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# DRY-HOLE AGREEMENTS AND DEBT LIMITATION PROVISIONS: THE LESSONS OF WPPSS

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## I. INTRODUCTION

A fundamental duty of any municipality is to provide its citizens with electricity.<sup>1</sup> To ensure an adequate future supply of power, the municipality must base its plans on estimates of future electrical needs. In the state of Washington, miscalculations of these estimates led to an unprecedented bond default when cost overruns halted the completion of two nuclear power plants.<sup>2</sup> In the wake of litigation resulting from this default, municipalities that contracted with the regional power supply system sought to escape from their payment obligations.<sup>3</sup>

Courts examining the contracts between the power supply system and the municipalities focus on two issues. First, because contracts with the power supply system obligated municipalities to pay regardless of whether the power plants produced any electricity, some cities asserted a lack of statutory authority to enter into the contracts. The Washington Supreme Court held that local governments lacked the statutory authority to purchase electricity and to construct and operate generating facilities.<sup>4</sup> Basing this conclusion on a narrow interpreta-

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1. This duty arises from specific statutory authority. See *infra* notes 49-52. Municipal officials also feel a moral duty to provide their citizens with power. See Olsen, *infra* note 9, at 20.

2. Several sources provide a general background. See Hittle, *Pacific Northwest Power Generation, Multi-Purpose Use of the Columbia River, and Regional Energy Legislation: An Overview*, 10 ENVTL. L. 235 (1980); Foote, Larsen and Maddow, *Bonneville Power Administration: Northwest Power Broker*, 6 ENVTL. L. 831 (1976); Natural Resources Defense Council v. Hodel, 435 F. Supp. 590 (1977).

3. A general description of this litigation is found in Olsen, *infra* note 9.

4. *Chemical Bank v. Washington Pub. Power Supply Sys.*, 99 Wash. 2d 772, 666

tion of the statutes, the court ignored the proprietary character of the municipalities' acts.<sup>5</sup> Second, local governments also claimed that their unconditional obligation to pay the power system violated state debt limitation provisions. Disagreeing with the Idaho Supreme Court,<sup>6</sup> the Oregon Supreme Court<sup>7</sup> concluded that the amounts paid by the municipalities for the supply of power failed to violate statutory debt limitation provisions.<sup>8</sup>

This Note examines the positions of the Washington, Oregon, and Idaho courts and argues that the burden of the bond default should rest on the municipalities instead of the bondholders. Part II delineates the background of this litigation. Part III examines the correct standard of statutory interpretation for purchases of electricity. Part IV analyzes debt limitation provisions to determine whether the municipalities created debt. Part V urges the adoption of liberal statutory interpretation and the application of a broad special fund.

## II. THE SETTING

In 1957, sixteen public utility districts in the state of Washington formed a joint operating agency (JOA) to construct and operate electrical generating facilities and to sell the electricity produced.<sup>9</sup> Now called the Washington Public Power Supply System (WPPSS), this

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P.2d 329 (1983), is the principal case in the morass of litigation. It is an action by the bondholder trustee to hold the municipalities to their contracts.

5. According to a noted commentator, statutory authority must be interpreted in accord with the type of act the municipality is performing. *See infra* notes 89-90. A municipality acts either in a private capacity or in a governmental capacity.

6. *Asson v. City of Burley*, 105 Idaho 432, 670 P.2d 839 (1983).

7. *DeFazio v. Washington Public Power Supply Sys.*, 296 Or. 550, 679 P.2d 1316 (1984).

8. A debt limitation provision prevents a municipality from entering into projects that create debt without the assent of its voters. Debt limitation provisions and the exemptions from them are described in detail below. *See infra* notes 111-118 and accompanying text.

9. Olsen, *The Washington Public Power Supply System: The Story So Far*, 109 PUB. UTIL. FORT. 15, 17 (June 10, 1982).

Many states have joint operating agency statutes. These statutes authorize municipal entities to create a joint operating agency that is an agent or instrumentality of the municipalities. LA. REV. STAT. ANN. § 33.1332 (West Supp. 1983); WASH. REV. CODE ANN. § 43.52.360 (1983). The joint operating agency is managed by a board made up of representatives of the municipal entities. Comment, *Chemical Bank v. Washington Pub. Power Supply Sys.: The Questionable Use of the Ultra Vires Doctrine to Invalidate Governmental Take-or-Pay Obligations*, 69 CORNELL L. REV. 1094, 1105 (1984).

