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Article

Whoops, There Goes Washington: Is California Next?

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The decision of the Washington State Supreme Court in *Chemical Bank v. Washington Public Power Supply System*[1] has sent shock waves through the legal, municipal bond, and nuclear power communities. The court held that certain Washington cities and utility districts acted *ultra vires* by entering into contracts with the Washington Public Power Supply System (hereinafter referred to as "WPPSS"). These contracts obligated those cities and utility districts to pay for nuclear power plant construction even if the plants would never be completed. The decision of the court to invalidate these "take or pay" contracts led to a $2.25 billion bond default, the largest bond default

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1. 99 Wash. 2d 772, 666 P.2d 329 (Wash. 1983) [hereinafter "*WPPSS*"].

in the history of this nation.[2] Similar take or pay agreements in California support over $1 billion in notes and bonds issued exclusively for nuclear power plant construction. Consequently, the reasoning of the Washington Supreme Court suggests the possibility that a similar holding might invalidate existing bond agreements in California and other states.[3] The purpose of this article is to determine whether California courts will uphold or invalidate these bond agreements following the rationale of the *WPPSS* court by analyzing the *WPPSS* decision and examining the take or pay agreements in California.[4]

THE WPPSS DECISION

A. The Facts

WPPSS is a "joint operating agency" established in 1957 under Revised Code of Washington section 43.52. The agency was created to build generating facilities sufficient to meet the future power needs of the participants. Nine Washington cities, nineteen Washington public utility districts, and sixty other participants from six neighboring states became members of WPPSS.[5] By pooling their resources, WPPSS members envisioned low utility charges through the use of economies of scale in building power plants. The members also saw a way to be assured of "cheap power" into the 21st century by using the new

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2. New York Times, August 14, 1983, at F1. "Take or pay" contracts are defined *infra* note 13.

3. California, Connecticut and Minnesota are the states in which analysts are most interested. In these three states neither the state legislatures nor the state courts have ruled on the validity of "take or pay" contracts. Telephone conversations with various attorneys at Mudge Rose Guthrie and Alexander in New York, Counsel to public power agencies in Minnesota, California and Connecticut and Austen, "Take or Pay Contracts," Drexel Burnham Lambert, July 22, 1983. *See also* Memorandum of Connecticut Municipal Electric Energy Cooperative (CMEEC), August 17, 1983 (CMEEC's bond counsel, financial adviser and underwriters are in agreement that CMEEC operates a sound utility which is built on a firm legal and financial foundation).

4. *See* Bond Offering Statements of Southern California Public Power Agency and Connecticut Municipal Electric Energy Cooperative. The Southern California Public Power Agency (SCPPA) alone has $650,000,000 in bonds and $332,875,000 in notes outstanding that were issued for the purchase of a portion of the Palo Verde Nuclear Generating Plant.

5. *WPPSS*, 99 Wash. 2d at 776, 666 P.2d at 332. Because the Washington Supreme Court analyzed the "take or pay" contracts as a question of state delegation of power, only the Washington members of WPPSS were implicated in the decision. *Id.* A joint action or operating agency is formed when two or more public bodies, usually municipalities or utility districts combine to gain economies of scale. Such agencies generally exist for the development of costly generating facilities. *See* WASH. REV. CODE ANN. §43.52.360 (1961) ("any two or more cities or public utility districts or combinations thereof may form an operating agency for purpose of acquiring, constructing, operating, and owning plants, systems, and other facilities for generation and/or transmission of electric energy powers").

technology of nuclear energy.[6]

In the early 1970's, WPPSS issued $6.1 billion in public bonds to finance construction of the first three nuclear generating facilities, commonly referred to as Projects 1, 2, and 3.[7] These projects were not implicated in the *WPPSS* decision.[8] In 1974, however, members of the power industry predicted that the capacity from the first three projects would not meet future energy needs.[9] With the unwaivering support of previous WPPSS bonds by Wall Street investors, WPPSS decided to issue more revenue bonds to obtain construction funds for two more plants, Projects 4 and 5.[10]

Project 4 was to be owned entirely by WPPSS while Project 5 was to be owned 90% by WPPSS and 10% by Pacific Power and Light Company, a private utility.[11] Unlike the bonds issued for Projects 1, 2, and 3, which had been guaranteed by an agency of the federal government, the Bonneville Power Administration, bonds for these two projects were guaranteed solely by agreements between WPPSS and the participants.[12] These agreements, ultimately invalidated by the court, are known as "take or pay" contracts. In essence, take or pay contracts are unilateral and unconditional promises of performance made by participants in WPPSS. The contracts required WPPSS participants to repay WPPSS for all plant construction costs on Projects 4 and 5 come "hell or high water," i.e., regardless of whether the plants were ever completed.[13] Specifically, the agreements stated that "such payments shall not be conditioned upon the performance or non-performance by the Supply System [WPPSS]."[14]

In 1982, these contracts became the focus of considerable con-

6. Bernstein, *A Nuclear Fiasco Shakes the Bond Market*, FORTUNE, February 22, 1982, at 102, col. 2.

7. New York Times, August 14, 1983, at F1.

8. *See WPPSS*, 99 Wash. 2d at 777, 666 P.2d at 332-33; *see also infra* note 12.

9. Bernstein, *A Nuclear Fiasco Shakes the Bond Market*, FORTUNE, February 22, 1982, at 102, col. 2.

10. New York Times, August 14, 1983, at F1.

11. *WPPSS*, 99 Wash. 2d at 777, 666 P.2d at 332-33.

12. *Id.* The Bonneville Power Administration, through a complex "net-billing" agreement, retained all the risks of incompletion for Projects 1, 2 and 3. This guarantee was upheld in Springfield v. Washington Public Power Supply System, Slip. Op. No 82-1387 (D. Or., April 27, 1983).

