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INSPECTOR GENERAL

April 15, 2013

To: Joel Neimeyer, Federal Co-Chair

FINAL REPORT

FOR PUBLIC RELEASE

From: Mike Marsh, CPA, MPA, CFE, Esq., Inspector General

Subject: Inspection of state subaward # 340240 to City of Gustavus for tank farm

ABSTRACT: Interest group repeatedly complained of unfair treatment toward its member (City) by grantee (State) that made subaward to build local tank farm. Inspector general opened an inspection of the project's compliance with applicable laws. Inspector general found that (1) controversial 100-year lease was invalid from the start due to legal irregularities, (2) City has unwarranted fear that it will not have clear title to the underlying land and attached fixture, (3) this use of agency's appropriation presents a significant legal issue that requires a GAO ruling, and (4) City's antitrust concerns may warrant further study by the Federal Trade Commission.

OVERVIEW

A state economist reported last year that Alaska ranks first in the nation in the per capita receipt of federal grants.¹ Congress has over the years sent around \$1 billion of these grants through the Denali Commission.

The Denali Commission (Denali) is an independent federal agency that Congress created in 1998 to build public facilities in "bush" Alaska.²

This inspection by the Office of Inspector General (OIG) concerns a tank farm³ that Denali funded in the small town of Gustavus (pop. ≈ 460).



EXHIBIT 1
LOCATION OF GUSTAVUS, ALASKA (POP. ≈ 460)

¹ 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>.

² See Denali Commission Act, P.L. 105-277, 42 USC 3121 note.

³ The tank farm is a set of five fuel storage tanks that support both the diesel powerhouse and retail sales.

PHOTO COURTESY OF STATE OF ALASKA DNR DMLW



EXHIBIT 2 — NEW TANK FARM AT GUSTAVUS, ALASKA

As detailed below, OIG is responding to a complaint that presents various legal issues concerning Denali’s relationship to its world.

THE PROJECT IN DISPUTE

The inspected tank farm is one of the four facilities (total > \$7 million) that Denali has funded in Gustavus since the city first incorporated back in 2004 (see EXHIBIT 3).

The four facilities function together as an integrated utility system. 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.

EXHIBIT 3 DENALI GRANTS FOR GUSTAVUS, ALASKA (Pop. ≈ 460)	
Hydroelectric powerhouse	\$2,800,000
Diesel powerhouse	\$1,679,504
Dock	\$907,700
Tank farm	\$1,973,370
<i>Total</i>	\$7,360,574

The tank farm (see EXHIBIT 2) gets its fuel from a 1,700-foot pipeline that runs under a roadside right-of-way, a causeway, and the public ferry dock. At the end of the public dock, delivery barges unload fuel into the pipeline’s “marine header.” The pipeline is actually a set of three individual pipes (each 3 inches in diameter) that accommodate the different types of fuel.

Like the metaphor of an iceberg, a key feature of the facility is the long pipeline that lies within the right-of-way, causeway, and dock — not just the set of small tanks visible at the end of the line. 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 saves Gustavus from the impending spectre of costly fuel flights.

In other words, the tank farm with its pipeage is a form of ship-to-shore distribution analogous to the wiring that connects bush residents with their local “earth station” for phone, Internet, and cable television. Or the buried pipes that commonly transmit natural gas in the neighborhoods of the Lower 48.

Indeed, Denali’s grant that funded the tank farm explicitly states that, “[a]s a precondition of construction funding, a project must demonstrate that it is part of a sustainable electric utility or bulk fuel system.”⁴

But the centerpiece of Gustavus’ four-component system is the hydroelectric powerhouse — not the tank farm. Though Denali contributed \$2.8 million toward the hydroelectric powerhouse, its total cost of \$8.8 million was spread among a variety of funders.

Nevertheless, the Denali-funded tank farm is more than a “footnote” to the people who live in Gustavus. The operations manual, required by the Coast Guard, notes this tank farm’s important role in the community:

*The Facility provides storage for virtually all of the unleaded gasoline, aviation gasoline, #1 diesel, and #2 diesel fuel imported into the community for power generation, public building heating, retail sales and marine fueling. . .*⁵

The small tank farm thus doubles as support for both the local electric company (a state-regulated utility) and traditional retail sales at the local gas station and airport (an unregulated activity).

COMMUNITY CONTEXT OF THE FUNDED FACILITY

Denali addresses the third world conditions of the “other Alaska”⁶ — the impoverished “bush” where the cruise ships don’t take their visitors from the Lower 48. We have previously⁷ described the typical scenario as follows:

The remote settlements served by the Denali Commission are far from the roads, the power grid, and the state’s scenic railroad. The electricity is sometimes, the fuel tanks leak, the food rots, the garbage sits, and the homes wash away. The water is undrinkable, a shower is a treat, and the bathroom is a bucket. The teeth fall out and people get diseases that we assumed were history.

⁴ Denali award # 331-07 to the State of Alaska, award condition 12.

⁵ See *Marine Transfer Operations Manual* (May 2011), page 1.

⁶ 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).

⁷ See “Inspector General’s Perspective on Management and Performance Challenges Facing the Denali Commission” at page 59 of the *Denali Commission Agency Financial Report (AFR) Fiscal Year 2012*, available online at www.denali.gov.

In short, the third world conditions of the “other Alaska” are still out there in the land beyond the tourism commercials and the travelogues.

But tiny Gustavus is an exception to this traditional context for a Denali-funded project.

Statistics published by the State of Alaska (the State) indicate that the median family income in Gustavus is around \$52,000 and that only 24 residents are “persons in poverty.”⁸

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.

In fact, Gustavus is a geographic “notch” that was carved out of the national park to accommodate homesteaders who were there first. The State’s 2009 description for the inspected project asserts that there are “approximately 60,000 tourists visiting or transiting the gateway community of Gustavus annually.”⁹ And the State’s 2010 description for the project notes that “[s]ummer fuel consumption is driven by tourism, and commercial and sport fishing.”¹⁰

Around 40% of Gustavus homes are seasonal ones, given its popularity as a weekend and summer escape from urban Alaska. The State indicates that “[t]he number of residents during the summer approximately doubles.”¹¹

Gustavus even boasts one of the few golf courses found in the rainy Southeast Panhandle that lies between Vancouver and Anchorage. The course advertises that “it can truly classify as one of the world’s most magnificent courses” and “will challenge even the best qualified golfers.”¹²

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 the job and to spend its funding wisely, as though it had been raised by a bake sale.*¹³

⁸ See <http://commerce.alaska.gov/dca/comddb> (accessed Dec. 22, 2012).

⁹ See *Business Operating Plan of the Gustavus Bulk Fuel Facility*, Aug. 10, 2009, page 3.

¹⁰ See Alaska Energy Authority, “Statement of Conformance with Denali Commission Policies” (Aug. 20, 2010).

¹¹ See <http://commerce.alaska.gov/dca/comddb> (accessed Dec. 22, 2012).

¹² See www.gustavus.com/activities/golf.html (accessed Dec. 22, 2012).

¹³ See *Gustavus Strategic Plan 2005*, page 17, at www.commerce.state.ak.us/dca/plans/Gustavus-SAP-2005.pdf.

Nevertheless, Denali has made a sizeable investment of over \$7 million in Gustavus during the city's short lifespan.

Since the federal government is itself the largest employer in the state,¹⁴ there is a further issue as to the degree that Congress should pay for the local impacts — past and present — of federal facilities that dominate adjacent communities. Military sites, environmental remediation, and popular national parks all present this situation. Such non-Denali impacts should be addressed through the appropriations of other federal agencies — behemoths that dwarf the Denali Commission in the federal system.

The role of Denali funding in such a setting raises still other policy questions that we have previously discussed in our *Semiannual Report to the Congress* required under the Inspector General Act.¹⁵

THE COMPLAINT

The collection of four Denali-funded facilities would appear to be a success story for tiny Gustavus. All four facilities were successfully completed,¹⁶ and the state energy agency reports that the consumer cost for electricity has now been cut in half.¹⁷

In fact, one former mayor described the new tank farm as follows at a public meeting of the Denali Commission:

*[W]e have a state-of-the-art tank farm sitting there right now. It's wonderful. It is absolutely wonderful. . .*¹⁸

Nevertheless, Denali's agency head referred this matter to OIG based upon a long series of complaints from the Alaska Municipal League (AML) that the City of Gustavus (one of its members) was being treated unfairly.¹⁹ AML also referred the matter to the Alaska governor's

¹⁴ 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>.

¹⁵ See Denali OIG, *Semiannual Report to the Congress* (Nov. 2011), pages 9-17, at www.oig.denali.gov.

¹⁶ Denali's online public database reports the following for the dock: "*Primary project construction completed summer, 2012. Additional minor work items via construction contract change order pending in order to provide needed improvements that were not originally part of contract drawings.*" See www.denali.gov.

¹⁷ 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.

¹⁸ See page 129 of the transcript of the Denali Commission's public meeting held in Juneau, Alaska on Feb. 23, 2012.

¹⁹ AML persistently pursued its complaint in a series of 6 emails to Denali employees over a period of 15 months. The specific dates of these emails are: Feb. 17, 2011; March 22, 2011; March 29, 2011; Aug. 5, 2011; Feb. 6, 2012; April 4, 2012.

