc. (Chugach) undertakes no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances that may occur after the date of this report or the effect of those events or circumstances on any of the forward-looking statements contained in this report, except as required by law.*

## **PART I FINANCIAL INFORMATION**

### **Item 1. Financial Statements**

The unaudited financial statements and notes to financial statements of Chugach as of and for the quarter ended September 30, 2004, follow:

**CHUGACH ELECTRIC ASSOCIATION, INC.**  
**BALANCE SHEETS**

<u>Assets</u>	(Unaudited) <u>September 30, 2004</u>	<u>December 31, 2003</u>
Utility plant:		
Electric plant in service	\$ 746,890,350	\$ 744,260,390
Construction work in progress	<u>18,793,652</u>	<u>16,560,438</u>
	765,684,002	760,820,828
Less accumulated depreciation	<u>(301,048,910)</u>	<u>(293,371,966)</u>
	464,635,092	467,448,862
Other property and investments, at cost:		
Nonutility property	3,550	3,550
Investments in associated organizations	<u>11,388,139</u>	<u>11,381,796</u>
	11,391,689	11,385,346
Current assets:		
Cash and cash equivalents	10,852,270	11,185,086
Cash-restricted construction funds	0	488,846
Special deposits	222,163	222,163
Accounts receivable, net	18,415,139	18,812,199
Fuel cost recovery	0	2,032,730
Materials and supplies	23,442,617	21,888,794
Prepayments	1,631,314	1,458,649
Other current assets	<u>286,771</u>	<u>357,265</u>
	54,850,274	56,445,732
Deferred charges	<u>20,643,211</u>	<u>23,511,563</u>
Total Assets	<u>\$ 551,520,266</u>	<u>\$ 558,791,503</u>

**CHUGACH ELECTRIC ASSOCIATION, INC.**  
**BALANCE SHEETS**  
*(Continued)*

<u>Liabilities and Equities</u>	(Unaudited) <u>September 30, 2004</u>	<u>December 31, 2003</u>
Equities and margins:		
Memberships	\$ 1,190,948	\$ 1,155,818
Patronage capital	129,439,193	126,341,413
Other	<u>6,699,102</u>	<u>6,718,891</u>
	137,329,243	134,216,122
Long-term obligations, excluding current installments:		
2001 Series A Bond payable	150,000,000	150,000,000
2002 Series A Bond payable	120,000,000	120,000,000
2002 Series B Bond payable	46,200,000	51,100,000
National Bank for Cooperatives Bonds payable	<u>52,157,786</u>	<u>63,189,179</u>
	368,357,786	384,289,179
Current liabilities:		
Current installments of long-term obligations	15,931,393	5,545,000
Accounts payable	4,655,794	7,676,906
Provision for rate refund	0	671,071
Consumer deposits	1,911,993	1,834,752
Fuel cost payable	739,488	0
Accrued interest	1,903,021	6,165,790
Salaries, wages and benefits	5,762,989	4,886,600
Fuel	10,942,321	9,006,758
Other current liabilities	<u>1,236,861</u>	<u>785,760</u>
	43,083,860	36,572,637
Deferred credits	<u>2,749,377</u>	<u>3,713,565</u>
Total Liabilities and Equities	<u>\$ 551,520,266</u>	<u>\$ 558,791,503</u>

See accompanying notes to financial statements.