13. "Take or pay" (also called "hell or high water" or "dry hole" contracts) are unconditional pledges of revenues. These contracts were first devised by early constructors of gas pipelines and have since become a standard part of large power-plant financing. They obligate customers to "take" the products (in this case, electricity) as soon as it is produced but to pay for it at a fixed pre-determined time irrespective of ultimate delivery of the product. Bernstein, *supra* note 6, at 103; Telephone interview with Mr. Charles Sullivan, Los Angeles Department of Water and Power (October 19, 1983) and Austen, "Take or Pay Contracts," Drexel Burnham Lambert, July 22, 1983.

14. *WPPSS*, 99 Wash. 2d at 777, 666 P.2d at 332.

troversy. High inflation and gross mismanagement of plant construction by WPPSS led that agency to acknowledge that it no longer had sufficient bond revenues to complete Projects 4 and 5.[15] On January 22, 1982, construction was halted, leaving Project 4 twenty-four percent completed and Project 5 sixteen percent completed. Costs incurred at that point nearly reached the original total cost for completion of both plants. With completion of either plant unlikely, the participants began breaching their take or pay agreements by withholding their contractual periodic bond payments to WPPSS.[16]

Chemical Bank, as trustee for the bondholders,[17] subsequently brought an action in the Superior Court of Washington against WPPSS and the participants. The bank sought a declaratory judgment that the participants must pay their fair share of construction costs for the two projects even though the plants might never be completed. Although WPPSS itself agreed with the plaintiff, the WPPSS participants argued that they lacked the legal authority to enter into a take or pay type of agreement.[18] The participants argued that as creatures of the state of Washington, they could exercise only those powers given to them by the state and that the state had never given them the authority to contract to pay something for nothing.[19] The trial court ruled for Chemical Bank,[20] upholding the obligation of the participants under the take or pay contracts. On appeal, the Washington Supreme Court reversed the lower court, considering only whether the Washington public utility districts (hereinafter referred to as "PUD's") and municipalities of Washington had the authority to enter into these contracts.[21]

B. The Opinion of the Washington Supreme Court

The decision of the Washington Supreme Court was directed only to the issue of whether the Washington Legislature had delegated the authority to WPPSS participants to enter into contracts with take or pay provisions. The court determined the scope of the participants' authority by analyzing the express power to purchase electricity[22] and

15. *Id.* at 776, 666 P.2d at 331.
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.* at 779, 666 P.2d at 333.
20. *Id.* at 780, 666 P.2d at 333-34. The trial court held that the participants were obligated to pay WPPSS their respective shares, whether or not the plants were completed and that WPPSS and the participants had statutory authority to enter into such agreements. *Id.*
21. *Id.* at 781, 666 P.2d at 334.
22. *See infra* notes 27-30 and accompanying text.

acquire electric generating facilities,[23] and the implied powers to pay for those services.[24] The court also evaluated the participants' powers under joint operating[25] and development[26] statutes. As no authority to enter a WPPSS-type contract was found under any of these analyses, the court invalidated the WPPSS contracts.

1. Express Powers

The court first noted that the participants in WPPSS had express statutory authority to purchase electricity for the citizens in their communities.[27] The participants also had the power to contract with any operating agency or public utility for the purchase or sale of electric energy.[28] The court held, however, that WPPSS participants were not buying or selling electricity but only "project capability,"[29] or the possibility of future power. An agreement that expressly provides for payment even if no electricity is generated, did not qualify as a "purchase" of electricity.[30]

Next, the court noted that the participants had the express power to construct, acquire, and operate electric generating facilities.[31] The power to acquire power generating facilities (acquisition power) is exercised validly only when participants retain either (1) an ownership interest in the project to be constructed,[32] or (2) "sufficient control" over the project.[33]

The court held that the acquisition power of the participants could not validate the WPPSS take or pay contracts because the participants

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23. *See infra* notes 31-50 and accompanying text.
24. *See infra* notes 52-61 and accompanying text.
25. *See infra* notes 62-64 and accompanying text.
26. *See infra* notes 65-68 and accompanying text.
27. *WPPSS*, 99 Wash. 2d at 782, 666 P.2d at 334. Washington public utility districts, pursuant to WASHINGTON REVISED CODE ANNOTATED section 54.16.040 (1961) have the power to "purchase, within or without its limits, electric current for sale and distribution within or without its limits." Municipalities, whether first class cities or code cities, have this authority under the similar language (a first class city had the power to "provide for lighting . . . and for furnishing the inhabitants of the city with gas, electric, or other lights. . ." *WPPSS*, 99 Wash. 2d at 782, 666 P.2d at 335.
28. *WPPSS*, 99 Wash. 2d at 783, 666 P.2d at 335.
29. *Id.*
30. *Id.*
31. *Id.* at 784, 666 P.2d at 335. WASHINGTON REVISED CODE ANNOTATED section 35.92.050 (1961) authorizes a city or town "to construct, condemn and purchase, purchase, acquire, add to, maintain and operate works . . . for the purpose of furnishing . . . inhabitants. . . with . . . electricity . . . with full authority to regulate and control the use, distribution and price thereof . . . authorize the construction of such plant . . . and purchase gas, electricity, or power from either within or without the city. . . ." *See also* WASH. REV. CODE ANN. §54.16.040 (1961) (almost identical language giving PUD's express authority to do the same).
32. *WPPSS*, 99 Wash. 2d at 785, 666 P.2d at 336.
33. *Id.* at 787, 666 P.2d at 337.

had only contracted to buy a share of project capability from WPPSS and acquired no actual ownership interest in the projects.[34] The WPPSS Participant Agreements expressly provided that only WPPSS itself (as distinguished from the participants) and the Pacific Power and Light Company retained ownership interests in the Project.[35]

The court then faced the issue of whether the participants had retained "sufficient control" over the projects to uphold the take or pay contracts.[36] In light of the enormous risk posed to ratepayers by take or pay contracts, the court believed that WPPSS participants must retain sufficient control over the projects, equivalent to an ownership interest, to uphold the validity of the contracts. Only through this control, could participants minimize the risks to utility ratepayers.[37]

