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December 1, 2003

Mr. Michael Cunningham, Chief Financial Officer  
Chugach Electric Association, Inc.  
5601 Minnesota Drive  
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Dear Mike:

As you know, in May 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150). SFAS 150 is effective for most public companies during the first interim period after June 15, 2003. For purposes of this statement, however, Chugach Electric Association, Inc. (Chugach or the Association) is defined as a nonpublic entity because it does not offer equity securities in the public market (refer to section D-1), therefore Chugach's effective date is for interim periods beginning after December 15, 2003.

SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. Certain items that were previously classified as equity may now be required to be classified as liabilities. SFAS 150 requires the following instruments to be classified as liabilities:

- A financial instrument issued in the form of shares that is mandatorily redeemable.
- A financial instrument, other than an outstanding share, that embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and requires the issuer to settle the obligation by transferring assets.
- A financial instrument that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares, subject to certain conditions.

SFAS 150 also addresses specifically the issue of stock to be redeemed upon the death of the holder (section A6) and states that "The death of the holder is an event that is certain to occur. Therefore, the stock is classified as a liability."

#### **Chugach's Capital Credit Rotation Policies**

Chugach's bylaws provide for the following with respect to return of patronage capital to members (excerpted from Article VII):

In order to induce patronage and to assure that the Association will operate on a nonprofit basis, the Association is obliged to account on a patronage basis to all its patrons, members and non-members alike, for all amounts received from the furnishing of electric energy in excess of operating costs and expenses properly chargeable against the furnishing of electric





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energy. . . The Association is obligated to pay all such amounts in excess of operating costs and expenses to the patrons by credits to a capital account for each patron. . . All such amounts credited to the capital account of any patron shall have the same status as though they had been paid to the patron in cash in pursuance of a legal obligation to do so, and the patron had then furnished the Association corresponding amounts for capital. In the event of dissolution or liquidation of the Association, after all outstanding indebtedness of the Association shall have been paid, outstanding capital credits shall be retired without priority on a pro rata basis before any payments are made on account of property rights of members. If, at any time prior to dissolution or liquidation, the board of directors shall determine that the financial condition of the Association will not be impaired thereby, the capital then credited to patrons' accounts may be retired in full or in part, according to policies adopted by the board. . . Notwithstanding any other provisions of these bylaws, the board of directors, at its discretion, shall have the power at any time, upon the death of any patron, if the legal representative of his estate shall request in writing that the capital credited to any such patron be retired prior to the time such capital would otherwise be retired under the provisions of these bylaws, to retire capital credited to any such patron immediately upon such terms and conditions as the board of directors, acting under policies of general application, and the legal representative of such patron's estate shall agree upon, provided, however, that the financial condition of the Association will not be impaired thereby.

Approval of actual capital credit retirements, excluding retirement of estate payments, is at the discretion of Chugach's Board of Directors, typically reviewed annually. Limitations on capital credit retirements are also included in its bond indenture, which prohibits Chugach from making any distribution of patronage capital to customers if an event of default exists. Otherwise, Chugach is permitted to 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. With regard to estate payments, management has historically retired estate payments upon request, subject to the provisions of the indenture.

### **Accounting Issues**

The following questions arise in the context of SFAS 150:

- At what point does an unconditional obligation arise that would trigger recording a liability in the financial statements?
- Once a triggering event has occurred, in what amount would an obligation be recorded?

### **Conclusion**

The return of capital to deceased member's estates is considered to be conditional and the related capital therefore would not be recorded as a liability in the financial statements. Specific conditions include provisions that the member's estate request return of capital in writing, the bond indenture




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and Chugach's financial condition. Recent events, which led to discontinuance of patronage capital returns, support the conclusion that such return of capital is truly conditional. With regard to retirements other than to estates, such retirement appears to also be conditional due to the aforementioned specific conditions and the requirement for Board approval. Therefore, KPMG recommends the following:

- Estate payments should be recorded as a liability when requested by a member (assuming that such retirements do not violate the provisions of the indenture) in the amount of the member's capital credit account balance; and
- Other capital credits should be recorded as a liability when approved by the Board at the amount so approved for retirement.

Very truly yours,

KPMG LLP



Kathleen Porterfield  
Managing Partner

December 4, 2003

Kathy Porterfield  
KPMG  
701 W. 8<sup>th</sup> Ave., Suite 600  
Anchorage, AK 99501

Re: FAS 150

Dear Kathy:

This is in response to your request for a legal opinion concerning Article VII, Section 1 of Chugach Electric Association, Inc.'s bylaws. It is our opinion that the retirement of capital credits, as provided under Article VII, Section 1 of Chugach's bylaws, is discretionary with the board of directors. Capital credits, including those retired to the estates of deceased patrons, may only be retired based on a decision of the board or management that a specific retirement will not adversely impact the Association's financial condition. Except in the case of dissolution or liquidation of the Association, there is no conditional or unconditional obligation on the part of Chugach to retire capital credits.

Sincerely,



Carol Johnson  
General Counsel

cc: Don Edwards  
Mike Cunningham