**CHUGACH ELECTRIC ASSOCIATION, INC.**  
**Statements of Revenues, Expenses and Patronage Capital**  
**(Unaudited)**

	Three months ended September 30		Nine months ended September 30	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Operating revenues	\$ 47,991,700	\$ 41,163,160	\$ 146,025,052	\$ 133,091,838
Operating expenses:				
Fuel	15,401,482	12,267,067	46,351,134	34,120,453
Power production	4,544,688	3,363,789	11,365,200	9,486,981
Purchased power	5,400,612	4,681,807	14,892,444	12,714,043
Transmission	1,611,613	1,045,137	4,784,335	3,159,875
Distribution	3,140,476	2,869,990	8,571,666	8,147,487
Consumer accounts/Information expense	1,442,945	1,307,796	4,138,208	4,123,234
Administrative, general and other	5,478,919	5,976,266	16,337,182	19,261,872
Depreciation and amortization	<u>6,757,489</u>	<u>6,839,754</u>	<u>20,889,807</u>	<u>20,812,332</u>
Total operating expenses	43,778,224	38,351,606	127,329,976	111,826,277
Interest expense:				
On long-term obligations	5,503,915	5,845,448	16,357,359	17,590,018
On short-term obligations	0	0	(48,179)	11,900
Charged to construction-credit	<u>(130,511)</u>	<u>(110,826)</u>	<u>(329,463)</u>	<u>(212,510)</u>
Net interest expense	<u>5,373,404</u>	<u>5,734,622</u>	<u>15,979,717</u>	<u>17,389,408</u>
Net operating margins	(1,159,928)	(2,923,068)	2,715,359	3,876,153
Nonoperating margins:				
Interest income	126,456	99,950	320,483	282,033
Other	20,826	22,890	63,522	86,605
Property gain	<u>(1,584)</u>	<u>30,396</u>	<u>(1,584)</u>	<u>101,615</u>
Total nonoperating margins	<u>145,698</u>	<u>153,236</u>	<u>382,421</u>	<u>470,253</u>
Assignable margins	<u>(1,014,230)</u>	<u>(2,769,832)</u>	<u>3,097,780</u>	<u>4,346,406</u>
Patronage capital at beginning of period	130,453,423	127,204,532	126,341,413	120,148,502
Retirement of capital credits and estate Payments	<u>(0)</u>	<u>(0)</u>	<u>(0)</u>	<u>(60,208)</u>
Patronage capital at end of period	<u>\$ 129,439,193</u>	<u>\$ 124,434,700</u>	<u>\$ 129,439,193</u>	<u>\$ 124,434,700</u>

See accompanying notes to financial statements.

**CHUGACH ELECTRIC ASSOCIATION, INC.**  
**Statements of Cash Flows**  
**(Unaudited)**

Nine months ended September 30  
2004                      2003

<u>Cash flows from operating activities:</u>		
Assignable margins	\$3,097,780	\$4,346,406
Adjustments to reconcile assignable margins to net cash (used in) provided by operating activities:		
Provision for rate refund adjustment	0	(1,842,497)
Depreciation and amortization	23,586,909	24,813,600
Capitalization of interest	(382,496)	(245,983)
Property (gains) losses	1,584	(101,615)
Impairment of long-lived asset	0	1,846,816
Other	955	1,145
Changes in assets and liabilities:		
(Increase) decrease in assets:		
Fuel cost recovery	2,032,730	(100,714)
Accounts receivable	397,060	12,885,977
Prepayments	(172,665)	(1,422,453)
Materials and supplies	(1,553,823)	1,556,613
Deferred charges, net	171,250	(792,956)
Other	70,494	(14,389)
Increase (decrease) in liabilities:		
Accounts payable	(3,021,112)	(4,097,725)
Provision for rate refund	(671,071)	0
Fuel payable	739,488	(363,862)
Consumer deposits	77,241	(16,109)
Accrued interest	(4,262,769)	(4,388,496)
Deferred credits	(1,829,255)	(978,206)
Other	<u>3,263,053</u>	<u>1,444,009</u>
<b>Net cash provided by operating activities</b>	<b>21,545,353</b>	<b>32,529,561</b>
<u>Cash flows from investing activities:</u>		
Extension and replacement of plant	(17,695,126)	(18,419,642)
Investments in associated organizations	<u>(7,298)</u>	<u>(34,226)</u>
<b>Net cash used in investing activities</b>	<b>(17,702,424)</b>	<b>(18,453,868)</b>
<u>Cash flows from financing activities:</u>		
Short-term obligations	0	(6,081,250)
Repayments of long-term obligations	(5,545,000)	(5,165,821)
Retirement of patronage capital	0	(60,208)
Other	<u>1,369,255</u>	<u>529,251</u>
<b>Net cash used in financing activities</b>	<b>(4,175,745)</b>	<b>(10,778,028)</b>
Net increase (decrease) in cash and cash equivalents	(332,816)	3,297,665
<u>Cash and cash equivalents at beginning of period</u>	<u>\$11,185,086</u>	<u>\$7,284,292</u>
<u>Cash and cash equivalents at end of period</u>	<u>\$10,852,270</u>	<u>\$10,581,957</u>
Supplemental disclosure of cash flow information – interest expense paid, net of amounts capitalized	<u>\$20,242,486</u>	<u>\$17,456,325</u>

See accompanying notes to financial statements.

**CHUGACH ELECTRIC ASSOCIATION, INC.**  
*Notes to Financial Statements*  
(Unaudited)

**1. Presentation of Financial Information**

During interim periods, Chugach Electric Association, Inc. (Chugach) follows the accounting policies set forth in its audited financial statements included in Form 10-K filed with the Securities and Exchange Commission (SEC) unless otherwise noted. Users of interim financial information are encouraged to refer to the footnotes contained in Chugach's Form 10-K when reviewing interim financial results. The accompanying unaudited interim financial statements reflect all adjustments of normal and recurring nature, which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented.

Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation.

