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SEMIANNUAL REPORT TO THE CONGRESS

FY 2013 – FIRST HALF

OFFICE OF THE INSPECTOR GENERAL

DENALI COMMISSION

FINAL REPORT
FOR PUBLIC RELEASE

DENALI COMMISSION OFFICE OF INSPECTOR GENERAL

SEMIANNUAL REPORT
FOR
FIRST HALF OF FY 2013

Section 5 of the Inspector General Act requires the Office of Inspector General (OIG) at the Denali Commission (Denali) to prepare a semiannual report. The discussion below constitutes this report for the first half of FY 2013.

Denali's OIG remains as the smallest of the 73 OIGs that Congress has established at federal agencies, both in terms of our budget and our personnel (only 1 FTE, that is, the inspector general himself).

Compounding this limitation has been OIG's need to implement the OMB directives for all federal agencies — large and small — to reduce their travel costs,¹ economize in training,² reduce their office space,³ and cut their budgets by 5% for the “sequestration.”⁴ While Denali OIG did all this faithfully, the effect of the unpaid time off (3 weeks) was to reduce our little OIG function to even less than 1 FTE.

SCOPE LIMITATION FOR THIS REPORT

The statutory “prime directive” for the inspector general function is its independence. Strict professional standards prescribe the independence that is a prerequisite for our public reporting of inspections and other reviews under the Inspector General Act.⁵

Various players in the federal system have brought some matters to OIG and asked us to report our conclusions and analyses. However, during the past two weeks, OIG learned of an impairment to our independence for reporting upon the requested matters. Due to the timing of this subsequent event, we were unable to apply procedures that might have mitigated the

¹ See OMB Memorandum M-12-12 (May 11, 2012), sec. 1.

² See OMB Memorandum M-11-35 (Sept. 21, 2011).

³ See OMB Management Procedures Memorandum 2013-02 (March 14, 2013).

⁴ See OMB Memorandum M-13-06 (March 1, 2013); OMB Memorandum M-13-11 (April 4, 2013).

⁵ See CIGIE, *Quality Standards for Federal Offices of Inspector General*, sec. II(C); CIGIE, *Quality Standards for Inspection and Evaluation*, pages 2-6; GAO, *Government Auditing Standards*, sections 3.12 to 3.30; GAO, *Financial Audit Manual*, sections 650.15 to 650.18.

impairment. We cannot publicly report upon the matters until we receive authoritative guidance on how to cure the impairment.

SUMMARY OF SIGNIFICANT INSPECTION

Section 5(a) of the Inspector General Act directs that this semiannual report include the following:

a description of significant problems, abuses, and deficiencies relating to the administration of programs and operations of such establishment disclosed by such activities during the reporting period . . .

A state economist reported last year that Alaska ranks first in the nation in the per capita receipt of federal grants.⁶ Congress has over the years sent around \$1 billion of these grants through the Denali Commission. One of these grants was # 331-07 to the State of Alaska (State).

Denali awarded its grant # 331-07 to the State for \$10.8 million to build powerhouses and tank farms in 17 locations around Alaska. This included the tank farm for the City of Gustavus (City) that was the subject of a significant inspection which OIG completed in April 2013.

Denali's federal co-chair, counsel, and program manager received complaints about a subaward that the State made to the City for its new tank farm. All three referred the complaints to OIG and requested that we perform an inspection of the project. We opened our inspection for the purpose of assessing the project's compliance with laws, policies, and agreements.⁷

Our full inspection report on this matter appears at www.oig.denali.gov. Prior to publication, four drafts were reviewed with the federal co-chair over the course of three months. His formal response is attached to the final inspection report on OIG's website.

Overview

At first glance, the inspected project begs the question as to how many agencies — and how many lawyers — it takes to install five fuel tanks in a hamlet of less than 500 people. Three levels of government and the local fuel business all lawyered up.