A transcript also shows that AML discussed the complaint during a public meeting of the Denali Commission held in Juneau on February 23, 2012. Minutes for the September 18, 2012 public meeting show further discussion by AML in the context of the "private enterprise policy."

office in Washington, D.C.²⁰ And, at AML's urging, two Members of Congress have pursued this matter in the context of their constituent casework.²¹

AML's aggressive pursuit of this complaint is understandable given the commitment that its website²² indicates that it undertakes for its members. The website describes it as a "statewide organization of 140 cities, boroughs, and unified municipalities, representing over 98 percent of Alaska's municipalities." One stated purpose is to "[r]epresent the unified voice of Alaska's local governments to successfully influence state and federal decision making."

AML's concern about members like Gustavus is even more understandable given the critical subject matter of the grant. About 60 small cities are among the beneficiaries of Denali grants to the State for their powerhouses and tank farms. In fact, the same Denali grant²³ used at Gustavus was also used by the State for powerhouses or tank farms in nine other cities that are members of AML.

AML further offers investment and insurance pools through its associated nonprofits, the AML Investment Pool²⁴ and the AML Joint Insurance Association.²⁵ These are valuable services to small cities, given the limited availability to them of affordable insurance and the encouragement for such investment pools by an Alaska statute.²⁶

²⁰ Email dated Feb. 17, 2011.

²¹ Rep. Don Young (Alaska) and Senator Lisa Murkowski (Alaska).

²² See www.akml.org (accessed March 11, 2013).

²³ Denali awarded its grant # 331-07 to the State for \$10.8 million to construct such projects in 17 locations around Alaska. Eight of these were to design or build powerhouses for AML members. Two were for fuel storage tanks for AML members, including the tank farm in Gustavus.

²⁴ See www.akml.org/Investment_Pool.html and www.amlip.org (accessed March 12, 2013). In Resolution 2008-14, the Gustavus city council transferred the City's investment account from Smith-Barney to the AML Investment Pool.

²⁵ See www.akml.org/Insurance_Pooling.html and www.amlja.org/coverage (accessed March 12, 2013).

²⁶ See AS 37.23.010.

EXHIBIT 4 EXCERPTS FROM SELECTED CITY COUNCIL AGENDAS DURING 2012
<p><i>July 12, 2012:</i></p> <p>"Executive Session: Discussion with City attorneys regarding legal strategy, the immediate knowledge of which would clearly have an adverse effect upon the finances of the City--City of Gustavus Bulk Fuel Facility."</p>
<p><i>August 9, 2012:</i></p> <p>"Executive Session A. Discussion with city attorney regarding legal strategy, the immediate knowledge of which would clearly have an adverse effect upon the finances of the city - City of Gustavus Bulk Fuel Facility"</p>
<p><i>November 8, 2012:</i></p> <p>"Executive Session A. Executive Session To Discuss The Matter Of The Gustavus Tank Farm And Its Potential Adverse Effect On The City's Finances."</p>
<p><i>December 13, 2012:</i></p> <p>"Executive Session A. Executive Session To Discuss Legal Strategy In Regards to Alaska Energy Authority"</p>

But, given Denali's substantial investment and successful outcome in Gustavus, OIG had some initial difficulty in understanding AML's complaint. OIG thus retained the respected Federal Mediation and Conciliation Service to help clarify the issues.²⁷ This assisted OIG greatly in crafting a meaningful response in our role under the Inspector General Act.²⁸

OIG also reviewed records of the dissatisfaction that city officials expressed at public meetings, as well in their correspondence with the Denali Commission over the past three years.²⁹ Agendas for the city council reflect that four executive sessions were called in the past year to discuss legal issues concerning the tank farm (see EXHIBIT 4).

OIG interprets the AML complaint as a concern over (1) the policy considerations of Denali's longstanding "private enterprise policy" and (2) the legal requirements attached to the subaward that Gustavus received from the state government.

The Inspector General Act encourages us to review agency policies,³⁰ and we responded with our conclusions concerning the "private enterprise policy" in our *Semiannual Report to the Congress* (Nov. 2011). We will not repeat that eight-page analysis here, other than to quote our conclusion 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.*"³¹

Ironically, this questioned policy originated as a response to constituent casework by a Member of Congress³² 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.³³

Federal courts have cautioned that local governments can face antitrust liability when they promote monopolies.³⁴ However, this risk was apparently not recognized as Denali responded to

²⁷ See www.fmcs.gov.

²⁸ OIG paid out of its budget for these mediation services from FMCS. This is an appropriate use of OIG resources under Inspector General Act sections 4(a)(4), 6(a)(9), and 8G(g)(2).

²⁹ The City's latest complaint letter to Denali was dated March 19, 2013. It concerned the diesel powerhouse that Denali had funded in Gustavus.

³⁰ See Inspector General Act sec. 4(a)(3).

³¹ See Denali OIG, *Semiannual Report to the Congress* (Nov. 2011), pages 9-16, at www.oig.denali.gov.

³² Senator Frank Murkowski (Alaska 1981-2002).

³³ See Denali OIG, *Semiannual Report to the Congress* (Nov. 2011), page 9, at www.oig.denali.gov.

³⁴ See *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). And the U.S. Supreme Court has recently reiterated its position on the potential antitrust liability of local governments. See *Federal Trade Commission v. Phoebe Putney Health System*, 133 S.Ct. 1003 (2013).

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.

The Inspector General Act also encourages OIG to inspect the agency's compliance with the laws that apply to its programs.³⁵ This report thus responds to this second aspect of AML's complaint, that is, the legal requirements applicable to Gustavus' grant.³⁶

But we are quick to recognize that our opinion on what the law requires is ultimately just our opinion. The "primary jurisdiction" to authoritatively decide legal issues, of course, always lies with a state judge, a federal judge, or the U.S. Comptroller General — depending upon who is complaining about whom over what.

UNUSUAL EFFORTS BY DENALI'S MANAGEMENT TO ADDRESS AML'S COMPLAINT

Denali's management made extensive efforts of its own to resolve AML's complaint.

Denali's agency head (himself a civil engineer) flew to Gustavus and attempted to personally mediate between the State (Denali's grantee) and the City (the State's subaward). After directly observing the very hostile relationship, Denali agreed to take over completion of the project from the State.

Denali then arranged for completion by another grantee (Foraker Group)³⁷ and another federal agency (the Army Corps of Engineers).³⁸ They went on to successfully complete the project on behalf of Denali.

Such a federal takeover of a State subaward is unusual. As a general rule, the federal government is simply not in "privity" with a grantee's subaward or contracting.³⁹ In this case, the substitution changed the City's status to that of a direct federal grantee.

But, despite this intervention, the complaints continued.

³⁵ See Inspector General Act sections 4(a)(1) and 6(a)(2).

³⁶ 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).

"Inspections" respond to very specific issues that are often complaint-driven. Inspections are narrower in scope and procedures than the classic "audit" of an entire grant program. See George F. Grob, "Inspections and Evaluations: Looking Back, and Forward Too," *Journal of Public Inquiry* (spring/summer 2004).

³⁷ Denali grant # 1275.

³⁸ Denali interagency transfer # RA-544.

³⁹ See *Garreaux v. United States*, 77 Fed.Cl. 726, 731-733 (2007); *D.R. Smalley & Sons v. United States*, 178 Ct.Cl. 593, 597-598 (Ct.Cl. 1967); *Eubanks v. United States*, 25 Cl.Ct. 131, 137-138 (1992).

Denali's agency head then convened a regional "listening session" in Juneau, Alaska to hear the concerns of that area's communities — including Gustavus.⁴⁰ The panel of Denali "listeners" consisted of three statewide leaders: (1) the agency head himself, (2) the head of the Alaska Municipal League (the complainant on behalf of Gustavus), and (3) the head of the Associated General Contractors of Alaska.

This "listening session" was transcribed by a court reporter and functioned in effect as a public appeal hearing for the City of Gustavus. Both the City's former and current mayor presented their case that the City had been treated unfairly by the State as Denali's grantee.⁴¹

The former mayor requested a "forensic audit" during her testimony:

*[M]y recommendation [is] to conduct a forensic audit of any program partner, entity or individual the Commission has directly passed funding to. Additionally, any funding that is attached one -- attached to one of those projects that pass through DCCED [the State commerce department] to a program partner, entity or individual should also be audited using a forensic auditor preferably with absolutely no connections in the state of Alaska. . . [emphasis added]*⁴²

Gustavus' mayor identified this speaker as "the former Mayor and she's really the institutional history of the official community."⁴³ We further note that, per state records, she is also 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.⁴⁴ The original quoted price from that company was \$44,150, but the State granted a 90% change order that increased the price to \$84,125 because the "contour and overburden required additional material."

Denali's frustrated agency head (and his counsel) understandably referred this escalating matter to OIG for inspection. But, as noted above, OIG had some initial difficulty in understanding the continuing complaint — given Denali's substantial investment and successful outcome (electricity costs cut in half).

OIG thus arranged for six months of mediation from the respected Federal Mediation and Conciliation Service to help clarify the issues, and to moot any that were simply based on poor

⁴⁰ This was actually one of five such sessions held around Alaska during FY 2011 to obtain public feedback on Denali's past and future performance.

⁴¹ See pages 32-36, 40-43 of the transcript of the "Denali Commission — Listening Session" held in Juneau, Alaska on April 1, 2011.