An advantage of the JOA is that it allows the municipal entities to share the capital

JOA includes nineteen public utility districts and four cities.<sup>10</sup> WPPSS has authority to acquire, build, operate, and own electrical generating facilities.<sup>11</sup> As a JOA, WPPSS also has authority to issue revenue bonds payable from the revenues of the various utilities operated by it.<sup>12</sup>

The planners of WPPSS felt a moral duty to provide electricity regardless of any foreseeable catastrophe to the electrical system.<sup>13</sup> This self-imposed duty led the planners of WPPSS to provide for a surplus of electricity.<sup>14</sup> Unfortunately, the planners relied on grossly miscalculated future load growth estimates.<sup>15</sup> Compounded by cost escalation and mismanagement, these miscalculations intimated the demise of WPPSS.<sup>16</sup>

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costs and financial risks of electric generation projects. Worenklein, *Project Financing of Joint Ventures*, 108 PUB. UTIL. FORT. 39, 40-41 (Dec. 3, 1981).

The municipal entities that create the JOA are not directly obligated to pay debts incurred by the JOA. *Id.* Rather, investors who purchase the bonds issued by the JOA "must base their credit evaluations on the ability of the project as a whole to generate enough cash revenues to service the debt of the project company and to meet its other expenses." *Id.* at 40. The JOA usually lacks security for the bonds. To help market the bonds, the municipal entities provide credit support to secure the debt of the JOA. *Id.* Normally, the municipal entities provide capital to construct the project and agree to pay for the energy provided by the project in an amount sufficient to service the project debt. *Id.*

10. *Chemical Bank v. Washington Pub. Power Supply Sys.*, 99 Wash. 2d 772, 777, 666 P.2d 329, 331 (1983). The cities are Ellensburg, Richland, Seattle and Tacoma. *Id.*

11. See WASH. REV. CODE ANN. § 43.52.300 (1985).

12. WASH. REV. CODE ANN. § 43.52.3411 (1985). In general, revenue bonds are "long term municipal debt which is secured only by contractual obligation to repay the bonds from a designated source of revenue. Rankin, Osburn and Rogers, *Municipal Bonds and Property Tax Limitations*, 9 ENVTL. L. 453, 466 (1979). If there is a default on the revenue bonds, the issuer is not obligated to make payments from its general fund. *Id.* at 467. A revenue bond is more risky than a general obligation bond. *Id.* As a result, borrowing with revenue bonds is costlier than borrowing with general obligation bonds. *Id.* Here, WPPSS issued the revenue bonds to pay for WNP 4 and 5. The Participants agreed to pay WPPSS sufficient funds to cover the cost of the bonds plus interest.

13. Olsen, *supra* note 9, at 21.

14. *Id.* The planners assumed that forecast predictions that were too low could have significant social and economic consequences, such as reduced capital investment, fewer jobs, and lower living standards. *Id.* at 20.

15. *Id.* The planners believed that the region's future electrical loads would continue in accord with the past trend of five to seven percent annual increases. *Id.* In actuality, the average annual load increases about half of the estimates. *Id.*

16. *Id.* at 16. Except for the Tennessee Valley Authority, WPPSS is the largest public nuclear power plant construction program in the country. *Id.* at 15-16. When

In 1974, concern over increasing electrical loads prompted WPPSS to authorize the construction of two nuclear power plants (WNP 4 and 5).<sup>17</sup> WNP 4 and 5 were designed to supplement the power from WPPSS' three extant nuclear power facilities (WNP 1, 2 and 3).<sup>18</sup> To finance these two additional plants, WPPSS contracted with eighty-eight municipal entities in six states (Participants).<sup>19</sup> To represent these contracts, each Participant signed an identical "Participant's Agreement" (Agreement).<sup>20</sup>