Unfortunately, the City failed to pursue the appeal process that is prescribed by both state regulations and the terms of the subaward. The City might have resolved the matter long ago had it challenged the disputed conditions of the subaward through such an appeal. The resulting

⁶ See Neal Fried, "Federal Spending in Alaska," *Alaska Economic Trends* (Feb. 2012), pages 4-8, available online at <http://labor.state.ak.us/trends/feb12.pdf>

⁷ OIG's inspection of this matter was conducted pursuant to the Inspector General Act (sections 4a and 6a), OMB Form 424D (par. 2), the CIGIE inspection standards, and the City's grant agreement with the State (App. D sec. 3).

decisions (not OIG reports) would have offered authoritative closure on the legality of the requirements imposed by the State.

Regulations issued by the State's energy agency detail a multi-level appeal process that can progress from a hearing officer to a board of directors with high-level members.⁸ The City agreed to such a process in the disputes clause of its grant agreement with the State.⁹

After the State's own appeal procedures have been exhausted, the jurisdiction for a further binding review lies in the Alaska Court System — not the Denali Commission or its OIG.¹⁰ And the Alaska Supreme Court has previously affirmed the legitimacy of the State's appeal process in a decision involving the same agency's application of Denali funding.¹¹

Context of the funded project

The tank farm is one of the four facilities (total > \$7 million) that Denali has funded in Gustavus. They function together as an integrated utility system and would appear to be a success story for the small town (pop. ≈ 460). All four facilities were successfully completed, and the state energy agency reports that the cost for electricity has now been cut in half.¹²

The hydroelectric powerhouse provides the lowest cost electricity. Through a fiber-optic cable, it switches on the diesel powerhouse as needed for a supplement. The diesel powerhouse uses the fuel trucked from the tank farm. The tank farm gets its fuel from a 1,700-foot pipeline that runs down to the dock where the delivery barges unload into a "marine header."

The barge company was reticent to continue the risky practice of running a long hose down the road during deliveries. The new ability to safely unload into a pipeline saves Gustavus from the impending spectre of costly fuel flights.

All seem to agree that the tank farm has been successfully installed and is doing its job. One former mayor described the new tank farm as follows at a meeting of the Denali Commission:

⁸ See 3 AAC 108.910 to 3 AAC 108.920. The board of directors for the Alaska Energy Authority includes the state commerce commissioner, the state revenue commissioner, and five public members. See www.akenergyauthority.org/directors.html (accessed April 5, 2013).

⁹ See Alaska Energy Authority subaward # 340240, Appendix A, sec. 14.

¹⁰ See AS 22.10.020(d); Alaska Rule of Appellate Procedure 601; Alaska Court System Form AP-101, *Notice of Appeal (from Administrative Agency to Superior Court)*.

¹¹ See *Powercorp Alaska v. State, Alaska Industrial Development & Export Authority, Alaska Energy Authority*, 171 P.3d 159 (Alaska 2007). See also *Powercorp Alaska v. Alaska Energy Authority*, 290 P.3d 1173 (Alaska 2012).

¹² The project manager at the Alaska Energy Authority informed OIG that the cost of Gustavus' electricity dropped from 68 cents per kilowatt-hour to 28 cents per kilowatt-hour.

*[W]e have a state-of-the-art tank farm sitting there right now. It's wonderful. It is absolutely wonderful. . .*¹³

Gustavus' mayor described this speaker as "*the former Mayor and she's really the institutional history of the official community.*"¹⁴ We also learned from state records that she is the 40% owner and vice president of a local construction company that was paid \$84,125 by the State for work on the tank farm.¹⁵

Gustavus is an exception to the typical context for a Denali-funded project. Denali traditionally addresses the third world conditions of the "other Alaska"¹⁶ — the impoverished "bush" where the cruise ships don't take their visitors from the Lower 48. But little Gustavus is no poverty pocket, with state statistics reporting only 24 residents as "persons in poverty."¹⁷

Gustavus lies along the Inside Passage frequented by cruise ships. The town's dominant employer is the National Park Service, which administers nearby Glacier Bay as the scenic icon of Alaska tourism with the park's 16 tidewater glaciers. The State's 2009 description of the tank farm project asserts that there are "*approximately 60,000 tourists visiting or transiting the gateway community of Gustavus annually.*"¹⁸

Instead of widespread poverty, Gustavus has cruise ship tourism, sport fishing, seasonal second homes, and a golf course advertising that "*it can truly classify as one of the world's most magnificent courses*" and "*will challenge even the best qualified golfers.*"¹⁹

History

Gustavus incorporated itself as a city less than 10 years ago — and is still learning to be a city. Its city council consists of unpaid volunteers, who annually pick an unpaid mayor. The city has never had an audit, and its strategic plan states:

The Gustavus City Council members and Mayor remind their constituents regularly that the city plans to keep the least amount of government necessary for

¹³ See page 129 of the transcript of the Denali Commission's public meeting held in Juneau, Alaska on Feb. 23, 2012.