**2. Lines of credit**

Chugach maintains a line of credit of \$20 million with CoBank, ACB (CoBank). The CoBank line of credit expires December 31, 2004, subject to renewal at the discretion of the parties. At September 30, 2004, there was no outstanding balance on this line of credit. In addition, Chugach has an annual line of credit of \$50 million available at the National Rural Utilities Cooperative Finance Corporation (NRUCFC). At Sept 30, 2004, there was no outstanding balance on this line of credit. The NRUCFC line of credit expires October 15, 2007.

**3. Legal Proceeding**

*Matanuska Electric Association, Inc., v. Chugach Electric Association, Inc., Superior Court Case No. 3AN-99-8152 Civil, Supreme Court No. S-10598/10618*

This action is a claim for a breach of the 25-year all-requirements contract for power sales to Matanuska Electric Association, Inc. (MEA) through 2014. MEA asserted Chugach breached that contract by failing to provide information, by failing to properly manage our long-term debt, and by failing to bring our base rate action to a joint committee before presenting it to the Regulatory Commission of Alaska (RCA). The joint committee is defined in the power sales contract and consists of one MEA and two Chugach board members. All of MEA's claims were dismissed in Superior Court.

MEA appealed the Superior Court's decisions relating to our debt management and our failure to bring our base rate action to the joint committee before filing with the RCA to the Alaska Supreme Court. Chugach cross-appealed the Superior Court's decision not to dismiss the debt management claim on jurisdictional and res judicata grounds.

The Alaska Supreme Court issued a decision on October 8, 2004. The Supreme Court approved of the Superior Court's dismissal of this claim by ruling in Chugach's favor

*CHUGACH ELECTRIC ASSOCIATION, INC.*  
*Notes to Financial Statements*  
*(Unaudited)*

supporting its right under the power sales agreement to file for interim rate relief without first going to the Joint Committee.

The Supreme Court ruled against Chugach by overturning the Superior Court's decision that dismissed MEA's fifth cause of action. This claim asked the court to review Chugach's use of rate locks instead of defeasing debt based on the Prudent Utility Practice standard under our power sales agreement. The Superior Court had dismissed the claim finding that the Prudent Utility Practice standard found in the power sales agreement between the parties did not apply. The Supreme Court reversed that decision, finding that the Prudent Utility Practice standard does apply to Chugach's debt management. The Supreme Court also ruled against Chugach on arguments that the Superior Court should have dismissed the debt management claim on jurisdictional and res judicata grounds.

The case will be remanded to the Superior Court to consider the one remaining issue. Management is uncertain of the outcome of the proceeding before the Superior Court.

*Matanuska Electric Association, Inc. v. Chugach Electric Association, Inc. Superior Court Case No. 3AN-04-11776 Civil*

On October 12, 2004, MEA filed suit in Superior Court alleging a breach of the power sales agreement between the parties and violation of Chugach's bylaws in connection with allocation of margins (capital credits) to MEA for the years 1998 through 2003. Allocation of capital credits assigns a share of the margins earned in a particular year to each customer. Capital credits are repatriated to customers at the discretion of the board of directors typically many years after the margins are earned.

The suit seeks a declaration by the Court that Chugach is in breach of its bylaws and the power sales agreement based on its allocation of capital credits to MEA as well as injunctive relief requiring Chugach to calculate MEA's capital credit allocations based on MEA's patronage and in accordance with generally accepted accounting practices for nonprofit cooperatives and cooperative principles. The suit also seeks damages in an unspecified amount to compensate MEA for the alleged breach of contract.

Management intends to vigorously defend against the claim. Management is uncertain of the outcome of the suit.

*CHUGACH ELECTRIC ASSOCIATION, INC.*  
*Notes to Financial Statements*  
*(Unaudited)*

**4. Critical Accounting Policies**

Chugach's accounting and reporting policies comply with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires that management apply accounting policies and make estimates and assumptions that affect results of operations and reported amounts of assets and liabilities in the financial statements. Critical accounting policies are those policies that management believes are the most important to the portrayal of Chugach's financial condition and results of its operations, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about matters that are inherently uncertain. Most accounting policies are not considered by management to be critical accounting policies. Several factors are considered in determining whether or not a policy is critical in the preparation of financial statements. These factors include, among other things, whether the estimates are material to the financial statements, the nature of the estimates, the ability to readily validate the estimates with other information including third parties or available prices, and sensitivity of the estimates to changes in economic conditions and whether alternative accounting methods may be utilized under accounting principles generally accepted in the United States of America. For all of these policies management cautions that future events rarely develop exactly as forecast, and the best estimates routinely require adjustment. Management has discussed the development and the selection of critical accounting policies with the Chugach Audit Committee.

The following policies are considered to be critical accounting policies for the quarter ending September 30, 2004.