The federal government financed WNP 1, 2, and 3, but not WNP 4 and 5.<sup>21</sup> Rather, the Participants directly financed<sup>22</sup> WNP 4 and 5 through their own borrowing capabilities.<sup>23</sup> The Agreement provides that the Participants may pay WPPSS only from the revenues derived by the individual Participant from sale of its share of the electricity from WNP 4 and 5.<sup>24</sup> To ensure that the payments are made only

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WPPSS began planning construction, the five nuclear plants were projected to cost \$4.5 billion. *Id.* at 16. At least 20 billion additional dollars will be needed to effect this plan today. *Id.* This cost escalation was due to increases in inflation, interest rates, and construction delays. *Id.* at 19.

17. *Id.* at 20.

18. *Chemical Bank*, 99 Wash. 2d at 777, 666 P.2d at 331.

19. *Id.* at 778, 666 P.2d at 332. In addition to WPPSS itself and Pacific Power & Light Company, there are eighty-eight Washington cities, nineteen Washington public utility districts, one Washington irrigation district, seven Oregon cities, four Oregon peoples utility districts, five Idaho cities, and forty-three rural electric cooperatives in Washington, Idaho, Montana, Nevada, Oregon, and Wyoming. *Id.*

20. *Id.* Washington state law required these Participants' agreements on a plant before the JOA could issue revenue bonds. Olsen, *supra* note 9, at 20.

21. Olsen, *supra* note 9, at 20. The Bonneville Power Administration (BPA), a federal agency, aided the financing of WNP 1, 2, and through complex agreements that allocated the risk of noncompletion to the federal agency. *Chemical Bank*, 99 Wash. 2d at 777, 666 P.2d at 332. See *City of Springfield v. Washington Pub. Power Supply Sys.*, 564 F. Supp. 90, 95 (D. Or. 1983) ("net billing" agreements resulted in antirect guaranty by federal agency). Moreover, changes in Internal Revenue Service regulations subsequent to the construction of WNP 1, 2, and 3 prevented WPPSS from financing facilities with tax-exempt bonds if a federal agency purchased more than twenty-five percent of the power. Olsen, *supra* note 9, at 20.

22. Due to the lack of federal backing, the bonds issued by WPPSS for WNP 4 and 5 entailed greater risks than those issued for WNP 1, 2 and 3. To attract investors, these bonds carried a higher interest rate, further adding to cost overruns. Olsen, *supra* note 9, at 20.

23. The Participants issued revenue bonds to finance WNP 4 and 5. The bond resolution requires the Participants to make payments to WPPSS for electricity and capability, which are adequate to provide for payment of the revenue bonds. *Chemical Bank*, 99 Wash. 2d at 776, 666 P.2d at 332.

24. *DeFazio v. Washington Pub. Power Supply Sys.*, 296 Or. 550, 558, 679 P.2d

from this special fund,<sup>25</sup> the Agreement requires that each Participant maintain its rates high enough to cover its payments to WPPSS.<sup>26</sup>

Under the Agreement, each Participant must pay its proportionate share of the annual budget of WPPSS for a reciprocal share of the project's capability.<sup>27</sup> In other words, the Participants must pay even if no electricity is produced.<sup>28</sup> Such an agreement is commonly called a dry-

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1316, 1323 (1984). This provision requires that the Participants make payments to WPPSS only from a "special fund" established by each municipality. This obviates the need to pledge tax and other general revenue of the municipality. *See generally*, Heil *Another Day Older and Deeper in Debt: Debt Limitation, the Broad Special Fund Doctrine, and WPPSS 4 and 5*, 7 U. PUGET SOUND L. REV. 81 (1983). The Participants' Agreement provides:

No Participant . . . shall be required to make any payments to Supply System under this Agreement except from the revenues derived by such Participant from the ownership and operation of its electric utility properties.

*DeFazio*, 296 Or. at 558, 679 P.2d at 1323.

25. "Special Fund" is defined *infra* notes 111-118 and accompanying text.

26. The Agreement provides:

[Each] Participant covenants and agrees that it will establish, maintain and collect rates or charges for power and energy and other services, facilities and commodities sold, furnished or supplied by it through any of its electric utility properties which shall be adequate to provide revenues sufficient to enable the participant to make the payments to be made by it to Supply System under this Agreement and to pay all other charges and obligations payable from or constituting a charge or lien upon such revenues.