The court evaluated the "sufficient control" issue by analyzing the participants committee within the WPPSS organization and comparing the control held by WPPSS participants to the control required in previous decisions of Washington courts upholding acquisitions under joint operating agreements. The court found insignificant the control retained by participants through the participants committee.[38] Although the agreements between WPPSS and the participants required a committee meeting to approve or disapprove major decisions concerning the projects, the court found that the procedure for committee consideration of WPPSS proposals precluded meaningful deliberation by the committee.[39] In effect, the participants committee acted as a "rubber stamp" of WPPSS decisions.[40]

The court specifically emphasized the necessity and propriety of representative management committees in joint operating agencies such as WPPSS. For these bodies to warrant the upholding of acquisitions by joint operating agencies, however, they must allow participating members to exercise significant control over the projects.[41]

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34. *Id.*

35. *Id.* at 785, 666 P.2d at 337. The court noted that an ownership interest would not be necessary if the legislature had explicitly authorized "take or pay" provisions. *Id.* Although some states have expressly allowed unconditional guarantee clauses, e.g., South Carolina, Massachusetts and Maine, the court emphasized that Washington has no such statute.

36. *Id.* "Sufficient control" was considered synonymous with "substantial management control." *Id.*

37. *Id.* at 787, 666 P.2d at 337.

38. *Id.* The court objected to the procedure that requires 20% of the participants to register their disapproval of any WPPSS proposal within 15 days or the proposal would be approved. The court felt that given the complexity of problems and the part-time make up of the Committee, such as rigid procedures precluded any "significant input to the management of the projects." *Id.*

39. *Id.* at 788, 666 P.2d at 337.

40. *Id.*

41. *Id.* at 788-89, 666 P.2d at 337-38.

The court cited its decision in *Roehl v. PUD,*[42] a case that also involved the joint development and management of a generating project. In *Roehl,* five public utility districts attempted to acquire the generating facilities of Puget Sound Power and Light under a joint development agreement.[43] The court upheld the agreement in *Roehl* because control over the project was exercised by an executive board consisting of one member of each utility. This board was responsible for the overall management of the project. The *WPPSS* court found that the "same degree of participant control is not present [here] because most of the policy decisions and management control are delegated to WPPSS."[44]

The *WPPSS* court also implied that the participants acted *ultra vires* because the scope of authority wielded by WPPSS was excessive.[45] Citing *State ex rel. PUD 1 v. Wylie,*[46] the court noted that "even the *express* power to buy and sell electricity or to acquire or construct generating facilities may not be exercised in a manner beyond the scope of that primary purpose or such a project would be *ultra vires.*"[47] The Washington Supreme Court was thus unable to uphold the take or pay provisions under any express delegation of authority from the state legislature to WPPSS participants.

2. *Implied Powers*

The *WPPSS* court also held that the participants lacked implied power to enter into take or pay agreements.[48] The plaintiffs urged the court to follow the logic of *Metro Seattle v. Seattle,*[49] which held that when a utility district or a municipality has the power to provide utility services, "there is implied power to pay for it."[50] The trial court below had taken the holding of the *Metro* case to mean that

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42. 43 Wash. 2d 214, 261 P.2d 92 (1953). In addition to case law, the court cited WASHINGTON REVISED CODE ANNOTATED section 54.16.040 (1961) (Public utility districts) and §35.92.050 (1961) (cities). Both statutes provide that cities and PUD's have "full and exclusive authority to sell and regulate and control the use, distribution, rates, service, charges and price thereof. . . ." *WPPSS,* 99 Wash. 2d at 788-89, 666 P.2d at 337-38.

43. 43 Wash. 2d 237, 261 P.2d at 99; *WPPSS,* 99 Wash. 2d at 790, 666 P.2d at 338-39.

44. *WPPSS,* 99 Wash. 2d at 790, 666 P.2d at 339. The court also cited *State ex. rel. PUD 1 v. Schwab,* 40 Wash. 2d 814, 264 P.2d 1081 (1950). In *Schwab* the Washington Supreme Court upheld a PUD's ability to acquire plants for future power needs. The PUD in *Schwab,* however, retained *all* ownership interests in the facility as well as management and control of the project.

45. *WPPSS,* 99 Wash. 2d at 790, 666 P.2d at 338.

46. 28 Wash. 2d 113, 182 P.2d 706 (1947).

47. *WPPSS,* 99 Wash. 2d, at 789, 666 P.2d at 338.

48. *Id.*

49. 57 Wash. 2d 446, 357 P.2d 863 (1960).

50. *WPPSS,* 99 Wash. 2d at 791, 666 P.2d at 339.

the implied power to pay for a power plant also included the power to make financing arrangements such as the WPPSS Participant Agreements.[51] The Washington Supreme Court easily distinguished *Metro*, since that case did not have agreements containing take or pay provisions. In *Metro*, the City of Seattle undertook to pay for sewage services as they were provided. *Metro* thus involved a pledge conditioned on the receipt of services, not the unconditional promises contained in the WPPSS agreements.[52]

The court also emphasized that the relevant case law did not support a finding that broad implied powers have been delegated to municipalities and utility districts, including those entities with broad home rule powers.[53] The *WPPSS* court noted that the home rule powers of a Washington municipal corporation have been carefully limited by the legislature to powers expressly conferred or necessarily implied.[54] If the legislature has not expressly or impliedly authorized the specific action in question, in this case the "take or pay" contracts of WPPSS members, then the action must be held invalid.[55] Thus the *WPPSS* court concluded that "at least where the interest of the State is paramount to or joint with that of the municipal corporation," the municipal corporation has no power to act outside of the delegation of authority from the legislature.[56] The court found that the joint efforts of the WPPSS participants were a subject of state as well as local interest.[57] The state interest demanded that a municipality have either an express or implied delegation of authority. Since neither power existed, the agreements were invalid and could not stand.

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51. *Id.*

52. *Id.*

53. *Id.* at 789-91, 666 P.2d 334-40. Washington courts have narrowly interpreted home rule powers of Washington municipalities. They have limited home rule entities to their express powers in the same way as general law cities are so limited. *Id.* In many jurisdictions, states have conferred home rule powers onto municipal units. These units are given broad powers to legislate in any area not preempted by the state, even if the state has not expressly given the unit the power to so act. For example, a home rule city will have exentsive implied powers while a non-home rule city (also called a general law city) will be limited to those powers expressly given to it by the state or those necessarily implied in order for it to carry out its governmental function. *See generally* VALENTE, LOCAL GOVERNMENT LAW, 107-09, (1980).