*Electric Utility Regulation*

Chugach is subject to regulation by the RCA. The RCA sets the rates Chugach is permitted to charge customers based on allowable costs. As a result, Chugach applies Financial Accounting Standards Board (FASB) Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*. Through the ratemaking process, the regulators may require the inclusion of costs or revenues in periods different than when they would be recognized by a non-regulated company. This treatment may result in the deferral of expenses and the recording of related regulatory assets based on anticipated future recovery through rates or the deferral of gains or creation of liabilities and the recording of related regulatory liabilities. The application of Statement No. 71 has a further effect on Chugach's financial statements as a result of the estimates of allowable costs used in the ratemaking process. These estimates may differ from those actually incurred by the Company; therefore, the accounting estimates inherent in specific costs such as depreciation and pension and post-retirement benefits have less of a direct impact on Chugach's results of operations than they would on a non-regulated company. Management reviews the ultimate recoverability of these regulatory assets and liabilities based on applicable regulatory guidelines. However, adverse legislation and judicial or regulatory actions could materially impact the amounts of

**CHUGACH ELECTRIC ASSOCIATION, INC.**  
*Notes to Financial Statements*  
(Unaudited)

such regulatory assets and liabilities and could adversely impact Chugach's financial statements.

*Financial Instruments and Hedging*

Chugach used U.S. Treasury forward rate lock agreements to hedge expected interest rates on debt. We accounted for the agreements under Statement of Financial Accounting Standards (SFAS) 80 and 71 through December 31, 2000, and SFAS 133, 138 and 71 subsequent to that date. Gains or losses are treated as regulatory assets or liabilities upon settlement, based on authorization by the RCA in Order U-01-108(26) to recover these gains and losses.

Critical estimates also include provision for rate refunds and allowance for doubtful accounts. Actual results could differ from those estimates.

**5. *New Accounting Standards***

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This Statement established standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. Many of those instruments were previously classified as equity. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. The remaining provisions of this Statement are consistent with FASB's proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares depending on the nature of the relationship established between the holder and the issuer. While FASB still plans to revise that definition through an amendment to Concepts Statement 6, FASB decided to defer issuing that amendment until it has concluded its deliberations on the next phase of this project. That next phase will deal with certain compound financial instruments including puttable shares, convertible bonds, and dual-indexed financial instruments. Chugach implemented SFAS No. 150 effective January 1, 2004, and there was no material impact to the financial statements.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Reference is made to the information contained under the caption "CAUTION REGARDING FORWARD-LOOKING STATEMENTS" at the beginning of this Report.

Docket U-01-108

Chugach filed a general rate case on July 10, 2001, based on a 2000 Test Year.

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%. Three wholesale customers and the Public Advocacy Staff of the RCA participated in the rate case.

A hearing was held in November and December of 2002. Between February 6, 2003, and May 12, 2004, the RCA issued Order Nos. 26 through 39 containing various rulings on Chugach's rate case.

As compared to prior-approved permanent rates, Chugach's final approved rates on a system basis increased 0.07 percent, consisting of an increase of 3.5 percent to retail customers and a decrease of 7.9 percent to wholesale customers. These results were implemented on November 10, 2003. On June 30, 2004, the RCA issued Order No. 40, acknowledging receipt of compliance filings and closed the docket.

Appeal of RCA Orders

Chugach filed a timely appeal of RCA Orders Nos. 26, 30 and 33 to the Alaska Superior Court. In its Appellant's brief dated February 18, 2004, Chugach asserted that the RCA's orders contained three errors:

- The split TIER decision unduly discriminates against retail customers;
- Interest expense was allocated on the basis of plant associated with G&T and Distribution rather than on the basis of debt associated with each function; and
- Chugach is entitled to include all of its interest expense in rates and the RCA's offset for Interest During Construction (IDC) was not justified because nearly all of the plant that produced the IDC was in service by the time the new rate went into effect.

The resolution of the first two issues will not change the total amount Chugach can recover through rates. If Chugach prevails on the last issue, it will be authorized to recover approximately \$1,000,000 more each year in rates.

One of Chugach's wholesale customers, MEA, also appealed the RCA's orders. In its Appellant's brief, MEA argued that the RCA's decision to normalize Chugach's variable rate

debt at 3.8 percent and to authorize the corresponding interest expense constitutes error based on the historic rates prevailing for Chugach's variable rate debt. If MEA prevails on its argument, Chugach's authorized rates would be reduced by approximately \$1,000,000 each year.

The Alaska Superior Court heard oral argument on July 13, 2004. The Court took the matter under advisement. Management is uncertain as to the outcome but expects a decision in 2004.