*DeFazio*, 296 Or. at 558, 679 P.2d at 1323.

27. *Chemical Bank*, 99 Wash. 2d at 777-78, 666 P.2d at 332. The Participants' Agreement defined "[p]roject [c]apability" as:

the amounts of electric power and energy, if any, which the Projects are capable of generating at any particular time (including times when either or both of the Plants are not operable or operating or the operation thereof is suspended, interrupted, interfered with, reduced or curtailed, in each case in whole or in part for any reason whatsoever) less Project station use and losses.

*Id.*

It must be emphasized that the Agreement provides for the purchase of project capability rather than for the purchase of electricity. *See infra* note 28.

28. *Chemical Bank*, 99 Wash. 2d at 778, 666 P.2d at 332. The Agreement provided: The Participant shall make the payments to be made to Supply System under this Agreement whether or not any of the Projects are completed, operable or operating and notwithstanding the suspension, interruption, interference, reduction or curtailment of the output of either Project for any reason whatsoever in whole or in part. Such payments shall not be subject to any reduction, whether by offset or otherwise, and shall not be conditioned upon the performance or nonperformance by Supply System or any other Participant or entity under this or any other agreement or instrument, the remedy for any nonperforming being limited to mandamus, specific performance or other legal or equitable remedy.

*Id.* This provision makes the Participants' payments the unconditional obligation of the Participants.

hole agreement because the municipality assumes the risk that the project may fail.<sup>29</sup> Despite this obvious risk, dry-hole provisions remain a popular provision in financing agreements of utility projects.<sup>30</sup> The obligations of the WPPSS contracts seem particularly onerous because WNP 4 and 5 are less than twenty-five percent complete and have yet to produce any electricity.<sup>31</sup> Massive cost overruns and delays managed to consume the entire bond issue.<sup>32</sup> Once interest and carrying charges are computed, the Agreements held the Participants liable for seven billion dollars,<sup>33</sup> even though the Participants never received any electricity.<sup>34</sup>

Faced with a near insurmountable debt, the individual Participants sought to escape their contractual obligations with WPPSS.<sup>35</sup> The validity of such agreements turned on two issues. First, courts determined whether the Participants had statutory authority to enter into the dry-hole agreements.<sup>36</sup> Second, courts determined whether the issuance of the bonds violated state debt limitation provisions.<sup>37</sup>

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29. This term arises because those entering such an agreement must pay even if the project turns out to be a dry hole, producing nothing. Such clauses are also called "hell-or-high water" provisions. See Worenklein, *supra* note 9, at 40. By obligating themselves to pay under all circumstances, the municipal entities unconditionally guaranteed the WPPSS bonds. *Chemical Bank*, 99 Wash. 2d at 784, 666 P.2d at 335. These dry-hole provisions place the credit of all eighty-eight participants behind the bonds, thus making the arrangement more attractive to the investors. The municipalities, rather than the investors, bear the risk of non-completion.

30. See *infra* note 48.

31. *Chemical Bank*, 99 Wash. 2d at 776, 666 P.2d at 331. On January 22, 1982, WPPSS terminated construction of both plants. *Id.* At that time, WNP 4 was 24 percent completed and WNP5 was 16 percent completed. *But see* Olsen, *supra* note 9, at 25 (the possibility still exists that WNP 4 and 5 will be built by other utilities or investors).

32. See Heil, *supra* note 24, at 101.

33. *Id.* See also *Chemical Bank*, 99 Wash. 2d at 776, 666 P.2d at 331.

34. This clearly illustrates one of the disadvantages of dry-hole agreements.

35. See *Chemical Bank*, 99 Wash. 2d 776, 666 P.2d 329 (1983); *DeFazio*, 296 Or. 350, 679 P.2d 1316 (1984); *Asson v. City of Burley*, 105 Idaho 839, 670 P.2d 839 (1983).