54. 99 Wash. 2d at 793, 666 P.2d at 339, 340. *See* Trautman, *Legislative Control of Municipal Corporations in Washington,* 38 WASH. L. REV. 743, 772 (1963).

55. *Id.; see* Hillis Homes Inc. v. Snohomish County, 97 Wash. 2d 804, 808, 650 P.2d 193, 195 (1982) (if any doubt about a city's claimed grant of power, it must be denied).

56. *WPPSS*, 99 Wash. 2d at 793, 666 P.2d at 340.

57. The court stated that the state is vitally interested in the diverse municipal powers that might be employed in this type of project. *Id.*

3. Joint Operating Agreements

The *WPPSS* court then analyzed the state statutes covering joint operating agreements[58] to determine if take or pay contracts could be upheld under those provisions. Revised Code of Washington section 43.52.410 allows any city or district to enter into contracts or compacts with any operating agency, such as WPPSS, for the purchase and sale of electricity[59] and a similar statute also gives an operating agency authority to enter into contracts with local government units.[60] The court found these statutes inapposite because they explicitly allowed only for the *purchase* of electricity, and not for the purchase of only a *potential share* of electricity. The *WPPSS* court, therefore, found no basis for the participants' authority under the joint operating agreements statutes.[61]

4. Joint Development Agreements

Finally, the court analyzed the participants' scope of authority under the state electric power joint development statute.[62] This statute delineates the authority of cities and public utility districts to participate jointly in the development of power facilities as a means of achieving economies of scale and thus meeting the power needs of the state. The court held that the joint development statute was inapplicable because the participants failed to retain a sufficient ownership interest in the works[63] and because they were not responsible for more than merely their own debts and obligations in connection with the WPPSS facilities.[64] Citing *Public Utility District No. 1 of Snohomish County v. Taxpayers and Ratepayers of Snohomish County,*[65] the court held that to withstand scrutiny under a joint development statute, the participants must retain an ownership interest in their facilities and limit their own liability to their proportionate participation in the program.[66] Because these standards were

58. WASH. REV. CODE ANN. §§43.52.250-.910 (1961).
59. *Id.* §43.52.410 (1961).
60. *Id.* §43.52.391 (1961) (operating agency may make contracts for any term relating to the purchase of power . . . and may purchase or deliver power anywhere pursuant to contract).
61. *WPPSS,* 99 Wash. 2d at 794, 666 P.2d at 341.
62. WASH. REV. CODE ANN. § 54.44.010-.910 (1967).
63. *WPPSS,* 99 Wash. 2d at 795, 666 P.2d at 341.
64. *Id.* at 797, 666 P.2d at 341-42; WASH. REV. CODE ANN. §54.44.030 (1961) (In carrying out the powers granted in this chapter, each city . . . shall be severally liable only for its own acts and not jointly or severally liable for the acts . . . of others).
65. 78 Wash. 2d 724, 479 P.2d 61 (1971).
66. *WPPSS,* 99 Wash. 2d at 797, 666 P.2d at 342.

not complied with in WPPSS, the joint development agreement statute was not adequate authority to uphold the take or pay provisions in the participant agreement.

THE EFFECTS OF THE WPPSS DECISION

In essence, the *WPPSS* decision turned on equitable issues. Unsuspecting ratepayers guaranteed bond payments regardless of plant completion, surrendered ownership interest and control to WPPSS, and agreed to assume potentially astronomical obligations of defaulting participants.[67] The same issue of delegation of power that governed the *WPPSS* decision in Washington may be relevant in states that have not yet ruled on the validity of take or pay clauses in contracts financing the construction of nuclear power plants.[68] Particularly in the state of California, where nuclear plant construction costs are skyrocketing and anti-nuclear sentiment has been recently aroused over the Diablo Canyon power plant,[69] a challenge patterned after the *WPPSS* decision is foreseeable.

California and Washington present almost identical factual situations. California public power agencies, known as joint action agencies, contract with participants using take or pay agreements.[70] Although no challenge to these agreements has been brought to date, this article will now focus on California law and speculate as to whether the analogous financing arrangements secured by participant take or pay agreements will be upheld if challenged in California.

California has outstanding obligations of $1,620,000,000 in long-term bonds and $332,875,000 in two year short-term notes, both of which are backed by some type of take or pay provision.[71] The reliance

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67. *Id.* at 798, 666 P.2d at 343. The *WPPSS* court stated that if they had upheld the Participant Agreements, participants (and ratepaying consumers) collectively could have ended up paying $7 billion for nuclear plants which would never generate electricity. *Id.* at 777, 666 P.2d at 332.

68. *See supra* note 3.

69. N.Y. Times, September 29, 1981, at 8, col. 3 (Protestors arrested at Diablo Canyon Nuclear Power Plant).

70. Connecticut and Minnesota joint action agencies do not use these clauses with participant members but have themselves agreed to include take or pay provisions in purchase agreements with other utilities, both public and private (e.g., a Connecticut agency will contract with another utility company for energy supplies because it cannot meet all the needs of its participants with its own facilities). Whether take or pay contracts between a public power agency and non-participating parties are subject to the same scrutiny as participant agreement (as in *WPPSS*) has yet to be determined. Telephone interview with Robert Naylor, Executive Assistant, Connecticut Municipal Electric Energy Cooperative and Dave Loer, MinnCoda Power Cooperative. October 12, 1983.

71. MSR Public Power Agency has $215,000,000 of bonds outstanding which are supported by Public Service of New Mexico's agreement to take or pay for power generated from

of Southern California Public Power Agency (hereinafter referred to as "SCPPA") on nuclear power and take or pay agreements with participants so closely resembles the *WPPSS* arrangement that this article will consider the outcome of a *WPPSS*-like challenge in California based on the composition of SCPPA and the authority expressly or impliedly granted to SCPPA participants by the California Legislature.