**Results Of Operations**

**Current Year Quarter Versus Prior Year Quarter**

Assignable margins increased by \$1.8 million for the quarter ended September 30, 2004, over the same quarter in 2003 due to a decrease in administrative, general and other expense, a decrease in net interest expense and increased kWh sales. The decreases were offset by an increase in production, transmission and distribution expenses.

Operating revenues, which include sales of electric energy to retail, wholesale and economy energy customers and other miscellaneous revenues, increased by \$6.8 million, or 16.6%, for the quarter ended September 30, 2004, over the same quarter in 2003. The increase in revenues was due to an increase in revenue recovered through the fuel surcharge mechanism due to higher fuel prices, as well as increased kWh sales to both residential and wholesale customers.

The following table represents kWh sales for the quarter ended September 30:

<b>Customer</b>	<b><u>2004</u> kWh</b>	<b><u>2003</u> kWh</b>
Retail	281,952,973	270,956,140
Wholesale	287,864,611	269,168,585
Economy Energy	<u>49,464,608</u>	<u>48,747,730</u>
Total	<u>619,282,192</u>	<u>588,872,455</u>

Retail demand and energy rates and wholesale demand and energy rates charged to HEA, MEA and SES did not change in the third quarter of 2004 compared to the third quarter of 2003.

Fuel expense increased by \$3.1 million, or 25.6%, for the quarter ended September 30, 2004, compared to the same period in 2003 primarily due to higher fuel prices. Purchased power also increased \$718.8 thousand, or 15.4%, due to higher fuel prices. Fuel and purchased power is recovered through the fuel surcharge mechanism. Power production expense increased \$1.2 million, or 35.1%, due to annual maintenance projects starting later in the year in 2004 than in 2003. Transmission expense increased by \$566.5 thousand, or 54.2%, due to a change in directly assigning SCADA, communications and relay maintenance to the substation maintenance category. In 2003, these costs were recorded to the administrative, general and other financial statement category. Distribution expense increased by \$270.5 thousand, or 9.4%, due to increased scheduled maintenance. Consumer

Accounts/Information expense increased \$135.1 thousand, or 10.3%, due to increased customer record and collection expenses. Administrative, general and other expense decreased by \$497.3 thousand, or 8.3%, due to lower information services and garage allocated costs. The decrease was also caused by a write off in 2003 associated with a wind power project that was higher than a write off in 2004 of inventory associated with the fuel cell. Depreciation and amortization expense did not materially change for the three-month period ended September 30, 2004.

Interest on long-term debt decreased by \$341.5 thousand, or 5.8%, due to lower long-term debt balances and lower interest rates on the CoBank bonds. Interest charged to construction did not materially change in the third quarter of 2004 compared to the same period in 2003.

Other nonoperating margins decreased \$7.5 thousand, or 4.9%, for the three-month period ended September 30, 2004, compared to the same period in 2003 due to the sale of a crane in August of 2003, which caused 2003's nonoperating margins to be higher than usual.

**Current Year to Date Versus Prior Year to Date**

Assignable margins decreased by \$1.2 million, or 28.7%, in the first nine months of 2004, over the same period in 2003, primarily due to a \$5.2 million reversal recorded to revenue in March of 2003 of a \$7.1 million provision for rate refund recorded in 2002. This variance was offset by a decrease in interest expense and a decrease in administrative, general and other expense.

Operating revenues increased \$12.9 million, or 9.7%, due to an increase in revenue recovered through the fuel surcharge mechanism due to higher fuel prices and increased kWh sales. The increase was offset by decreased economy energy sales to GVEA.

The following table represents kWh sales for the nine months ended September 30:

<b>Customer</b>	<b><u>2004</u> kWh</b>	<b><u>2003</u> kWh</b>
Retail	889,250,801	845,910,228
Wholesale	875,228,226	819,762,696
Economy Energy	<u>148,728,850</u>	<u>166,840,860</u>
Total	<u>1,913,207,877</u>	<u>1,832,513,784</u>

Fuel expense increased by \$12.2 million, or 35.8%, for the first nine months of 2004, compared to the same period in 2003 due to higher fuel prices. Fuel expense is recovered through the fuel surcharge mechanism. Power production expense increased by \$1.9 million, or 19.8%, due to a shift from capital projects in 2003 to expense projects in 2004. Purchased power expense increased by \$2.2 million, or 17.1%, also due to higher fuel prices and is also recovered through the fuel surcharge mechanism. Transmission expense increased \$1.6 million, or 51.4%, due to a change in directly assigning SCADA, communications and relay maintenance to the substation maintenance category. In 2003, these costs were recorded to the administrative, general and other financial statement category. This expense category

was also lower in 2003 due to the accrual of a Federal Emergency Management Agency (FEMA) reimbursement of \$250,000 for windstorm damage recorded in the second quarter of 2003. Administrative, general and other expense decreased by \$2.9 million, or 15.2%, due primarily to a \$1.8 million write down of an impaired asset in 2003, as well as higher write offs of study projects and obsolete inventory in 2003. The decrease was also attributed to lower information services costs allocated to this expense category. Distribution, consumer accounts/information and depreciation and amortization expense did not materially change for the nine-month period ended September 30, 2004, compared to the same period in 2003.