36. See generally *Chemical Bank*, 99 Wash. 2d 772, 666 P.2d 329.

37. See generally *DeFazio*, 296 Or. 550, 679 P.2d 1316; *Asson*, 105 Idaho 432, 443, 670 P.2d 839, 851 (Bakes, J., dissenting).

### III. STATUTORY AUTHORITY

#### A. *Does the purchase of project capability qualify as a purchase of electricity?*

In *Chemical Bank v. Washington Public Power Supply System*,<sup>38</sup> the Washington Supreme Court considered whether the WPPSS Participants had the statutory authority to enter into agreements containing dry-hole provisions.<sup>39</sup> The court examined whether the statutory authority to purchase electricity<sup>40</sup> extends to the purchase of project capability. Without citing supporting authority, the *Chemical Bank* court held that such an agreement fails to qualify as a purchase of electricity.<sup>41</sup>

Disagreeing with the majority's narrow view of the statute,<sup>42</sup> the dissenting justice<sup>43</sup> urged a liberal interpretation<sup>44</sup> that would further the statutory purpose of furnishing power<sup>45</sup> and would include the purchase of project capability. The Participants formed the Agreement under circumstances that foreshadowed future energy shortfalls; therefore, at the time, the purchase of a future source of power was advisable.<sup>46</sup> The existence of statutory authority for the purchase of project

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38. 99 Wash. 2d 772, 666 P.2d 329 (1983).

39. In *Chemical Bank*, Chemical Bank, the bond trustee, brought a declaratory judgment action against WPPSS and the Participants. *Id.* at 776, 666 P.2d at 331. Chemical Bank sought a determination that the Participants "owe to WPPSS sufficient funds to pay the bonds, with interest." *Id.* WPPSS agrees with Chemical Bank as to the rights of the parties. *Id.* The Participants established defenses to the payment obligations. *Id.* The basic issue for the court in *Chemical Bank* was whether the Agreement was a contract within the statutory authority of the Participants located in the state of Washington. *Id.* at 781, 666 P.2d at 334.

40. *Id.* The Washington statute provides: "A district may purchase, within or without its limits, electric current for sale and distribution within or without its limits . . ." WASH. REV. CODE ANN. § 54.16.040 (1985).

41. 99 Wash. 2d at 784, 666 P.2d at 335.

42. See *infra* note 40.

43. Utter, J., dissenting. *Chemical Bank*, 99 Wash. 2d at 810, 666 P.2d at 348.

44. 99 Wash. 2d at 810, 666 P.2d at 349.

45. *Id.* See *State ex rel. PUD 1 v. Wylie*, 28 Wash. 2d 113, 182 P.2d 706 (1947). The court in *Frank v. City of Cody*, 572 P.2d 1106, 1115 (Wyo. 1977) also urges a liberal view of statutes. The court in *Frank* states, "It would be an impossible and impracticable demand for us to insist on the legislature providing every little detail on how to go about carrying out an authority bestowed." *Id.*

46. *Chemical Bank*, 99 Wash. 2d at 812, 666 P.2d at 349. Although the Agreement requires payment for a potential dry-hole, this is true of other standard contracts as well (i.e., option contracts). *Id.* at 811, 666 P.2d at 349. A dry-hole contract is "highly advisable" in a market with unpredictable power demands such as that of the Pacific

capability is further supported by the Washington state legislature's failure to react to the contracts<sup>47</sup> and the sustaining of dry-hole agreements by other courts.<sup>48</sup>

*B. Did the Participants possess authority to construct, operate, and acquire WNP 4 and 5?*

A second question is whether the Participants possessed the statutory authority to construct, acquire, and operate the generating facilities controlled by WPPSS.<sup>49</sup> The statutes of Washington,<sup>50</sup> Idaho,<sup>51</sup> and Oregon<sup>52</sup> specifically grant this authority. Although such a grant

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Northwest. *Id.* See also Olsen, *supra* note 9, at 20. Today, fifteen years after the formation of the Agreement, the days of the Arab oil embargo and what many leaders thought was the beginning of a national energy crisis are but distant memories. Justice Utter concludes that in light of this history, the overbuilding created by these contracts was justified, and a future reduction in demand was unforeseeable. 99 Wash. 2d at 812, 666 P.2d at 350.