⁴² See pages 35-36 of the transcript of the "Denali Commission — Listening Session" held in Juneau, Alaska on April 1, 2011.

⁴³ See page 40 of the transcript of the "Denali Commission — Listening Session" held in Juneau, Alaska on April 1, 2011.

⁴⁴ 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.

communication.⁴⁵ While the mediator assisted OIG greatly in clarifying the issues, the City was unable to reach a final resolution of its concerns.

CONCLUSIONS

1. The City disregarded the appeal process provided by state law.

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.⁴⁶ Protests concerning the terms of such non-federal arrangements should thus be pursued under the grantee's own appeal processes.

This is a fundamental of federal grants that was disregarded here.

Regulations issued by the State's energy agency detail a multi-level appeal process that can progress from a hearing officer to the board of directors with its high-level members.⁴⁷ After the agency'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.⁴⁸

The City also agreed to such a process in the disputes clause of its grant agreement with the State:

*Any dispute arising under this Grant Agreement which is not disposed of by mutual agreement must be raised to the Executive Director and will be decided by the Executive Director or the Executive Director's designee consistent with 3 AAC 108.910. . . The decision of the Executive Director or Designee is final and conclusive.*⁴⁹

Unfortunately, the well-meaning intervention by Denali's agency head allowed the City of Gustavus to disregard the appeal process prescribed by the State's regulations and the terms of its subaward. Denali should be careful not to displace that process, since the resulting decisions (not OIG reports) offer authoritative closure on the legality of the subaward requirements imposed by the State.

⁴⁵ 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).

⁴⁶ 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).

⁴⁷ 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).

⁴⁸ 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)*.

⁴⁹ See Alaska Energy Authority subaward # 340240, Appendix A, sec. 14.

In other words, the City here might have resolved its complaints long ago had it challenged particular conditions of the subaward through the appeal process prescribed by state regulation.

Disappointed cities can also express concerns during the “public comments” portion of meetings of the board of directors of the state energy agency.⁵⁰ Again, this might have effected a more meaningful, and quicker, resolution than the complaints that were made at Denali’s own public meetings.

2. Denali’s well-meaning intervention had its negative impacts.

It is important to realize that Denali’s takeover of the State’s project was hardly a “win-win” resolution for all concerned. There were negative side effects that should be carefully considered.

To begin with, Denali’s intervention unintentionally undermined the legitimacy of the State’s appeal process. This seems unwarranted, given a decision by the Alaska Supreme Court that affirmed the process in an earlier protest from the same agency’s use of Denali funding:

*The hearing officer . . . —after a careful review of the law and evidence bearing on the specific claims [the vendor] advanced to support its challenge—issued a thorough, well-supported, and clearly explained decision rejecting [the vendor’s] challenge. The Energy Authority has adopted the recommended decision and, on appeal, [the vendor] has failed to make a persuasive showing of any significant legal or factual error in the agency’s decision. Accordingly, we affirm the hearing officer’s recommended decision, set out its full text in Appendix A, and rely on it to explain our reasons for rejecting the points [the vendor] raises here renewing its arguments before the agency.*⁵¹

After Denali substituted itself for the State, Denali had to arrange for completion by another grantee and another federal agency. This resulted in the obvious inefficiency of Congress sending money to one federal agency (Denali) for completion of a small project by another federal agency (Army Corps of Engineers).

The public might understandably ponder why Congress didn’t just send the funding directly to the Corps of Engineers in the first place — without Denali as a “middleman” or “wholesaler.” And, of course, this situation begs the question as to how many agencies it takes to install five fuel tanks in a hamlet of less than 500 people.

But a less abstract impact was the loss of work by a long-time contractor with considerable experience in constructing fuel facilities around the state. Alaska Mechanical Inc. had a \$150,000 task order to manage construction of the Gustavus tank farm. However, the State terminated this

⁵⁰ See, for example, the board meeting minutes for August 14, 2012 at www.akenergyauthority.org/boardmin.html.

⁵¹ 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).

task order when Denali took the project over and substituted its own choice of a construction manager from another grantee (Foraker Group).⁵²

The State's amendment to its task order states:

Due to the Denali Commission taking over management of the remainder of the project, Alaska Mechanical's services are no longer needed. We are therefore reducing the contract by the remaining balance of thirty four thousand dollars (\$34,000) and closing out the contract.

3. The City's fears concerning its title to the facility are unwarranted.

The City complains that it has never received clear title to its new tank farm. Denali's agency head disagrees and responds that Denali considers the City to now be the facility's owner.

Still, Denali can record a release⁵³ of its implied federal lien ("reversionary interest"⁵⁴) if the agency has no further intention, ability, or need to police the facility's use. Per the enabling act,⁵⁵ Denali can ask GSA to assist it with the mechanics of this filing.

The State of Alaska — who actually built much of the tank farm — also acknowledges the City as the facility's current owner. This position is consistent with the language of the State's subaward⁵⁶ and the "business plan."⁵⁷ It is also consistent with the notice of substantial completion and closeout letter that the State sent to the City.

OIG contacted the state office⁵⁸ that handles the transfer of state land to city governments. There had been two remaining prerequisites to the transfer to the City of Gustavus of the land underlying the new tank farm: (1) a land survey and (2) remediation of the old tank farm next door. The State indicates that both have now been satisfactorily accomplished, and the process to transfer the land's ownership to the City is proceeding as planned.

⁵² Denali grant # 1275.

⁵³ This release would be similar to the "termination statement" for a security interest under AS 45.29.513(c).

⁵⁴ See *City of Hydaburg v. Hydaburg Cooperative Association*, 858 P.2d 1131 (Alaska 1993). See also *In re Joliet-Will County Community Action Agency*, 847 F.2d 430 (7th Cir. 1988).

⁵⁵ Denali Commission Act sec. 305(a) provides that "[a]gencies may, upon request by the Commission, make services and personnel available to the Commission to carry out the duties of the Commission."

⁵⁶ See Alaska Energy Authority subaward # 340240, Appendix B1, sec. 7, and Appendix B2, sec. 3.

⁵⁷ See *Business Operating Plan of the Gustavus Bulk Fuel Facility*, Aug. 10, 2009, pages 2, 4, 8, 9.

⁵⁸ The State of Alaska, Dept. of Natural Resources, Division of Mining, Land and Water.

There is thus no reason to think that the City will not get fee simple title to the tank farm's land before the temporary land use permit expires in June 2013. The tank farm itself has the legal status of an attached "fixture."⁵⁹ Under basic property law, the fee simple title to land implicitly includes any fixtures present at the time of transfer.⁶⁰ The title to such improvements is said to "merge" with the title to the underlying land.⁶¹ Or, put it another way, transfer of the land from one state agency automatically includes any fixtures previously attached by another state agency.

A Gustavus official recently 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.*"⁶² But OIG disagrees with this assumption of dependency, given the City's responsibility for "site control" under its grant agreement with the State:

*If the grant Project involves the occupancy and use of real property, the Grantee assures that it has the legal right to occupy and use such real property for the purposes of the grant, and further that there is legal access to such property. The Grantee is responsible for securing the real property interests necessary for the construction and operation of the Project, through ownership, leasehold, easement, or otherwise, and for providing evidence satisfactory to the [State] that it has secured these real property interests.*⁶³

In other words, the solution to the City's concern over its title lies with the City itself. Under basic property law, title to the fixture will merge with the title to the underlying land that the City has committed to secure.

Nevertheless, the City should recognize that this final transfer of the land, with its "fixture," will represent the City's receipt of over \$500,000 in annual "federal financial assistance." Federal law requires that grantees who cross this threshold obtain a "single audit" from a CPA firm.⁶⁴ And the new tank farm obviously has a value of well over \$500,000.

When the State constructs a powerhouse or tank farm for a community, OMB agrees that the project is subsumed within coverage of the State's own audit of its annual federal assistance. However, in the unusual case of Gustavus, the agency head released the State from its troubled

⁵⁹ See *K & L Distributors v. Kelly Electric*, 908 P.2d 429 (Alaska 1995); *Interior Energy Corporation v. Alaska Statebank*, 771 P.2d 1352 (Alaska 1989); *Rayl v. Shull Enterprises*, 700 P.2d 567 (Idaho 1984); *National Union Fire Insurance v. Structural Systems Technology*, 964 F.2d 759, 762 (8th Cir. 1992).

⁶⁰ See *Denny Wiekhorst Equipment v. Tri-State Outdoor Media*, 693 N.W.2d 506, 512 (Neb. 2005).

⁶¹ See *Dutchmen Mfg. v. Reynolds*, 849 N.E.2d 516, 520 (Indiana 2006).

⁶² Email dated Jan. 17, 2013 to OIG.

⁶³ See Alaska Energy Authority subaward # 340240, Appendix B1, sec. 2.

⁶⁴ See 31 USC 7502; 31 USC 7501(a)(5); OMB Circular A-133 sections 200(a), 205(a), 205(g).

relationship as the project manager. Denali then directly assumed the responsibility to complete Gustavus' tank farm.⁶⁵

In other words, Denali replaced the State and substituted itself into a direct relationship with Gustavus as its federal grantee. Though Gustavus has so far never had an audit, it will now need to obtain one (for its FY 2013⁶⁶) from a CPA firm under the standards of OMB Circular A-133.

Section 4.08.020 of the Gustavus Municipal Code explicitly authorizes the city council to obtain audits.