Interest on long-term debt decreased by \$1.2 million, or 7.0%, due to lower debt balances and lower interest rates. Interest charged to construction increased by \$117.0 thousand, or 55.0%, in the first nine months of 2004 compared to the same period in 2003, due to an adjustment that was made to a completed project in 2003. Other interest expense decreased by \$60.1 thousand, or 504.8%, during the same period in 2004 compared to the same period in 2003 due to an adjustment to interest associated with our provision for rate refunds that were made earlier in the year.

Other non-operating margins decreased by \$87.8 thousand, or 18.7%, for the nine-month period ended September 30, 2004, compared to the same period in 2003, caused by the gain associated with the disposal of a crane in 2003.

### **Financial Condition**

Total assets decreased \$7.3 million, or 1.3%, from December 31, 2003, to September 30, 2004. The decrease was due in part to a \$2.8 million, or 0.61%, decrease in net plant, primarily due to depreciation expense in excess of extension and replacement of plant. The decrease in total assets was also due to a \$488.8 thousand, or 100.0%, decrease in restricted construction funds, as well as a \$2.0 million, or 100.0%, decrease in fuel cost recovery caused by the collection of the previous quarter fuel cost through the fuel surcharge mechanism. There was also a decrease of \$2.9 million, or 12.2%, in deferred charges caused by the amortization of deferred projects, as well as the reclassification of software applications to utility plant in service. These decreases were offset by an additional \$1.4 million of costs associated with the Cooper Lake Relicensing project.

These decreases were offset by a \$1.6 million, or 7.1%, increase in materials and supplies caused by the purchase of generation and transmission inventory items in preparation for scheduled generation maintenance projects and capital transmission projects.

Notable changes to total liabilities and equities include a \$15.9 million, or 4.2%, decrease in long-term obligations caused by the reclassification to current maturities of long-term debt of the installment payments of the 2002 Series B bond and the CoBank 2, 3 and 4 bonds. Accounts payable also decreased \$3.0 million, or 39.4%, caused by a decrease in construction activity in the third quarter of 2004 and the payment of invoices that were accrued but not paid at December 31, 2003. Accrued interest also decreased \$4.3 million, or 69.1%, caused by the semi-annual interest payment on the 2001 Series A Bonds in the third quarter. There was also a \$671.1 thousand, or 100.0%, decrease in provision for rate refund

due to the payment of rate refunds since December 31, 2003. Deferred credits also decreased \$964.2 thousand, or 26.0%, due to the return of the Southern Intertie funds discussed above and to reduced refundable deposits.

These decreases were offset by a \$4.1 million, or 3.1%, increase in patronage capital due to the margins generated in the first three quarters of 2004 and an \$739.5 thousand, or 100.0%, increase in fuel cost payable due to the over-collection of the previous quarter fuel cost through the fuel surcharge mechanism. The decreases were also offset by an increase of \$10.4 million, or 187.3%, in current installments of long-term debt caused by the reclassification of CoBank 2, which is due in August of 2005. Salaries, wages and benefits also increased \$876.4 thousand, or 17.9%, due to higher accruals caused by the timing of pay dates. Fuel cost also increased \$1.9 million, or 21.5%, due to higher fuel prices.

**Liquidity and Capital Resources**

Chugach has satisfied its operational and capital cash requirements primarily through internally-generated funds, an annual \$20 million line of credit with CoBank and a \$50 million line of credit from NRUCFC. At September 30, 2004, there was no outstanding balance with NRUCFC or CoBank.