¹⁴ See page 40 of the transcript of the "Denali Commission — Listening Session" held in Juneau, Alaska on April 1, 2011.

¹⁵ The minutes for the July 20, 2009 meeting of the Gustavus City Council indicate her disclosure that this company "had received part of the contract bid on the dirt work" and her recusal from voting on the tank farm's lease.

¹⁶ The scenario is analogous to the 1960s poverty of the Lower 48 that Michael Harrington wrote about in his classic, *The Other America* (Macmillan 1971).

¹⁷ See <http://commerce.alaska.gov/dca/commdb> (accessed Dec. 22, 2012).

¹⁸ See *Business Operating Plan of the Gustavus Bulk Fuel Facility*, Aug. 10, 2009, page 3.

¹⁹ See www.gustavus.com/activities/golf.html (accessed Dec. 22, 2012).

*the job and to spend its funding wisely, as though it had been raised by a bake sale.*²⁰

The showdown in this idyllic setting started with a Faustian bargain by the city council's members of the moment. They voted to award a 100-year lease²¹ of the tank farm to a local fuel business, with a rent of only \$1 per year for at least the first 50 years. A year later, some council members had "buyer's remorse," asserting that the State made them do it.

This issue of the City's long-term lease is the core of the conflict that has now extended for longer than it took to construct the facility itself. While the lawyers were debating who had the responsibility to do what for whom, the engineers simply went ahead and completed the facility.

The U.S. Court of Claims has made it clear that federal agencies are not a party to the subawards contracts, and leases that their grantees make with others.²² But the City argued that Denali had a responsibility to intervene, asserting that Denali's longstanding "private enterprise policy" was a root cause of the dispute.

One mayor even argued that Denali should forcibly lock the tenant out to settle the matter.²³ In past centuries, federal officials in coastal Alaska were both less common and more empowered to physically mete out such summary justice.²⁴ But those days are long past, and the federal employee correctly understood that she did not have the authority to act as the City's enforcer in effectuating the self-help of a lockout.

OIG took a careful look at the controversial policy's terms and origins, which we published as an 8-page analysis in a prior *Semiannual Report to Congress*. We concluded that "*while Denali's private enterprise policy no doubt seemed like a good idea at the time (a decade ago), the policy has now outlived its usefulness.*"²⁵ And the federal co-chair ultimately suspended Denali's application of the policy to its grants.

²⁰ See *Gustavus Strategic Plan 2005*, page 17, at www.commerce.state.ak.us/dca/plans/Gustavus-SAP-2005.pdf.

²¹ Technically a 50-year lease with a right for the tenant to renew for another 50 years.

²² See *Garreaux v. United States*, 77 Fed.Cl. 726, 731-733 (2007); *D.R. Smalley & Sons v. United States*, 372 F.2d 505, 597-598 (Ct.Cl. 1967); *Eubanks v. United States*, 25 Cl.Ct. 131, 137-138 (1992).

²³ Email dated March 26, 2011 from Gustavus mayor to Denali Commission.

²⁴ See Letter from the Secretary of the Treasury, Senate Ex. Doc. 37, 44th Congress, 1st Session (March 1876). See also Truman R. Strobridge and Dennis L. Noble, *Alaska and the U.S. Revenue Cutter Service 1867-1915* (Annapolis, Md.: Naval Institute Press, 1999).

²⁵ See Denali OIG, *Semiannual Report to the Congress* (Nov. 2011), pages 9-16, at www.oig.denali.gov.