The Southern California Public Power Agency

The Southern California Public Power Agency is comprised of nine cities and one irrigation district.[72] Each city of SCPPA is also the owner of a local utility.[73] A city that owns a utility is a very different creature of state law from an irrigation district. The two are treated quite differently by the California Legislature and the courts. If a city or town supplies its inhabitants with water, light, and power, the utility is considered "municipally owned."[74] Municipally owned utilities are generally managed by a city administrator or employee who is responsible to the mayor and the city council. An irrigation district, on the other hand, is established by citizens of a county who decide to combine their resources for a very limited purpose, generally to supply themselves with sewer, water, or power services. An irrigation district is run by an elected Board of Directors.[75] Each director represents a specific area of the district and stands for re-election periodically. The director is responsible only to his or her constituents and does not report to any other governing body or elected official.[76]

Each SCPPA participant has entered into a Power Sales Agreement with SCPPA in which the participants agree to make payments according to take or pay provisions[77] that are almost identical to the

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coal. Northern California Public Power Agency has $55,000,000 of bonds outstanding, guaranteed by participant take or pay contracts for geothermal energy. Kings River Conservation District has bonds of $700,000,000 supported by take or pay agreements with California Department of Water Resources for hydroelectric power. Finally, Southern California Public Power Agency has $650,000,000 outstanding in bonds and $332,875,000 in notes which are secured by participant take or pay agreements. SCPPA power is 100% nuclear. Austen, "Take or Pay Contracts", Drexel Burnham Lambert, at 2-3 (July 22, 1983).

72. SCPPA Bond Anticipation Notes Offering Statement, July 15, 1983, at 22. The member cities are Riverside, Vernon, Burbank, Glendale, Pasadena, Azusa, Banning, Colton and the City of Los Angeles Department of Water and Power. The irrigation district is the Imperial Irrigation District.

73. *Id.*

74. *See generally* Cal. Pub. Util. Code §§10001-10006.

75. *See generally* Cal. Water Code §§20500-21550.

76. *Id.*

77. SCPPA Bond Anticipation Notes Offering Statement at 9.

clauses in the WPPSS agreements.[78] The Sales Agreements also contain provisions concerning the termination of the project[79] and the obligations of each participant under the bond indenture.[80]

Like WPPSS, SCPPA was formed by a joint agreement for the "purpose of planning, financing, developing, acquiring, constructing, operating and maintaining projects for the generation or transmission of electric energy."[81] The Agency is governed by a Board of Directors consisting of one representative for each member.[82] Each director is entitled, however, to cast votes proportionate to the amount of electricity to be consumed by their organizations.[83] SCPPA has issued bonds and notes[84] to finance the purchase of a portion of the Palo Verde Nuclear Generating Station Units 1, 2, and 3. Unit 1 was scheduled to begin operation by 1984, Unit 2 in late 1984, and Unit 3 in 1986.[85] Those projected operating dates, however, were based on the assumption that no additional delays in construction would occur. On July 29, 1983, internal damage to the cooling system in Unit 1 was discovered and the operating schedule for that unit has been postponed indefinitely.[86]

Assuming there is a challenge to the Power Sales Agreements that SCPPA has with participating cities and the irrigation district, the California Supreme Court would quite possibly take the same approach used by the *WPPSS* court. The court would review the express or implied authority under state law of the SCPPA participants to purchase power and acquire or construct facilities with take or pay contracts. Moreover, the California Supreme Court would also consider whether state joint operating or joint developing statutes similar to the Washington statute examined by the *WPPSS* court would be sufficient to uphold such contracts.

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78. *See supra* notes 12-14 and accompanying text. The SCPAA clauses read "[w]hether or not the authority interest or any part thereof is operating or operable (or has been completed) . . . such payments shall not be subject to reduction whether by offset or otherwise and shall not be conditional upon performance or non-performance by any party . . ." SCPAA Bond Anticipation Notes Offering Statement at 9.

79. *See infra* notes 124-26 and accompanying text.

80. *See infra* notes 119-22 and accompanying text.

81. SCPPA Bond Anticipation Notes Offering Statement at 12.

82. *Id.* at 13.

83. Votes are in direct relationship to cost and entitlement shares of power to be generated. Presently, Los Angeles Department of Water and Power has a 67% share, Imperial Irrigation 6.5%, Riverside 5.4%, Vernon 4.9%, Burbank, Glendale and Pasadena 4.4% each, and Azusa, Banning and Colton 1.0% each. *Id.* at 22.

84. *See supra* note 71 and accompanying text.

85. SCPPA Board Anticipation Notes Offering Statement at 16.

86. *Id.*

A. Express Powers

Under California law, all SCPPA participants have the power to purchase and sell electricity.[87] As in Washington, however, this express authority is silent on the power to purchase "project capability" or the possibility of future power. Following the *WPPSS* rationale that an agreement providing for payment even if no electricity is actually generated does not qualify as a "purchase" of electricity, the California Supreme Court would probably strike down take or pay clauses based on the statutory power to purchase electricity.[88]

As in *WPPSS*, all of the SCPPA participants are granted statutory authority to acquire or construct generating facilities.[89] Under the *WPPSS* analysis, however, this power alone was insufficient to uphold take or pay clauses. Following the Washington court's analysis, the California court may determine whether the acquisition power has been validly exercised by determining whether the participants are required to retain an ownership interest in, or sufficient control over, the construction project, and whether the SCPPA participants have actually retained the requisite control.[90]

Municipalities that own their own utilities (nine of the ten SCPPA participants) are responsible for *acquiring* and *controlling* those facilities. California Public Utility Code section 10003 describes the scope of a municipality's acquisition powers:

> The power to *acquire and operate* a public utility includes the power to complete, reconstruct, extend, enlarge . . . a public utility. . . .[91]

This provision seems to require that whenever the acquisition power is exercised by a local government, operation of the facility by that government must follow.[92]

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87. The nine cities own their own utilities and have the power to acquire or operate any "public utility." A "public utility" is anything established to "supply a municipal corporation alone or together wth its inhabitants or any portion thereof with . . . light." CAL. PUB. UTIL. CODE §10001. Imperial Irrigation, the irrigation district, has virtually the same powers. It has the power to "purchase or lease electric power . . . and provide for [the] sale and lease of electric power." CAL. WATER CODE §22115.