4. The “business operating plan” had no legal effect in itself.

At first glance, this matter begs the question as to how many lawyers it takes to install five fuel tanks in a hamlet of less than 500 people. All four sides⁶⁷ “lawyered up,” starting with the inevitable FOIA request. However, while the lawyers were debating who had the responsibility to do what for whom, the engineers simply went ahead and completed the facility.

The essence of the dispute lies in a set of documents that Denali commonly uses for this type of grant. Various incorporations by reference link the documents together to collectively function as the grant agreement.

For Gustavus' tank farm, considerable institutional energy has been expended in a debate over the significance of the “business plan.” The debate persists because this document's use and effect vary from project to project.

The State retains a contractor to develop a “business operating plan” for each tank farm built with Denali funding. While the completed facility is provided without charge to the recipient, the plan's template estimates the fees and expenses that local users must bear to keep the facility functioning over the next 30 to 40 years.

This business plan's narratives and spreadsheets can run for many pages. For the Gustavus tank farm, the State contracted for a business plan that extends for 49 pages (not including the copies of five other documents attached for reference).

Nevertheless, a “plan” is not a “promise.” The business plan has no legal status in itself. Its role depends upon the context of a particular subaward.

⁶⁵ See Amendment 4, dated April 7, 2011, to Denali grant # 331-07.

⁶⁶ Per OMB Circular A-133 sec. 205(a), “the receipt of property” is the point that determines the fiscal year subject to the audit. The State will presumably complete its title transfer for the underlying land — which includes the tank farm as an attached “fixture” — before June 30, 2013. The required single audit will then be for the City's fiscal year ending June 30, 2013.

⁶⁷ Gustavus Dray (fuel vendor); City of Gustavus; State of Alaska; Denali Commission.

If the business plan is produced before the project is selected, the plan can aid in the screening of grant applications for local “capacity” to successfully support the facility. The resulting award can also specify that the plan will be incorporated by reference as part of the enforceable terms. For Gustavus, though, the business plan was produced *after* the subaward was made and had neither of these roles.

The business plan may also be incorporated into a security agreement that gives Denali various enforcement rights if the owner fails to properly support the facility over its useful life of 30 to 40 years. Denali arcanelly labels this document as its “secondary operator agreement.” While such a security agreement was proposed for the Gustavus tank farm, Denali never signed it and it did not materialize as an enforceable document (discussed below).

The business plan may also be incorporated into a lease with a local business that will actually operate the tank farm for the public owner. As detailed below, this was the plan’s context at Gustavus.

And, last but not least, the business plan can simply serve as a form of training or “technical assistance” to bolster local success with the new facility. Such a public conversation (“coordination”) can be more beneficial in practice than legal provisions that are binding, but buried in boilerplate.

5. Denali’s potential security agreement was never effectuated.

The City and a local fuel business (Gustavus Dray) signed a proposed “secondary operator agreement” in 2009 and forwarded it on to Denali for its signature as the secured party. The agreement incorporated the business plan by reference and, if effective, would have given Denali creditor-type enforcement rights⁶⁸ if there was a default in the expected use and other conditions during the 40-year life of the facility.

The assumption that Denali would insist upon such a security agreement⁶⁹ was understandable, since boilerplate in the business plan had this language:

The Secondary Operator Agreement references the Plan and includes language requiring the Plan be followed. The Plan takes effect after the Secondary Operator Agreement is executed. Acceptance of the Plan by execution of the Secondary Operator Agreement is prerequisite to funding from the Denali

⁶⁸ The potential agreement was couched in the language of the public interest in assuring uninterrupted service. However, the enforcement remedies described in section 4 were, by any name, the classic ones applied by commercial creditors. The proposal would have given Denali the right to repossess the facility, seize its inventory, books, cash, and receivables, and hire a replacement contractor. Denali would, in effect, have the powers to function like a receiver in the event of a default.

⁶⁹The tank farm with pipeage constituted a “fixture” for purposes of secured transactions covered by Alaska’s version of Article 9 of the Uniform Commercial Code. See *K & L Distributors v. Kelly Electric*, 908 P.2d 429 (Alaska 1995). While security agreements commonly protect a seller or lender from nonpayment, the security agreement in Denali’s case provides a remedy for defaults upon other types of obligations — such as the facility’s continuing use, various reporting requirements, and the annual deposits into a savings account for the facility’s maintenance and eventual replacement.

Commission (the “Commission”), which will be provided through a separate Grant Agreement (See Attachments).⁷⁰

In fact, an OMB regulation⁷¹ explicitly encourages federal agencies to consider such an option for some types of grants:

Agencies may require recipients to record liens or other appropriate notices of record to indicate that personal or real property has been acquired or improved with Federal funds and that use and disposition conditions apply to the property. [emphasis added]

However, section 6 of the proposed security agreement required “[t]he exchange of a fully executed Agreement.” This is consistent with the basic legal requirement that a security agreement involve the mutual consent of the secured party and the party required to perform.

Given the ambivalence expressed by both the City and Denali, such an agreement was never reached. Two mayors wrote Denali late in the game and requested that the agency *not* sign the agreement, explaining that the City wanted to renegotiate its arrangement for a tenant to operate the tank farm.⁷² And, since Denali never signed, returned, or recorded the proposed security agreement, it had no legal effect.⁷³

Regardless of Denali’s terms for other projects in other locations, the agency was free to forego any requirement that it did not choose to include.⁷⁴ It may have decided, quite legally, that it wanted to provide the City with a tank farm without becoming enmeshed in “privity of contract” with the City’s long-term tenant.⁷⁵

In fact, the State had already executed its subaward to the City by the time that the business plan was issued. At this point, any Denali requirement for additional assurances of performance would have constituted a significant unilateral grant modification of questionable legality.⁷⁶

Even if fully signed, the proposed terms of the security agreement had a potentially fatal flaw. Sections 5 and 9 provided that any disputes would be decided under state laws in the state court system. This would be problematic for the Government, given that GAO has previously

⁷⁰ See *Business Operating Plan of the Gustavus Bulk Fuel Facility*, Aug. 10, 2009, page 2.

⁷¹ See 2 CFR 215.37, which applies to grants that federal agencies make to nonprofits.

⁷² Letter dated Sept. 26, 2010 from Mayor B to Denali Commission; Letter dated Dec. 10, 2010 from Mayor C to Denali Commission.

⁷³ See *Sea Hawk Seafoods v. City of Valdez*, 282 P.3d 359, 364-365 (Alaska 2012). From the technical perspective of commercial law, Denali’s potential security agreement did not “attach” and was never “perfected.”

⁷⁴ See *Heckler v. Chaney*, 470 U.S. 821 (1985).

⁷⁵ See *Eubanks v. United States*, 25 Cl.Ct. 131, 137-138 (1992).

⁷⁶ See *Lynch v. United States*, 292 U.S. 571 (1934).

cautioned Denali that “*it is a well-established principle that only Congress can waive an executive agency’s sovereign immunity.*”⁷⁷

Though Denali’s written security interest was never effectuated, the Alaska Supreme Court still implies a federal “reversionary interest” in the improvements funded through such a grant. So long as the grant-related property continues to have value, the Government as a general rule retains this implied federal lien that secures its use for the intended purpose.⁷⁸ But Denali can, of course, still record a release of this lien well before 40 years have elapsed, if the agency has no intention, ability, or need to police the matter that long.⁷⁹

6. The City had “buyer’s remorse” after leasing its tank farm for the next 100 years.

The City did not plan to directly operate its new tank farm. Rather, in July 2009, the city council approved a long-term lease to a local fuel business (Gustavus Dray). The lease incorporates the terms of the business plan and promises the tenant the “exclusive right” to use the new facility as well as “quiet and peaceful enjoyment of the Premises” (non-interference).⁸⁰

Neither the State nor Denali is a party to this lease.

Rent is only symbolic for the lease’s initial term of 50 years (\$1 per year). The tenant has a right to renew for an additional 50 years, with rent to “be mutually agreed upon” or “decided by a mutually agreeable neutral.”⁸¹

In short, the lease on its face appears to commit the City for the next century. Nevertheless, Mayor “A” signed the lease in September 2009 at the direction of the city council.

But one of the approving council members apparently had “buyer’s remorse” a year later. When he was selected as Mayor “B,” he wanted out of the arrangement:

[A] second fuel provider is now in business here serving a substantial share of the market. . . The second provider currently lacks access to the existing tank farm and so has had to ship fuel to Gustavus in small tanks via landing craft. It is very important to the City of Gustavus that our new facility be available for equal use by multiple competitive fuel providers and that there be flexibility for renewal of

⁷⁷ See GAO, *Denali Commission—Authority to Receive State Grants*, # B-319246 (Sept. 1, 2010) at www.gao.gov.

⁷⁸ See *City of Hydaburg v. Hydaburg Cooperative Association*, 858 P.2d 1131 (Alaska 1993). See also *In re Joliet-Will County Community Action Agency*, 847 F.2d 430 (7th Cir. 1988). Cf. 2 CFR 215.32(a) (grants to nonprofits).

⁷⁹ This release would be similar to the “termination statement” for a security interest under AS 45.29.513(c).

⁸⁰ See Bulk Fuel Storage and Handling Agreement and Facility Lease, sections 1, 4, 7.