The questioned policy originated as a response to constituent casework by a Member of Congress back in 2000 (that is, shortly after Denali's creation). The Member sought to protect an existing merchant from the competition of a tribal proposal to operate a new tank farm.²⁶

Federal courts have cautioned that local governments can face antitrust liability when they promote monopolies.²⁷ However, this risk was apparently not recognized as Denali responded to the Member's concern. Ideally, both the Member and Denali would have sought the proactive guidance of the Federal Trade Commission in the crafting of Denali's policy.²⁸

A Gustavus official expressed his assumption that *"the city had no responsibility in the construction of the tank farm other [than] to accept it when it was complete."*²⁹ A sensitive issue is, of course, the possibility that the City has now found its "free" tank farm to be a poor fit and no longer wants it. This sometimes happens with experimental programs like Denali, and GSA can be enlisted to move the white elephant ("excess property") to a better home — if that's the unspoken reality at this point.

The 100-year term of the "lease"

The duration of the City's lease is indeed a full century if the tenant chooses to renew for the second 50-year term. Since it would obviously outlive all current City leaders, OIG understands the possible perception that the distant "Crown" is sanctioning a sentence "for the term of their natural lives."

However, despite the protests of the City's leaders, a lease for 100 years is legally permissible in Alaska — and many other places. Unless state law limits the length of a lease, the general rule is that *"[a] landlord-tenant relationship may be created to endure for any fixed or computable period of time."*³⁰

Congress has specifically authorized many tribal entities to lease their land for 99 years.³¹ And the Alaska Supreme Court has found a school district's 55-year lease of local land for a dollar a

²⁶ See Denali OIG, *Semiannual Report to the Congress* (Nov. 2011), page 9, at www.oig.denali.gov.

²⁷ See *Federal Trade Commission v. Phoebe Putney Health System*, 133 S.Ct. 1003 (2013); *Community Communications Company v. City of Boulder, Colorado*, 102 S.Ct. 835 (1982); *Lancaster Community Hospital v. Antelope Valley Hospital District*, 940 F.2d 397 (9th Cir. 1991).

²⁸ Our inspection report quotes strong rhetoric in which recent city officials are implicitly questioning whether their predecessors' choices were consistent with federal antitrust laws. They openly assert that their local government has effected a long-term "monopoly" and obstructed new entrants to the market. See Denali OIG's inspection report for Gustavus, Alaska (April 2013), pages 17-18, at www.oig.denali.gov.

²⁹ Email dated Jan. 17, 2013 from city council member.

³⁰ See *Restatement (Second) of Property*, Landlord & Tenant sec. 1.4 (1977), which lists state laws around the country that restrict the time period of leases.

³¹ See 25 USC 415 and Senate Report 110-480 at page 2.

year to not be “unconscionable.” The court noted four other communities in the district that had the same type of 55-year lease for the land underlying the local schoolhouse.³²

Missed possibilities and prerequisites

The City’s plight is initially not one that draws sympathy. The surrounding circumstances, as detailed in our inspection report, show that this was hardly an irreversible “impulse purchase.” Our report reviews various missed opportunities that the City had for a legal escape from its 100-year lease.

OIG nevertheless concluded that the 100-year lease is void and unenforceable — for reasons other than the general distaste that Gustavus’ leaders of the moment seem to have for it.

State and local laws prescribe specific procedures for such an arrangement. And the City did not follow those procedures. Case law around the country indicates that the attempted agreement is invalid when a city skips the required prerequisites that protect the public.³³

Status as a procurement for services

The full title for the parties’ agreement is “*Bulk Fuel Storage and Handling Agreement and Facility Lease*.” This strongly suggests that the tenant is agreeing to perform a beneficial activity using the City’s fixture (the “facility”), rather than simply occupying a piece of real estate. And, unless the City is agreeing to give away its new asset (unlikely), the symbolic “rent” of only a dollar a year further indicates that the City is obtaining something else for the public in return.

The Gustavus Municipal Code requires a competitive process for the procurement of services over \$5,000.³⁴ To the extent that the City was contracting for 50 years of operator services for its new tank farm, the City certainly conveyed more than \$5,000 in value to the vendor. Though the city council had a series of discussions before approving the lease, OIG found no evidence in the minutes of a competitive award.

Status as a “public franchise”

The disputants have in practice labeled the City’s long-term agreement with the fuel company as a “lease.” However, it is the substance of the transaction — rather than the parties’ shorthand — that determines the required legal formalities.³⁵ Based upon case law from around the country,³⁶

³² See *Askinuk Corporation v. Lower Yukon School District*, 214 P.3d 259, 268 (Alaska 2009).