88. *Compare supra* notes 27-30 and accompanying text.

89. CAL. PUB. UTIL. Code §10002 (Any municipal corporation may acquire, construct, own, operate or lease any public utility); CAL. WATER CODE §22115 (any irrigation district may provide for the acquisition, leasing and control of plants for generation, transmission distribution, sale and lease of electric power).

90. *Compare supra* notes 31-50 and accompanying text.

91. CAL. PUB. UTIL. CODE §10003 (emphasis added).

92. *Compare* CAL. PUB. UTIL. CODE §12801 *with id.* §10003. Section 12801 describes the acquisition powers of a municipal utility district (MUD), an entity that is totally unrelated to a municipally owned utility. A MUD may "acquire, construct, own, operate, control or use generating facilities . . . ." Unlike the acquisition powers of a municipally owned utility,

Irrigation districts, like SCPPA participant Imperial Irrigation District, also need to retain an ownership interest after acquiring a public utility. The statutory provisions that permit an irrigation district to acquire facilities also imply that a district must retain control over the utility's operations:

> Any district . . . may provide for the acquisition, operation, leasing *and control* of plants for the generation, sale and lease of electric power.[93]

Other code provisions imply that the legislature intended irrigation districts to control their facilities. Section 22118 states that an irrigation district will undertake necessary and proper acts for the construction *and operation* of its electric power works[94] and section 25656 provides that the board of an irrigation district is responsible for setting rates that will insure that such facilities will be self-sustaining.[95] These restrictive statutory provisions indicate that the legislature intended irrigation districts to be responsible for their own utilities.

1. Retention of An Ownership Interest

The California court thus may require SCPPA participants to retain an ownership interest in the projects operated by SCPPA. SCPPA has applied its bond revenues to purchase an interest in the Palo Verde Nuclear Generating Stations 1, 2, and 3, and to acquire the right to use certain portions of the Arizona Nuclear Power Project Transmission System.[96] SCPPA has a 5.91% ownership interest in the generating stations, but has no ownership interest in the transmission system.[97] Furthermore, pursuant to an agreement with Arizona Public Services (hereinafter referred to as APS), APS will be responsible for operating and maintaining both the stations and the transmission system.[98] The SCPPA participants thus, have no significant ownership interest in these projects.

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however, the legislature has not limited a MUD's powers by defining the scope of such authority. (*See* §10003, Scope of the powers of a municipally owned utility, *supra* text accompanying note 90). The decision of the legislature to define the powers of a municipally owned utility (and not the powers of a MUD) and its description of this authority as "the power to *acquire* and *operate*" indicates that the legislature intended a city acquiring a power plant to maintain managerial control over the facility as well.

93. CAL. WATER CODE §22115 (emphasis supplied).

94. *Id.* §22118 (emphasis supplied).

95. *Id.* §25656(b) (the board shall fix such charges for commodities or service furnished by any revenue producing utility as will pay all of the expenses of the government of the district).

96. SCPPA Bond Anticipation Notes Offering Statement at 2.

97. *Id.*

98. *Id.*

2. *Maintaining "Sufficient Control" Over The Projects*

Under the *WPPSS* rationale, if no ownership share in the projects exist, then sufficient *control* over the power plant projects is required.[99] The *WPPSS* court held that sufficient control can exist even though participants do not exercise control directly, but act through an executive committee. This committee, however, must be responsible for overall management and allow participants a voice in the decisions made by the power supply organization, WPPSS in Washington or SCPPA in California.[100]

The SCPPA Board does not meet the requirements enunciated by the *WPPSS* court. Although the Board consists of one representative for each of the participating members,[101] each representative's vote does not carry the same weight. A Director is entitled to cast votes weighted according to the size of the entitlement that is represented.[102] For example, the Los Angeles Department of Water and Power (the Department) and the City of Colton each have a member on the Board. The Department representative, however, has sixty-seven votes while the Colton representative has only one.[103] Although all matters before the Board must be decided by 80% of the votes cast and no vote can occur unless Directors making up more than 50% of the votes are present,[104] it is clear that the Department will always prevail. The other participants, even voting as a block, cannot exercise control over SCPPA. SCPPA committee procedures thus appear to confer even less power on participating members than was allowed under WPPSS procedures.

B. *Implied Powers*

1. *Municipally Owned Utilities*

Of the nine municipally owned utilities in SCPPA, six are charter cities under California law. The City of Los Angeles, which controls the Los Angeles Department of Water and Power, and the cities of Riverside, Vernon, Burbank, Glendale, and Pasadena are all charter

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99. *See supra* notes 36-41 and accompanying text.
100. *Id.*
101. This was one factor supporting "sufficient control" in the eyes of the *WPPSS* court. *See supra* note 7.
102. SCPPA Bond Anticipation Notes Offering Statement at 13. For entitlement shares, see *supra* note 83.
103. SCPPA Bond Anticipation Notes Offering Statement at 22; *see supra* note 83.
104. *Id.* at 13.

cities. The cities of Azusa, Banning, and Colton are considered general law cities.[105]

General law cities have only those powers given to them by the legislature. Under California law, grants of power to general law cities are strictly construed and any doubts are resolved against the power claimed.[106] Charter cities, on the other hand, are treated differently. California law confers broad power and discretion to charter cities, especially when they are conducting municipal affairs. The California Constitution provides:

> cities and towns hereafter organized *under charters* . . . are hereby empowered . . . to make and enforce all laws and regulations in respect to municipal affairs, subject only to restrictions and limitations provided by their charters and in respect to other matters they shall be subject to and controlled by general laws.[107]

The powers of a charter city are limited only if laws enacted by the city conflict with a state law of California or an expressly stated purpose.[108] In essence, if the state has already spoken, local law will be invalid, but when the state has not spoken, the municipalities are given a free hand.[109]

A California court of appeal has stated that the implied powers of a charter city include management of electric power. The court held that the sale and distribution of electrical energy is a "municipal affair" over which local governments have great discretion.[110] Under a *WPPSS* analysis, the take or pay contracts between the six charter cities and SCPPA, therefore, would probably be upheld because the SCPPA Power Sales Agreements concern the sale and distribution of electricity, a matter of local concern.