Chugach also has a term loan facility with CoBank. Loans made under this facility are evidenced by promissory notes governed by the Master Loan Agreement, which became effective on January 22, 2003. At September 30, 2004, Chugach had the following promissory notes outstanding under this facility:

<u>Promissory Note</u>	<u>Principal balance</u>	<u>Interest rate at September 30, 2004</u>	<u>Maturity Date</u>	<u>Principal Payment Dates</u>
CoBank 2	\$10,000,000	7.76%	2005	2005
CoBank 3	\$20,634,830	3.12%	2022	2003 – 2022
CoBank 4	\$22,554,349	3.12%	2022	2003 – 2022
CoBank 5	\$10,000,000	3.12%	2012	2002 – 2012
Total	\$63,189,179			

On January 22, 2003, Chugach and CoBank finalized a new Master Loan Agreement pursuant to which the CoBank term loan facility was converted from secured to unsecured debt and the obligations represented by the outstanding bonds then held by CoBank were converted into promissory notes governed by the new Master Loan Agreement. Chugach's mortgage indenture was replaced in its entirety by an Amended and Restated Indenture dated April 1, 2001. All liens and security interests imposed under the indenture were terminated and all outstanding Chugach bonds (including New Bonds of 2001 Series A, 2002 Series A and 2002 Series B) became unsecured obligations governed by the terms of the Amended and Restated Indenture.

Capital construction in 2004 is estimated at \$30.0 million. At September 30, 2004, approximately \$17.7 million had been expended. Capital improvement expenditures are expected to decrease in the fourth quarter of 2004 as the construction season ends.

Chugach management continues to expect that cash flows from operations and external funding sources will be sufficient to cover operational and capital funding requirements in 2004 and thereafter.

### **Outlook**

Chugach is currently planning for future resource needs. An Integrated Resource Plan (IRP) is in development. This effort studies several possible future scenarios for power sales.

On March 17, 2004, the Chugach Board of Directors authorized the Chief Executive Officer (CEO) or his designee to enter into an agreement to form a Joint Action Agency (JAA) that, if implemented, could provide a structure with which Chugach and other eligible Alaska utilities might jointly acquire, own and operate certain generation and transmission facilities.

On September 15, 2004, the Chugach Board of Directors authorized the CEO to undertake all necessary steps to craft a plan to create a single-member Generation and Transmission (G&T) cooperative that would hold all Chugach G&T assets, contractual arrangements, and associated debt. Chugach is considering this option as a way to more effectively track the finances of the G&T functions and to help address issues in future rate cases involving the relative margin earning burdens among customer classes.

These two organizational structures are not mutually exclusive.

### **Environmental Matters**

#### **Compliance with Environmental Standards**

Chugach's operations are subject to certain federal, state and local environmental laws. The costs associated with environmental compliance are included as a component of both the operating and capital budget processes. Chugach accrues for costs associated with environmental remediation obligations when such costs are probable and reasonably estimable.

#### **Cooper Lake**

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. In an 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.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Chugach is exposed to a variety of risks, including changes in interest rates and changes in commodity prices due to repricing mechanisms inherent in gas supply contracts. In the normal course of our business, we manage our exposure to these risks as described below. Chugach does not engage in trading market risk-sensitive instruments for speculative purposes.

#### **Interest Rate Risk**

The following table provides information regarding auction dates and rates in 2004 on the 2002 Series B bonds.

<b><u>Auction Date</u></b>	<b><u>Interest Rate</u></b>
January 28, 2004	1.12%
February 25, 2004	1.09%
March 24, 2004	1.10%
April 21, 2004	1.11%
May 19, 2004	1.20%
June 16, 2004	1.40%
July 14, 2004	1.55%
August 11, 2004	1.65%
September 8, 2004	1.75%
October 6, 2004	1.90%
November 3, 2004	2.05%

The following table provides information regarding cash flows for principal payments on total debt by maturity date (dollars in thousands) as of September 30, 2004.

<b><u>Total Debt*</u></b>	<b><u>2005</u></b>	<b><u>2006</u></b>	<b><u>2007</u></b>	<b><u>2008</u></b>	<b><u>Thereafter</u></b>	<b><u>Total</u></b>	<b><u>Fair Value</u></b>
<b>Fixed rate</b>	\$10,000	\$0	\$0	\$0	\$270,000	\$280,000	\$311,611
<b>Average interest rate</b>	7.76%	-	-	-	6.39%	6.44%	
<b>Variable rate</b>	\$5,931	\$6,326	\$11,729	\$7,241	\$73,063	\$104,289	\$104,289
<b>Average interest rate</b>	2.25%	2.25%	2.68%	2.25%	2.76%	2.66%	

\* Includes current portion

### **Commodity Price Risk**

Chugach's gas contracts provide for adjustments to gas costs based on fluctuations of certain commodity prices and indices. Because purchased power costs are passed directly to our wholesale and retail customers through a fuel surcharge rate, fluctuations in the price paid for gas pursuant to long-term gas supply contracts do not normally impact margins. The fuel surcharge mechanism mitigates the commodity price risk of market fluctuations in the price of purchased power.