⁸¹ See Bulk Fuel Storage and Handling Agreement and Facility Lease, sections 2, 3.

*user contracts as frequently as every five years. . . Operation and maintenance of the facility by a single user no longer appears appropriate. . .*⁸²

And similar regret was later expressed by another city council member who had voted in favor of the 100-year agreement:

*What has been done is one single individual, a private business with taxpayer money, has gained a tremendous asset to his business for \$1 a year. . . [H]ow could anybody possibly think about coming to town and starting another business or competing with the grant at this point in time. . . [T]he big problem is the monopoly situation. . . [I]s this a standard deal, this 50-year lease? I mean, I, really, as a businessman, would never sign anything like that. . .*⁸³

And Mayor “C” expressed his similar concern when Denali’s agency head held a regional “listening session.”

*[T]he way AEA [the State] set this up there was to be a 50-year exclusive contract renewable for another 50 years, this is a century, for the fuel distributor in Gustavus to operate this tank farm. And it was a -- this was built with, you know, taxpayer dollars, two million of them. And it's going to support -- if this -- if this actually comes to fruition it's \$2 million of taxpayer money going to support a monopoly for 100 years for fuel distribution in Gustavus. And we think that's unconscionable here.*⁸⁴

In other words, the City had changed its mayors and changed its mind.

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. In fact, the City has continued to file complaints with Denali’s agency head as recently as the past month.⁸⁵

7. The City’s implicit antitrust arguments require further study to resolve.

In the strong rhetoric of this debate over competition, 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.

⁸² Letter dated Sept. 26, 2010 from Gustavus mayor to Denali Commission.

⁸³ See pages 235-237 of the transcript of the Denali Commission’s public meeting held in Juneau, Alaska on Feb. 23, 2012.

⁸⁴ See pages 42-43 of the transcript of the “Denali Commission — Listening Session” held in Juneau, Alaska on April 1, 2011.

⁸⁵ Letter dated March 19, 2013 from Gustavus mayor to Denali Commission.

Such admissions by Gustavus officials present a serious legal issue under a case decided two months ago by the U.S. Supreme Court. In that case, the Court reiterated that local governments are subject to federal antitrust liability unless state law sanctions their grant of a monopoly.⁸⁶ And for over 20 years, that has also been the legal position of the U.S. Court of Appeals that serves Alaska.⁸⁷

Nevertheless, this complex issue is beyond the scope of OIG's inspection. We are referring it to the Federal Trade Commission for such further study as that regulator deems warranted.⁸⁸ Given the length of the City's arrangement, potential new entrants could conceivably raise the issue over the next century.

This issue obviously presents the parties with a long-range uncertainty that is the antithesis of the years of predictability they had hoped to achieve.

8. A lease for 100 years is not inherently illegal.

The duration of this lease is indeed a full century if the tenant chooses to renew. 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.

Well-known examples are the "99 year leases" for Hong Kong and the land underlying American skyscrapers — or perhaps the 9,000 year lease to a famous brewery in Dublin.⁸⁹ Another example would be the 1988 collapse of a 2,000-foot antenna tower in Missouri, on land which a broadcaster had leased "*for a term of fifty years, renewable for terms of twenty-five years up to a total of fifty years.*"⁹⁰

⁸⁶ See *Federal Trade Commission v. Phoebe Putney Health System*, 133 S.Ct. 1003 (2013). See also *Community Communications Company v. City of Boulder, Colorado*, 102 S.Ct. 835 (1982).

⁸⁷ See *Lancaster Community Hospital v. Antelope Valley Hospital District*, 940 F.2d 397 (9th Cir. 1991).

⁸⁸ This is an appropriate approach to this arcane issue under Inspector General Act sections 4(a)(4) and 6(a)(3).

⁸⁹ See www.guinness.com/en-us/thestory-1750.html. But www.guinness-storehouse.com goes on to somewhat deflate the long-term mystique:

The 9,000 year lease signed in 1759 was for a 4 acre brewery site. Today, the brewery covers over 50 acres, which grew up over the past 200 years around the original 4 acre site. The 1759 lease is no longer valid as the Company purchased the lands outright many years ago.

⁹⁰ See *National Union Fire Insurance v. Structural Sys. Tech.*, 756 F.Supp. 1232, 1235-1236 (E.D. Missouri 1991).

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.”⁹¹ The iconic case from Delaware states that “[t]here being no statute in this state to the contrary, the law permitted the lease notwithstanding its length of two thousand years.”⁹²

In fact, Congress has specifically authorized⁹³ many tribal entities to lease their land for 99 years:

*As business opportunities and economic considerations changed over time, leases longer than 25 years were desired. To facilitate economic development on trust lands, over the years, a number of tribes have obtained amendments to the Long-Term Leasing Act so that they could enter into leases for terms longer than 25 years. Approximately 50 tribes have obtained these amendments and all are listed in the Long-Term Leasing Act as having authority to enter into leases for terms as long as 99 years.*⁹⁴

And the Alaska Supreme Court has found a school district’s 55-year lease of local land for a dollar a 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.⁹⁵

9. The City had repeated opportunities for a legal escape from its 100-year lease.

The City now wants out of its perceived Faustian bargain. But the City’s position is initially not one that draws sympathy, given the repeated opportunities that its process allowed for reconsideration and reversal.

Public minutes for the city council show that it discussed the proposed lease at five meetings during 2009, including two in which the City’s legal counsel participated.⁹⁶ Further, there was a 50-day gap between the date on which the council authorized the mayor to sign and when he actually signed the lease. Under basic contract law, there was arguably no offer on the table until the signed document was sent on to the tenant.⁹⁷

⁹¹ 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.

⁹² See *Monbar, Inc. v. Monaghan*, 162 A. 50, 52 (Delaware Court of Chancery 1932).

⁹³ See 25 USC 415.

⁹⁴ See Senate Report 110-480 at page 2.

⁹⁵ See *Askinuk Corporation v. Lower Yukon School District*, 214 P.3d 259, 268 (Alaska 2009).

⁹⁶ See <http://cms.gustavus-ak.gov/government/council/meetings>.

⁹⁷ See AS 09.25.010(a)(6); AS 09.25.010(b).

In fact, there was a further gap of nine months between the mayor's signature in 2009 and the tenant's signature in 2010. Basic contract law would presumably have allowed the City to withdraw its offer before the tenant signed with its acceptance.⁹⁸

However, even after both parties had signed the lease, the rental period did not actually begin until the State issued its "notice of substantial completion" for the facility. And the lease explicitly allowed either signer to unilaterally cancel if the State had not issued its notice by December 31, 2010.⁹⁹

Since the State did not issue this notice until March 2011, the City had yet another gap (two months) in which to effect its escape. And, since the subaward gave the City a period of 30 days to challenge the notice, the City arguably had the opportunity to extend the lease cancellation window even further while the "substantial completion" appeal was being decided.¹⁰⁰

The City had a new mayor during this gap (Mayor "C"), and the city council's minutes for February 2011 reflect a two-hour executive session over the tank farm dispute. Despite the protest in Mayor B's letter of September 2010 (quoted above), Mayor C did not exercise the right to cancel that the lease provided. Nor did he challenge the important state notice that the project had been substantially completed.

In short, the 100-year lease was hardly an irreversible "impulse purchase."

10. The Denali Commission properly declined to lock the tenant out.

Though the City had the right to cancel the lease for some time, Mayor C instead instructed a Denali employee to take the following forcible action against the City's tenant:

I was fairly amazed to know that Gustavus Dray's locks were on the tank farm. The tank farm is public property, and having Gustavus Dray's locks on it looks entirely too cozy and is of questionable legality. I would advise you to quickly notify Gustavus Dray to remove their locks and have Denali Commission locks installed. You can send locks or the city can get them and the city can put them on and keep the keys in City Hall. This will assert the Denali Commission's control over the project. If Gustavus Dray's locks remain, it will appear that the Denali Commission is AEA [the State grantee] in different clothing.¹⁰¹

⁹⁸ The offeror can revoke its offer up until acceptance. See *Restatement (Second) of Contracts*, sections 36(c), 42; *Copper River School District v. Traw*, 9 P.3d 280, 286 (Alaska 2000). See also *Franchises from Public Entities*, 36 Am.Jur.2d sec. 7 ("[U]ntil accepted by the grantee, a grant of a franchise is a mere offer that may be withdrawn by the sovereign at any time.").

⁹⁹ See Bulk Fuel Storage and Handling Agreement and Facility Lease, sections 2 and 21.

¹⁰⁰ See Alaska Energy Authority subaward # 340240, Appendix B2, sec. 3.

¹⁰¹ Email dated March 26, 2011 from Gustavus mayor to Denali Commission.

While the City's lease promised the tenant "quiet and peaceful enjoyment of the Premises,"¹⁰² Mayor C was nevertheless insisting that a federal employee function like a judge in a suit to physically evict a tenant (forcible entry and detainer). When the federal employee did not quickly respond to these instructions, the City again requested the Alaska Municipal League to intercede as the City's advocate:

*[The tenant] seems to be attempting to assert some sort of ownership or control of the tank farm. It seems this issue is far from being resolved. As always, thanks for your interest and help.*¹⁰³

However, the lockout requested by the City was not consistent with Alaska law. Such self-help by a landlord is only legal if the lease provides for it, or the tenant is behind in rent.¹⁰⁴ Neither scenario is the case here.