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105. Telephone conversation with Lydia Levin, Associate, Rourke and Woodruff, Counsel to SCPPA, Santa Ana, California (November 18, 1983).

106. Los Angeles Flood Control District v. Southern California Edison Co., 51 Cal. 2d 331, 338, 333 P.2d 1, 5 (1958).

107. CAL. CONST. art. IX, §6. (emphasis added). *See* Taylor v. Crane, 595 P.2d 129, 134, 155 Cal. Rptr. 695 (1979) (city charter is construed to permit exercise of powers not expressly limited by charter or by superior state or federal law); Medford v. City of Tulare, 102 Cal. App. 2d 910, 228 P.2d 847, 850 (Cal. 1951) (in respect to municipal affairs, city is not subject to general law except as the charter may provide). *See also* Foundation for San Francisco's Architectural Heritage v. City and County of San Francisco, 106 Cal. App. 3d 893, 906 (1980); Bayless v. Limber, 26 Cal. App. 3d 463, 469, 102 Cal. Rptr. 647, 650 (1972).

108. Cunningham v. Hart, 80 Cal. App. 2d 902, 183 P.2d 75, (1947) (where matter is statewide concern, a state law may control provisions of municipal charter on same subject).

109. John Tennant Memorial Homes v. City of Pacific Grove, 27 Cal. App. 3d 372, 384, 103 Cal. Rptr. 215, 223 (1972).

110. Los Angeles Gas and Electric Corp. v. the City of Los Angeles, 188 Cal. 307, 318-20 (1922) (court upheld a challenge to a contract between Los Angeles and private electric companies for distribution of the city's surplus electricity); *In re* Bonds of Orosi Public Utility District, 196 Cal. 43, 57, 235 P. 1004, 1010 (1925) (public service activities, such as sale and distribution of electrical energy are municipal affairs).

The sweeping incidental powers granted to municipalities under California Public Utilities Code section 10004 augment the implied powers granted to charter cities. Section 10004 states that a municipality has the power to "acquire, own, control, sell or *exchange . . . rights of every nature* within or without its corporate limits."[111] A strong argument can be made that "rights of every nature" includes the "capacity rights" in the Palo Verde nuclear power plant. Although this argument alone may not necessarily be enough to validate the take or pay provisions in question, the combination of this power and the charter city's broad implied powers would seem to be sufficient to create implied authority to enter into the SCPPA take or pay agreements. Finally, the legislature has not expressly forbidden charter cities to enter into these types of contracts. Thus, the actions of charter cities in joining SCPPA do not explicitly conflict with any state law. Although it is likely that the California Supreme Court would not uphold the take or pay contracts of the general law city participants of SCPPA based on their very limited implied powers,[112] the court would probably allow these provisions for charter city participants because of (1) the broad powers of the cities, both express and implied, over municipal affairs, and (2) the failure of the legislature to prohibit cities from entering into take or pay agreements.

2. *Irrigation Districts*

The implied powers of irrigation districts are much less extensive than the powers of charter cities. Although irrigation districts have sometimes been characterized as municipal corporations,[113] due to their nature as districts with a specific, limited purpose, they lack broad general charter city powers.[114] In *People ex. rel. Jones v. Cardiff Irrigation District*[115] the California Supreme Court stated that the

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111. CAL. PUB. UTIL. CODE §10004 reads in full:
Incidental Powers. For the purpose set forth in 10002 and 10003, a municipal corporation may acquire, own, control, sell or exchange lands, easements, licenses and *rights of every nature* within or without its corporate limits, and may operate a public utility within or without the corporate limits when necessary to supply the municipality or its inhabitants or any portion thereof with the service desired (emphasis added).

112. *Cf. supra* note 106 and accompanying text.

113. Glenbrook Development Co. v. City of Brea, 61 Cal. Rptr. 189, 194 (1967) (term "municipal corporation" as used in art. XI, §19 of Constitution embraces entities other than cities and includes irrigation districts). A municipal corporation is simply any corporate body consisting of inhabitants of a designed area created by the legislature with or without consent of those inhabitants. BLACK'S LAW DICTIONARY, 917 (5th ed. 1979).

114. CAL. CONST. art. XI, §6. Only *cities and towns* organized under charters can be granted broad charter city powers, not all "municipal corporations."

115. 197 P. 384, 51 Cal. App. 307 (1921).

powers of an irrigation district are more limited than the powers of other municipal organizations.[116] California courts have interpreted the powers of an irrigation district in the narrowest possible way stating that the districts have "only those powers expressly provided or necessarily implied."[117] Specifically, the courts have invoked "Dillon's Rule," which limits the powers of a municipal corporation to those (1) expressly granted, (2) necessarily implied by express powers, or (3) essential to the achievement of a declared objective; any doubt concerning the validity of power is to be construed against the municipal corporation.[118] Thus, it appears that irrigation districts do not enjoy implied powers broad enough to sustain take or pay agreements.

C. Joint Operating Statute

The joint operating statute in California is similar to the one analyzed by the *WPPSS* court. The California statute[119] expressly allows for the creation of SCPPA, and also determines the composition of the power agency.[120] California Government Code section 6545, like the Washington statute, implies that SCPPA may enter into contracts for project capacity, and agencies may issue revenue bonds to pay the cost of any capacity rights in the facility.[121] Under the *WPPSS* reasoning, however, this power is not enough because the statute is silent on the power of the *participants* to purchase electricity that may not be actually generated and that cannot be classified as a purchase of electric energy. The *WPPSS* court stated:

> If WPPSS were simply selling the electric energy, the participants obviously would be authorized to buy it. However, since the terms of the agreement encompass only a potential share to be generated, it is not accurate to analyze participants' authority in terms of purchasing electric energy. Since the statutes do not provide for the purchase of electric energy that may not be generated, we can discern

116. *Id.* at 385-86, 51 Cal. App. at 308.