### **Item 4. Controls and Procedures**

As of the end of the period covered by this report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Our principal executive officer (CEO) and principal financial officer (CFO) supervised and participated in this evaluation. Based on this evaluation, our CEO and CFO each concluded that our disclosure controls and procedures are effective and timely in alerting them to material information required to be included in our periodic reports to the Securities and Exchange Commission. The design of any system of controls is based in part upon various assumptions about the likelihood of future events and there can be no assurance that any of our plans, products, services or procedures will succeed in achieving their intended goals under future conditions. In addition, there have been no significant changes in our internal controls or in other factors known to management that could significantly affect our internal controls subsequent to our most recent evaluation.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

*Matanuska Electric Association, Inc., v. Chugach Electric Association, Inc., Superior Court Case No. 3AN-99-8152 Civil, Supreme Court No. S-10598/10618*

This action is a claim for a breach of the 25-year all requirements contract for power sales to MEA through 2014. MEA asserted Chugach breached that contract by failing to provide information, by failing to properly manage our long-term debt, and by failing to bring our base rate action to a joint committee before presenting it to the Regulatory Commission of Alaska (RCA). The joint committee is defined in the power sales contract and consists of one MEA and two Chugach board members. All of MEA's claims were dismissed in Superior Court.

MEA appealed the Superior Court's decisions relating to our debt management and our failure to bring our base rate action to the joint committee before filing with the RCA to the Alaska Supreme Court. Chugach cross-appealed the Superior Court's decision not to dismiss the debt management claim on jurisdictional and res judicata grounds.

The Alaska Supreme Court issued a decision on October 8, 2004. The Supreme Court approved of the Superior Court's dismissal of this claim by ruling in Chugach's favor

supporting its right under the power sales agreement to file for interim rate relief without first going to the Joint Committee.

The Supreme Court ruled against Chugach by overturning the Superior Court's decision that dismissed MEA's fifth cause of action. This claim asked the court to review Chugach's use of rate locks instead of defeasing debt based on the Prudent Utility Practice standard under our power sales agreement. The Superior Court had dismissed the claim finding that the Prudent Utility Practice standard found in the power sales agreement between the parties did not apply. The Supreme Court reversed that decision, finding that the Prudent Utility Practice standard does apply to Chugach's debt management. The Supreme Court also ruled against Chugach on arguments that the Superior Court should have dismissed the debt management claim on jurisdictional and res judicata grounds.

The case will be remanded to the Superior Court to consider the one remaining issue. Management is uncertain of the outcome of the proceeding before the Superior Court.

*Matanuska Electric Association, Inc. v. Chugach Electric Association, Inc. Superior Court Case No. 3AN-04-11776 Civil*

On October 12, 2004, MEA filed suit in Superior Court alleging a breach of the power sales agreement between the parties and violation of Chugach's bylaws in connection with allocation of margins (capital credits) to MEA for the years 1998 through 2003. Allocation of capital credits assigns a share of the margins earned in a particular year to each customer. Capital credits are repatriated to customers at the discretion of the board of directors typically many years after the margins are earned.

The suit seeks a declaration by the Court that Chugach is in breach of its bylaws and the power sales agreement based on its allocation of capital credits to MEA as well as injunctive relief requiring Chugach to calculate MEA's capital credit allocations based on MEA's patronage and in accordance with generally accepted accounting practices for nonprofit cooperatives and cooperative principles. The suit also seeks damages in an unspecified amount to compensate MEA for the alleged breach of contract.

Management intends to vigorously defend against the claim. Management is uncertain of the outcome of the suit.

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

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not applicable

**Item 3. Defaults Upon Senior Securities**

Not applicable

**Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable

**Item 5. Other Information**

Chugach and MEA met on October 27, 2004, pursuant to Section 12(c) of the MEA/Chugach Power Sales Agreement. This provision requires the parties to meet no later than ten years prior to the termination date of the Agreement, to discuss a possible renewal, extension, or modification of the Agreement, as well as the desires and potential circumstances of all parties following the termination date. At that meeting and shortly thereafter by letter dated November 2, 2004, MEA communicated to Chugach that MEA does not desire to renew, extend or modify the Agreement. Further, MEA stated that it does not envision any type of firm power purchase arrangement with Chugach following expiration of the Agreement on December 31, 2014. MEA assured Chugach that it intends to continue to purchase power from Chugach in accordance with the Agreement through December 31, 2014.

**Item 6. Exhibits**

Exhibits:

Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Signatures*

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

***CHUGACH ELECTRIC ASSOCIATION, INC.***

**By:** /s/ Evan J. Griffith

*Evan J. Griffith*  
*Chief Executive Officer*

**Date:** November 12, 2004

**By:** /s/ Michael R. Cunningham

*Michael R. Cunningham*  
*Chief Financial Officer*

**Date:** November 12, 2004

## ***EXHIBITS***

Listed below are the exhibits, which are filed as part of this Report:

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002