The City's lease has a 365-word section¹⁰⁵ entitled "*Breach, Termination and Remedies.*" It details various processes and timelines for notice, cure, alternative dispute resolution, and the last resort of litigation. Construing these provisions together, a non-judicial lockout would arguably be allowed only if the tenant abandoned the property or began using it for something other than a tank farm. For any lesser defaults, the lease seems to presume that physical removal of the tenant will be left for a court to accomplish through the traditional remedy of forcible entry and detainer.

In past centuries, federal officials in coastal Alaska were both less common and more empowered to physically mete out summary justice.¹⁰⁶ But those days are long past, and the federal employee here correctly understood that she did not have the authority to act as the City's enforcer in effectuating the self-help of a lockout.

In fact, such unilateral joint action could have subjected both levels of government to a suit under the federal civil rights law for interference with the tenant's property rights. While federal agencies are not normally subject to such suits, that immunity can be compromised if federal officials join with local officials in committing violations. The U.S. Court of Appeals that serves Alaska has over the years issued a series of decisions that caution officials in this regard.¹⁰⁷

¹⁰² See Bulk Fuel Storage and Handling Agreement and Facility Lease, sec. 7.

¹⁰³ Email dated March 29, 2011 from Gustavus mayor to Alaska Municipal League.

¹⁰⁴ See AS 09.45.690; *Sengul v. CMS Franklin, Inc.*, 265 P.3d 320, 324-327 (Alaska 2011).

¹⁰⁵ Section 9.

¹⁰⁶ 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).

¹⁰⁷ See *Scott v. Rosenberg*, 702 F.2d 1263, 1269 (9th Cir. 1983); *Merritt v. Mackey*, 827 F.2d 1368, 1372 (9th Cir. 1987); *Cabrera v. Martin*, 973 F.2d 735, 742 (9th Cir. 1992); *Billings v. United States*, 57 F.3d 797, 801 (9th Cir. 1995).

11. The 100-year “lease” is void and unenforceable.

However, OIG concludes 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.¹⁰⁸

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 \$5,000.¹⁰⁹ 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.

The disputants have in practice labeled the City’s long-term agreement with Gustavus Dray as a “lease.” However, it is the substance of the transaction — rather than the parties’ shorthand — that determines the required legal formalities.¹¹⁰ Based upon case law from around the country (discussed below), OIG concludes 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.¹¹¹ However, the city council’s minutes reflect that it approved the 100-year “lease” with only a “motion.”¹¹²

¹⁰⁸ See *Quality Towing v. City of Myrtle Beach*, 547 S.E.2d 862, 866-867 (S.C. 2001); *Berkeley Elec. Co-op v. Town of Mount Pleasant*, 417 S.E.2d 579 (S.C. 1992); *City of Gary v. Major*, 822 N.E.2d 165 n.3 (Indiana 2005); *Shaw v. City of Asheville*, 152 S.E.2d 139, 146 (N.C. 1967); *McBirney & Associates v. State of Alaska*, 753 P.2d 1132 (Alaska 1988); *Miller v. Marshall County*, 641 N.W.2d 742, 750-752 (Iowa 2002); *Failor’s Pharmacy v. Dept. of Social and Health Services*, 886 P.2d 147, 153 (Wash. 1994); *Franchises from Public Entities*, 36 Am.Jur.2d sec. 15; *Municipal Corporations*, 56 Am.Jur.2d sec. 466.

¹⁰⁹ See Gustavus Municipal Code sec. 4.17.020(a).

¹¹⁰ 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.*”).

¹¹¹ See AS 29.25.010(a)(5); Gustavus Municipal Code sec. 1.02.020(a)(9).

¹¹² Minutes for the July 16, 2009 meeting of the Gustavus City Council.

Alaska law provides even stronger protection for the public when the grant of a franchise exceeds five years.¹¹³ 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.”¹¹⁴

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.

Alaska law unfortunately provides little guidance as to what municipal arrangements constitute a “franchise.” However, case law from around the nation has emphasized a variety of characteristics: (1) service in the public interest,¹¹⁵ (2) a favored position in local competition,¹¹⁶ (3) a utility-like distribution system;¹¹⁷ (4) infrastructure in a public right-of-way.¹¹⁸ On the other hand, status as a “franchise” does not assume an absolute monopoly¹¹⁹ or regulation by a state utility commission.¹²⁰

The City’s “lease” appears to meet all of these case law characteristics for a “franchise.”

Section 22 of the “lease” (see EXHIBIT 5) establishes sustainable service to the public as the expected performance standard. This is supported by the lack of all but symbolic rent (\$1 annually) for at least the first 50 years. Since a city is unlikely to donate a new \$1.9 million

EXHIBIT 5
LANGUAGE FROM 100-YEAR “LEASE”
INDICATIVE OF A PUBLIC “FRANCHISE”

Section 22 (“Public purpose and use”):

“The site for the Facility will be conveyed to Gustavus pursuant to AS 38.05.810(a) which requires that the conveyance *serve a public purpose and is in the public interest*. The Parties agree that the conveyance and the associated development of the Facility *will serve a public purpose and be in the public interest because the existing fuel storage in the City of Gustavus is failing and the Facility is essential to assure a reliable site for bulk fuel storage which is essential to the continued vitality of the City of Gustavus*. Article IX of the Business Operating Plan requires annual reporting by the lessee of annual O&M and R&R costs, providing assurance that the Facility will be operated *for a public purpose and in the public interest* during the term of this lease. [emphasis added]”

¹¹³ See AS 29.35.060(b).

¹¹⁴ See Gustavus Municipal Code sec. 10.06.05.

¹¹⁵ See *In re O’Harra Bus Lines*, 12 Alaska 129 (D. Alaska Terr. 1948); *Burns v. City of Seattle*, 164 P.3d 475, 483 (Wash. 2007); *Franchises from Public Entities*, 36 Am.Jur.2d sec. 1.

¹¹⁶ See *MAC Amusement Company v. State*, 633 P.2d 68, 71 (Wash. 1981); *Quality Towing v. City of Myrtle Beach*, 547 S.E.2d 862, 866-867 (S.C. 2001).

¹¹⁷ See *In re O’Harra Bus Lines*, 12 Alaska 129 (D. Alaska Terr. 1948); *Burns v. City of Seattle*, 164 P.3d 475, 483 (Wash. 2007).

¹¹⁸ See *City of Tacoma v. City of Bonney Lake*, 269 P.3d 1017, 1020 (Wash. 2012); *Burns v. City of Seattle*, 164 P.3d 475, 483 (Wash. 2007); *Shaw v. City of Asheville*, 152 S.E.2d 139, 145 (N.C. 1967); *Franchises from Public Entities*, 36 Am.Jur.2d sec. 1.

¹¹⁹ See *Quality Towing v. City of Myrtle Beach*, 547 S.E.2d 862, 866-867 (S.C. 2001).

¹²⁰ See *Shaw v. City of Asheville*, 152 S.E.2d 139, 145 (N.C. 1967).

asset to a private business, the essence of the 100-year transaction is to promote the permanent availability of a local service to the public.

The operations manual, required by the Coast Guard, openly acknowledges the tank farm's status as a public monopoly:

*The Facility provides storage for virtually all of the unleaded gasoline, aviation gasoline, #1 diesel, and #2 diesel fuel imported into the community for power generation, public building heating, retail sales and marine fueling. . .*¹²¹

Similar language appears in the State's formal decision to convey its land to the City for the new tank farm. The latter replaces the old tanks that were

*used for storing virtually all of the #1 diesel, # 2 diesel, unleaded gasoline and aviation fuel imported into Gustavus. The fuel is used for community power generation and local heating fuel deliveries as well as retail dispensing at the gas station and airport.*¹²²

And the lease itself¹²³ provides that “[t]he City hereby leases to Gustavus Dray the exclusive right to use, operate and maintain a bulk fuel storage and handling Facility, constructed on the following real property . . .”

Though tank farms aren't regulated by the state utility commission, section 8 of the “lease” still requires “reasonable and prudent utility practices.” This seems appropriate since the tank farm with its pipeage is a form of ship-to-shore distribution system — analogous to the wiring that connects bush residents with their local “earth station” for phone, Internet, and cable television. Or the buried pipes that commonly transmit natural gas in the neighborhoods of the Lower 48.

Indeed, Denali's grant that funded the tank farm explicitly states that, “[a]s a precondition of construction funding, a project must demonstrate that it is part of a sustainable electric utility or bulk fuel system.”¹²⁴

But an important purpose of such Denali grants is to prevent the damage from leaking tank farms and from coastal fuel spills during barge deliveries. While the risk from the tanks themselves can be minimized through containment dikes, the larger risk lies along the route that the fuel must transverse from the barge as the tanks are filled.

¹²¹ See *Marine Transfer Operations Manual* (May 2011), page 1.

¹²² Alaska Dept. of Natural Resources, “Land Conveyance to City of Gustavus under AS 38.05.810(a),” Preliminary Decision re ADL 107623 (April 2, 2008), page 2.

¹²³ Section 1.

¹²⁴ Denali award # 331-07 to the State of Alaska, award condition 12.

Thus, much of this facility's value lies in the 1,700-foot pipeline that traverses the public right-of-way, the causeway, and the public ferry dock. At the end of the dock, delivery barges unload fuel into the pipeline's "marine header." At the other end of the pipeline, trucks take the stored fuel further down the road to supply homes, vehicles, airplanes, and the local powerhouse.