117. Bottoms v. Madera Irrigation District, 74 Cal. App. 681, 694-95, 242 P. 100, 103 (1925).

118. DILLON, MUNICIPAL CORPORATIONS, §237 (89) (5th Edition 1911). *See* VALENTE, *supra* note 53, at 75-76. Other California case law further supports the findings of the *Bottoms* court. *See* Harden v. Superior Court in and for Alameda County, 44 Cal. 2d 630, 638-39, 284 P. 2d 9, 14-15 (1944) (endorsing Dillon's Rule for non-charter city "municipal corporations"); Los Angeles Flood District v. Southern California Edison, 51 Cal. 2d 331, 335-36, 333 P.2d 1, 3 (1958) (grants of power to non-charter city municipal corporations are to be strictly construed and any doubts resolved against power claimed).

119. CAL. GOV'T CODE §§6500-6546.

120. *Id.* §6508 authorizes joint power agency governance by committee and allows elected members of that governing body to be elected in any ratio agreed to by parties.

121. *Id.* §6545.

no basis for the participants authority in RCW 43.52 (Joint Operating Agreements).[122]

Although California does not have a joint development statute, the liability questions raised by the *WPPSS* court would still be relevant. In *WPPSS*, the participants were jointly and severally liable for the indebtedness of WPPSS. The unlimited liability played an important part in the decision of the *WPPSS* court, since the tax payers were left unprotected and subject to increased liabilities.[123]

The agreements between SCPPA and its members do not create joint and several liability on the part of the participants.[124] However, the failure of a participant to make payments when due "may result in larger payments by other participants in subsequent periods so the Agency can pay . . . costs."[125] Although the Power Sales Contracts explicitly limit liability, this limit seems fictitious because SCPPA retains the right to amend the annual budget and increase participant billings to cover any deficiencies. The participants are obligated to pay these amended billings. Although a participant would be liable only for its respective entitlement share of the debt service if the Agency terminated a project,[126] anything less than termination is a "dry hole." Participants face seemingly *endless* liability.

Conclusion

The Washington State Supreme Court analyzed the issue in *WPPSS* as a question of the delegation of power to WPPSS participants by the State of Washington. The court held that the express and implied delegation of state power to the WPPSS participants to purchase electricity, acquire or construct facilities, and enter into joint operating or development agreements was insufficient to uphold the take or pay agreements. The court therefore invalidated the agreements of the participants in WPPSS.

The California Supreme Court, following a similar approach when called upon to analyze Southern California Public Power Agency participation agreements, might be persuaded by the decision of the Washington court to invalidate some of the agreements. The statutory power to purchase electricity granted to SCPPA participants does not expressly authorize take or pay provisions. Furthermore, California

122. *WPPSS*, 99 Wash. 2d at 791, 666 P.2d at 340. *See supra* notes 65-68 and accompanying text.
123. *WPPSS*, 99 Wash. 2d at 797, 666 P.2d at 342-43.
124. SCPPA Bond Anticipation Notes Offering Statement at 9.
125. *Id.*
126. *Id.*

law concerning municipally owned utilities (nine of the ten SCPPA participants) and irrigation districts (one of the SCPPA participants) supports the reasoning of the *WPPSS* court that an ownership interest or "sufficient control" must accompany the exercise of the power to acquire and construct generating facilities. Because the municipally-owned utilities and the irrigation district neither retain an ownership interest in SCPPA's project nor exercise "sufficient control" of SCPPA's Executive Board, they cannot use their "acquisition" powers to unconditionally pledge their revenues.

California law, however, does imply broad powers to *charter cities*, which constitute six of the ten participants in WPPSS. Because of these broad powers, the take or pay provisions in the contracts entered into by the six charter city SCPPA members and SCPPA would probably be upheld. The implied powers of the four non-charter city members (three general law cities and one irrigation district), however, are not extensive enough to support their entering into take or pay contracts.

Non-charter city members can find no support for their commitments under joint operating or development statutes. Joint operating statutes do not expressly provide for take or pay contracts and the failure of SCPPA Power Sales Contracts to limit participating members' liability also cuts sharply against take or pay provisions for equitable reasons.

Therefore, the California Supreme Court is likely to uphold the take or pay provisions in the Power Sales Contracts for six of SCPPA's ten members, the municipally owned utilities controlled by the charter cities of Los Angeles, Riverside, Vernon, Burbank, Glendale, and Pasadena. Because these members are responsible for 90.5% of SCPPA's outstanding debt,[127] failure of the California Supreme Court to uphold the take or pay provisions of the other four SCPPA members would not materially jeopardize the Agency's activities.

Finally, it is arguable that the political setting of the WPPSS decision is relevant.[128] The justices of the Washington Supreme Court must stand for re-election every six years.[129] Consequently, the Washington court may have been more sensitive to the political ramifications of their decision than the justices on the California

127. The six charter cities have assumed 90.5% of the SCPPA liability. Los Angeles Department of Water and Power is responsible for 67%, Riverside 5.4%, Vernon 4.9%, Burbank, Glendale and Pasadena 4.4% each. *Id.* at 22.

128. Christian Science Monitor, June 20, 1983, at 10.

129. WASH. CONST. art. IV, §3.

Supreme Court.[130] A judgment for WPPSS in Washington would have been politically unpopular because it would have forced the municipalities to comply with their contracts and pay for failed WPPSS projects. The municipalities would then have had to pass the increased costs on to utility ratepayers. The California court is somewhat more insulated from the electorate and might vote more freely to uphold a greater state interest in the future supply of energy and the continuation of SCPPA in its present form.

130. *See* CAL. CONST. art. VI, §16 (Supreme Court Justices elected by state voters to a 12 year term after nominations or appointment by governor).