³³ Detailed at page 23 of Denali OIG’s inspection report for Gustavus, Alaska (April 2013) at www.oig.denali.gov.

³⁴ See Gustavus Municipal Code sec. 4.17.020(a).

³⁵ See *Shaw v. City of Asheville*, 152 S.E.2d 139, 144 (N.C. 1967) (“The fact that this agreement is denominated by the parties a ‘Lease-License Agreement’ is not controlling. Its nature, not its title, determines the power of the city to enter into it.”); *MAC Amusement Company v. State*, 633 P.2d 68, 71 (Wash. 1981) (“In contrast to a leasehold, a monopoly right when conferred by a municipality is usually a franchise.”).

OIG concluded that the document functioned in substance as the City's grant of a 100-year public "franchise."

Both Alaska law and the Gustavus Municipal Code require that a city follow the formal process for adopting an "ordinance" when granting a franchise.³⁷ However, the city council's minutes reflect that it approved the 100-year "lease" with only a "motion."³⁸

Alaska law provides even stronger protection for the public when the grant of a franchise exceeds five years.³⁹ The statute requires either a competitive process or the approval of local voters. In fact, the Gustavus Municipal Code seems to require the same if the City leases its property to a business corporation (instead of a nonprofit) for less than fair market value in order to provide "a necessary public service."⁴⁰

But, again, OIG saw no evidence in the minutes of a competitive award. Nor did we find any evidence that the agreement had been submitted to local voters for their approval.

Due to the missing procedural prerequisites, we found the 100-year arrangement — whether labeled as a franchise, lease, or service contract — to be invalid for the purposes of our inspection of Denali's grant.

Remedies available at this point

However, we are quick to recognize that our opinion is just our opinion. The "primary jurisdiction" to authoritatively decide the lease's status now lies with the Alaska Court System in the context of an action to quiet title,⁴¹ an action to decide the tenancy,⁴² a suit to set aside the franchise,⁴³ a declaratory judgment to decide "rights and legal relations,"⁴⁴ or a suit alleging one of the business interference torts recognized by state law.⁴⁵ And that is the setting that offers the

³⁶ Detailed at pages 23-24 of Denali OIG's inspection report for Gustavus, Alaska (April 2013) at www.oig.denali.gov.

³⁷ See AS 29.25.010(a)(5); Gustavus Municipal Code sec. 1.02.020(a)(9).

³⁸ Minutes for the July 16, 2009 meeting of the Gustavus City Council.

³⁹ See AS 29.35.060(b).

⁴⁰ See Gustavus Municipal Code sec. 10.06.05.

⁴¹ See AS 09.45.010.

⁴² See AS 09.45.070, AS 09.45.630.

⁴³ See *Franchises from Public Entities*, 36 Am.Jur.2d sec. 17. But see Alaska Rule of Civil Procedure 91(a) (Alaska does not use the remedy of quo warranto.).

⁴⁴ See AS 22.10.020(g); *McBirney & Associates v. State of Alaska*, 753 P.2d 1132 (Alaska 1988).

⁴⁵ See *K & K Recycling v. Alaska Gold Co.*, 80 P.3d 702, 717 (Alaska 2003); *Alaska Marine Pilots v. Hendsch*, 950 P.2d 98 (Alaska 1997).

final answer as to whether there are equitable (fairness) grounds for legally requiring modification, rescission, or disregard of the agreement.

OIG recognizes that the tenant is currently in possession of the facility with both an inventory of fuel and what it considers to be a long-term lease that promises “*quiet and peaceful enjoyment of the Premises.*” In hopes of defusing this escalating legal dispute, OIG arranged for six months of mediation from the respected Federal Mediation and Conciliation Service.⁴⁶ While the mediator assisted OIG greatly in clarifying the issues, the City and its tenant were unfortunately unable to reach a voluntary resolution of their lease dispute.

MIKE MARSH, INSPECTOR GENERAL
DENALI COMMISSION

⁴⁶ See www.fmcs.gov. This is an appropriate use of OIG resources under Inspector General Act sections 4(a)(4), 6(a)(9), and 8G(g)(2).