In other words, a key element of the facility is the long delivery pipeline — rather than just the set of small tanks at the end of the line. This is why the business plan¹²⁵ proposed the following:

Pipeline Easements / Right of Ways: The City will acquire, from the State of Alaska Department of Natural Resources, a 4,155' x 10' easement along the east side of Dock Road for purposes of routing fuel lines to the Facility and to the Gustavus Dock.

The tanks, the pipeline, and the dock all lie within the city limits. The tank farm itself has a relatively small footprint of around 16,000 square-feet¹²⁶ on a roadside tract that the City obtained specifically for this purpose. More technically, the City obtained this tract under a state land use permit¹²⁷ pending a full conveyance of title from the State under AS 38.05.810(a) ("public and charitable use").

However, the land survey for the State's conveyance¹²⁸ shows that this small footprint is overshadowed by the State's dedication of an additional 49,000 square-feet¹²⁹ of roadside right-of-way for burying the pipeline on its way to the end of the public dock. The need for this is understandable given that the "pipeline" actually consists of three separate pipes — each 3 inches in diameter — that are together buried several feet deep along with a related electrical control cable.

After the land was surveyed, Mayor C signed the following statement on the surveyor's plat:

ACCEPTANCE OF DEDICATION

The Mayor hereby accepts for public uses and for public purposes the real property dedicated to the public by this plat including easements, rights-of-ways, alleys, and roadways shown on this plat. . .

¹²⁵ Page 8.

¹²⁶ OIG's estimate is based on the distances shown on the site plan submitted to the State for land use permit ADL 107623. Our estimate includes the surrounding berm and fencing, as well as the storage units and truck loading area.

¹²⁷ State land use permit ADL 107623.

¹²⁸ Alaska State Land Survey No. 2009-15.

¹²⁹ A note on the plat for ASLS 2009-15 states that the "right-of-way dedicated by this plat" is "1.128 acres," which converts to 49,136 square-feet.

In other words, the State signed over significant roadside property rights to the City — who in turn awarded their use to a private corporation for the next 50 to 100 years. OIG thus concludes that the long-term “lease” was in true substance the City’s grant of a public “franchise.”

And, due to the missing procedural prerequisites, we find 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.

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,¹³⁰ an action to decide the tenancy,¹³¹ a suit to set aside the franchise,¹³² a declaratory judgment to decide “rights and legal relations,”¹³³ or a suit alleging one of the business interference torts recognized by state law.¹³⁴ And that is the setting that offers the 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.¹³⁵ While the mediator assisted OIG greatly in clarifying the issues, the City and Gustavus Dray were unfortunately unable to reach a voluntary resolution of their lease dispute.

12. Remediation of the prior tank farm was not within the scope of Denali’s grant.

Despite all of Denali’s investment and intervention in tiny Gustavus, OIG noted a common expectations gap that was fortunately resolved by other agencies.

The State’s site plan for the new facility shows the old tank farm next door, with the notation “*existing tank farm to be abandoned in place.*”

¹³⁰ See AS 09.45.010.

¹³¹ See AS 09.45.070, AS 09.45.630.

¹³² 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.).

¹³³ See AS 22.10.020(g); *McBirney & Associates v. State of Alaska*, 753 P.2d 1132 (Alaska 1988).

¹³⁴ See *K & K Recycling v. Alaska Gold Co.*, 80 P.3d 702, 717 (Alaska 2003); *Alaska Marine Pilots v. Hensch*, 950 P.2d 98 (Alaska 1997).

¹³⁵ 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).

In a 2010 letter to the Denali Commission,¹³⁶ Mayor “B” seemed to anticipate that the Government would both build the City a new tank farm *and* remediate the old one:

The project is nearing completion with the laying of new fuel lines along the dock to the tanks. Removal of the old tanks and site remediation also remain to be done. We trust that the fuel lines will be completed before winter sets in, but we understand that the old tanks cannot be removed until the fuel in them has been dispensed. We look forward to operating our completed and fully compliant bulk fuel facility.

However, cleanup of the neighboring “brownfield” wasn’t within the scope of work under either the State’s grant to the City or the underlying grant from the Denali Commission. And this is neither an oversight nor a new limitation on Denali’s grants.

OIG described the longstanding issue as follows in an inspection report some years back:¹³⁷

[L]ike other Denali-funded energy projects, there was an implicit “mammoth” in the room that Denali has limited ability to resolve.

While Denali funds the construction of new generators and tank farms around the state, Denali doesn’t try to remove their rusting predecessors — or remediate the soil they’ve contaminated over the decades. Communities periodically voice this disappointed expectation to Denali’s management. . .

Though the Denali Commission out of necessity sidesteps this resident “mammoth” of brownfield cleanup, it still casts a shadow over the agency’s ultimate historical success in solving Alaska’s frontier problems.

Environmental remediation — like the relocation of communities after disasters — is a costly mission that Congress so far hasn’t funded at the Denali Commission.

The old tanks in Gustavus belonged to the FAA for almost 40 years, and the site’s remediation in this case was fortunately accomplished through agencies other than Denali.

13. Use of Denali’s “base” appropriation for this facility presents a question of federal law.

Congress provided Denali with an FY 2007 “base” appropriation of \$50 million that was available for “[f]or expenses of the Denali Commission including the purchase, construction, and acquisition of plant and capital equipment as necessary and other expenses . . .”¹³⁸

¹³⁶ Letter dated September 26, 2010.

¹³⁷ See Denali OIG’s inspection report for Nikiski, Alaska (Sept. 2008), pp. 9-10, at www.oig.denali.gov.

¹³⁸ See P.L. 109-103, title IV, 119 Stat. 2282, which was extended for FY 2007 by P.L. 110-5 (Feb. 15, 2007).

As required by Denali's distinctive enabling act,¹³⁹ the agency head asked a statutory panel of six beneficiaries to identify how this money should be spent. The Alaska Municipal League (the complainant here), the Associated General Contractors, and the State of Alaska are members of this statutory panel.¹⁴⁰

As required by the enabling act,¹⁴¹ this board of beneficiaries publicly voted on a "work plan" that expressed their collective preference as to how the agency head should spend Denali's funding. The work plan stated in pertinent part that \$27 million from Denali's "base" appropriation should be used for "*bulk fuel [tank farms], RPSU [powerhouses], etc.*"¹⁴²

The agency head respected this request and responded by awarding grant # 331-07 to the State for \$10.8 million to construct such projects in 17 locations around Alaska. Eight of these were to design or build powerhouses for AML members. Two were for fuel storage tanks for AML members, including the tank farm in Gustavus.

At first glance, this application of Denali's "base" appropriation to Gustavus' tank farm would seem uncontroversial. Congress indeed provided that the "base" funding for FY 2007 was available for "*the purchase, construction, and acquisition of plant and capital equipment as necessary . . .*"¹⁴³

However, Congress has also directed that certain interest earned on the Oil Spill Liability Trust Fund (Trust Fund) will be used by Denali "*to repair or replace bulk fuel storage tanks in Alaska.*"¹⁴⁴ The agency's failure to use this more specific source for Gustavus' tanks presents an issue under federal appropriations law.

When an agency has an appropriation for a specified purpose, it is usually barred from using a more general appropriation for that same purpose.¹⁴⁵ Congress is considered to have signaled an implicit ceiling on the agency's spending for the specified purpose. To spend more than the specific appropriation for that purpose is considered an unlawful "augmentation" of the general appropriation, that is, a violation of the Antideficiency Act.¹⁴⁶

¹³⁹ See Denali Commission Act sections 303(b) and 304(a).

¹⁴⁰ See Denali Commission Act sec. 303(b)(1)(C).

¹⁴¹ See Denali Commission Act sec. 304(a).

¹⁴² See Denali Commission FY07 Work Plan, page 5, and Minutes for the Denali Commission Quarterly Meeting (May 31, 2007), page 15. See also 72 Federal Register 19479 (April 18, 2007).

¹⁴³ See P.L. 109-103, title IV, 119 Stat. 2282, which was extended for FY 2007 by P.L. 110-5 (Feb. 15, 2007).

¹⁴⁴ See 42 USC 3121 note, P.L. 105-277, div. C, title III, 112 Stat. 2681-640 to 112 Stat. 2681-641, as amended by P.L. 106-31, title 1, sec. 105, 113 Stat. 63; 43 USC 1653 note, P.L. 105-277, div. A, sec. 101(g), 112 Stat. 2681-470.

¹⁴⁵ See GAO, *Principles of Federal Appropriations Law*, 3rd ed., vol. I, pages 2-21 to 2-23, 4-29. The Comptroller General has previously addressed the boundaries of the Oil Spill Liability Trust Fund in two decisions involving the U.S. Coast Guard. Both decisions involved augmentation issues. See GAO decisions # B-289209 and # B-255979 at www.gao.gov.

¹⁴⁶ See GAO, *Principles of Federal Appropriations Law*, 3rd ed., vol. II, pages 6-162 to 6-164.

The issue is further complicated by the Energy Policy Act of 2005 which “authorized” — but did not actually fund — Denali’s “*replacement and cleanup of fuel tanks*” for “*fiscal years 2006 through 2015.*”¹⁴⁷ While Congress could have incorporated this authorization into Denali’s base appropriation for FY 2007, it did not. Permissible use of the base appropriation thus remains unsettled.

The U.S. Comptroller General is the authoritative “booth referee” for legal interpretations of Congress’ appropriations.¹⁴⁸ OIG has applied for such a ruling to resolve this issue with a safe harbor for all concerned.¹⁴⁹

In retrospect, this legal uncertainty should have been proactively resolved when the agency head and Secretary of Commerce conducted their statutory review of the work plan forwarded by the board of beneficiaries.¹⁵⁰ But it wasn’t — and it now remains for the Comptroller General to decide whether a violation of the Antideficiency Act occurs when the general “base” appropriation is spent for the specific use of a tank farm.¹⁵¹

EPILOGUE

Denali has made a sizeable investment of over \$7 million in Gustavus during the city’s short lifespan of less than 10 years.

But tiny Gustavus is still learning to be 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 candidly 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 the job and to spend its funding wisely, as though it had been raised by a bake sale.*¹⁵²

¹⁴⁷ See P.L. 109-58 sec. 356, 119 Stat. 719-720.

¹⁴⁸ See 31 USC 3526(d) and 31 USC 3529.

¹⁴⁹ See GAO, *Denali Commission—Use of Oil Spill Liability Trust Fund*, # B-323365 (pending for decision). This is an appropriate approach to such an issue under Inspector General Act sections 4(a)(4) and 6(a)(3).

¹⁵⁰ See Denali Commission Act sec. 304(b).

¹⁵¹ Federal officials violate the Antideficiency Act if they spend appropriations for purposes beyond those that Congress has authorized. See GAO, *Antideficiency Act—Applicability to Statutory Prohibitions on the Use of Appropriations*, # B-317450 (March 23, 2009) at www.gao.gov.

¹⁵² See *Gustavus Strategic Plan 2005*, page 17, at www.commerce.state.ak.us/dca/plans/Gustavus-SAP-2005.pdf.

To put it bluntly, OIG concludes that Denali and its state grantee misjudged the capacity of this tiny and inexperienced¹⁵³ settlement to handle yet another federal project. Denali and its state grantee simply expected too much.

This was sadly evident when a Gustavus official recently 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.*”¹⁵⁴ Similarly, a recent City letter¹⁵⁵ about its Denali-funded powerhouse seems to expect decades of dependence upon the federal government:

The City of Gustavus accepted the Gustavus Power Plant Facility with written assurance that the Denali Commission would provide the long-term oversight specified in the Business Operating Plan. . .

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. In a past inspection report,¹⁵⁶ we have noted some instances in which Alaska’s military has assisted with moves for the purpose of training and community service.

The intense level of interest in this small project reflects its status as a showdown among several competing interest groups. Such groups obviously have a keen interest in the federal funding that passes through the Denali Commission. Per a state economist’s report,¹⁵⁷ Alaska ranks first in the nation in the per capita receipt of federal grants and fourth in the receipt of federal contracts.

On one hand, the dispute at Gustavus reflects the longstanding tension among non-federal leaders who wear numerous hats around the state. On the other hand, it demonstrates the value of Denali as a federal forum to “coordinate” competing interests — a constructive alternative to Alaska’s litigious history over its federal projects.¹⁵⁸

¹⁵³ One illustration of this inexperience was the complaint to a Member of Congress that OIG would not meet directly with two council members concerning the City’s claims against the federal government. They apparently did not understand that a rule of the Alaska Supreme Court bars OIG from meeting directly with parties who are represented by lawyers. Rule 4.2 is, of course, intended for such parties’ own protection.

¹⁵⁴ Email dated Jan. 17, 2013 sent to OIG.

¹⁵⁵ Letter dated March 19, 2013 from Gustavus mayor to Denali’s agency head concerning the diesel powerhouse.

¹⁵⁶ See Denali OIG’s inspection report for Sterling Landing, Alaska (Jan. 2007), page 11, at www.oig.denali.gov.

¹⁵⁷ 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>.

¹⁵⁸ See OIG’s discussion of this litigious history at pages 4-5 of our inspection report, “Training event in 2009,” available at www.oig.denali.gov.

Four drafts of this report were provided to Denali's agency head over the course of three months, along with several opportunities¹⁵⁹ to comment both formally and informally. OIG carefully considered his comments before publication. His formal response to this report is attached for the reader.

MIKE MARSH, CPA, MPA, CFE, ESQ.

INSPECTOR GENERAL
DENALI COMMISSION

¹⁵⁹ This feedback from the agency head occurred on January 25, 2013, March 8, 2013, March 29, 2013, April 5, 2013, and April 15, 2013.



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Memo

To: Mike Marsh, Inspector General, Denali Commission

From: Joel Neimeyer, Federal Co-Chair, Denali Commission

Subject: Gustavus Inspection Report – State subaward #340240

Date: April 15, 2013

This memo is written in response to the above referenced document. I appreciate the opportunity to provide input on the inspection report – both in this final written document to you as well as our conversations on the Gustavus matter for over a year now. The following is offered.

1. I believe it is important to compare the Gustavus bulk fuel tank farm project with other rural energy projects that the Commission has historically funded to demonstrate to your readers how atypical this project is to the Commission's portfolio of work.
 - A. Year-round marine shipping: Gustavus can, and does, receive marine service from barges and other vessels throughout the year. In contrast, the vast majority of rural Alaska villages only receive barge service in the summer months when the rivers and shallow bays are not frozen. The Gustavus bulk fuel farm is surprisingly small in size compared to other tank farms funded by the Commission.
 - B. Existing for-profit fuel provider: Gustavus Dray was an existing for-profit fuel provider prior to the Commission providing the Alaska Energy Authority (AEA) funding to build the modest Gustavus bulk fuel tank farm (the business is still in operation). With one exception I am not aware of another bulk fuel project in which a for-profit business was the sole fuel provider in a Commission funded bulk fuel project. Most rural Alaska tank farms are owned and managed by Tribes, cities, boroughs and school districts – many of them lacking the specific administrative skill sets that Gustavus Dray has already developed over years of operating the fuel delivery business.
 - C. Gustavus's financial capacity to pay for infrastructure: I question why the Commission provided capital funding to the Gustavus bulk fuel project as Gustavus Dray clearly had the financial and administrative capacity to take out commercial loans and pay for a new tank farm to replace the existing tank farm they were using as part of their for-profit fuel delivery business. I stated this opinion to the Gustavus City Council when I met with them in 2011. Furthermore, the community is financially well-off in comparison to other rural Alaska communities and could afford to pay for local infrastructure, or a portion of the infrastructure, with bonding or establishing a property tax. In hindsight, I

believe there was a missed opportunity for a public-private partnership in the delivery, storage and sale of fuel in Gustavus. It is clear to me that the Commission must take a closer look at how we engage the private sector in operating and maintaining public infrastructure. This is particularly important as we continue our dialogue with state-wide partners on developing a rural Alaska maintenance program including engaging the private sector on a property management model with existing infrastructure in rural Alaska. So that our readers do not get the wrong opinion of my thoughts about Commission funding the bulk fuel farm, I should state that I believe the Commission investments into improving the electrical transmission, generation and hydro-electric systems were appropriate with public funding. Upon return from Gustavus I learned that Commission and AEA staff viewed the tank farm as part of the larger community energy project as the bulk fuel was used for power generation when the hydro-electric improvements would not be on-line or during times when the electrical transmission line was under repair.

- D. Broken agency relationships: When I visited Gustavus in 2011, I witnessed one of the most broken agency to agency relationships in my 28 years of governmental service. The animosity between AEA and the City of Gustavus (City) astonished me and both sides spoke of it publically including AEA's statement at the Gustavus City Council meeting that AEA was leaving the community and not finishing the bulk fuel tank farm and the marine header from the dock to the tank farm. My experience with AEA is that they have carried out over \$263M in hundreds of Commission funded projects in a professional manner. Over the course of 14 years there have been some individual project hiccups along the way, but I have never questioned the desire and intent of AEA in completing rural energy projects on time, on budget and within the project scope. The relationship between AEA and the City is the only example I can point to where AEA wanted out of a project funded by the Commission.
2. I am disappointed that the City did not take full advantage of the mediation services offered to them in addressing what appears to be the heart of the matter – the 100-year lease for the operation of the bulk fuel farm that the City provided to Gustavus Dray. It certainly appears that the animosity the City had with AEA has now been transferred to the Commission. My hope is that with your inspection report, the City will take to heart that they have the opportunity to constructively work with Gustavus Dray instead of relying on AEA and the Commission to address the City's concerns over the 100-year lease.
 3. I do believe it is important to record for readers that the City had a significant concern during the development of the bulk fuel farm. It was reported that in 2010 the AEA tank contractor was grinding the steel tanks in preparation of painting. Unknown to the contractor was that fuel was in one of the tanks – creating a potentially explosive situation and leaving the City as owner of the land in a potential position of liability. It appears that all parties subsequently took appropriate steps to insure the future safety of all workers on the bulk fuel farm.

4. Finally, Commission and AEA staffs have spent a significant amount of time on the Gustavus energy projects with the goal that the public investments will result in the provision of more dependable electrical and fuel service and with reduced rates. I hope that the local players can come back to this goal as the basis of their future discussions on how they can work together to maintain and sustain this infrastructure in the long-term.