Yet this view is easily contrasted with the facts known by those in charge of WPPSS in 1974. By the 1970's, it was clear that WPPSS suffered from massive cost overruns. In 1974 alone, the estimated completion costs for WNP 1, 2, and 3 increased by almost one billion dollars. Olsen, *supra* note 9, at 21. In fact, in 1974, the managing director of WPPSS warned of delays that will "increase plant costs for an industry already encountering high financial charges and escalating labor and equipment costs." *Id.* Although the predictions of future shortages did create a perceived need for WNP 4 and 5, cost overruns may have been avoidable.

47. 99 Wash. 2d at 812-13, 666 P.2d at 350. Justice Utter stated, "Legislative acquiescence in such an entity's interpretation of the statutes . . . is a significant indication of legislative intent." *Id.* at 813, 666 P.2d at 350. *Cf.* Washington Educ. Ass'n v. Smith, 96 Wash. 2d 601, 606, 638 P.2d 77, 80 (1981) (legislature's acquiescence to Attorney General's interpretation indicates legislature's intent).

48. See Board of Commr's v. All Taxpayers, 360 So. 2d 863, 867 (La. 1978); *State ex rel. Mitchell v. Sikeston*, 555 S.W.2d 281 (Mo. 1977); *Johnson v. Piedmont Mun. Power Agency*, 277 S.C. 345, 287 S.E.2d 476 (1982).

49. 99 Wash. 2d at 785, 666 P.2d at 335.

50. The Washington statute provides:

A city or town may also construct, condemn and purchase, purchase, and acquire, add to, alter, maintain and operate works, plants, facilities for the purpose of furnishing the city or town and its inhabitants, and any other persons, with gas, electricity. . .

WASH. REV. CODE ANN. § 35.92.05 (1985).

51. The Idaho statute provides:

Cities shall have authority: to acquire, own, maintain and operate electric power plants, purchase electric power, and provide for distribution to the residents of the city, and to sell excess power. . .

IDAHO CODE § 50-325 (1976).

52. The Oregon statute provides:

In addition to the powers otherwise conferred on cities of this state, such a city

of power seems to provide clear statutory support for the Participants' Agreements with WPPSS to build WNP 4 and 5, courts often add additional requirements.

### 1. The requirement of an ownership interest

According to the court in *Chemical Bank*, to exercise this clear statutory authority, the Participants must retain either an ownership interest or the equivalent of an ownership interest in the project.<sup>53</sup> The court in *Chemical Bank* stated that only WPPSS and the Pacific Power & Light Company retained an ownership interest in WNP 4 and 5,<sup>54</sup> concluding that the Participants lack an ownership interest because they contracted only to purchase a share of project capability.<sup>55</sup>

The court in *Chemical Bank* asserted that the states which recognize the validity of dry-hole agreements base that recognition on explicit statutory authority which the court asserted is lacking here.<sup>56</sup> The

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owning and operating an electric light and power system may plan, finance, construct, acquire, operate, own and maintain an undivided interest in common facilities within or without the state jointly with one or more other cities, with one or more districts, with one or more electric cooperatives or with one or more privately owned electric utility companies subject to regulation by the Public Utility Commissioner of Oregon or the equivalent officer or commission of California, Idaho, Montana, Nevada or Washington, or with any combination of such cities, districts, electric cooperatives or companies in this or such other states, and may make such plans and enter into such contracts and agreements as are necessary or appropriate for such joint planning, financing, construction, acquisition, operation, ownership or maintenance.

OR. REV. STAT. § 225.470 (1980).

53. 99 Wash. 2d at 785, 666 P.2d at 336. The court states that in construing the statute, they have "never found authority for a project in which the participants did not have an ownership interest." *Id.*

54. *Id.* The court states that WNP 4 is "owned" completely by WPPSS and WNP 5 is "owned" by WPPSS (90%) and the Pacific Power and Light Company (10%). *Id.* at 777, 666 P.2d at 331-32.

55. *Id.* at 785, 666 P.2d at 336.

56. *Id.* Specifically, the court cites a South Carolina statute:

Any municipality which is a member of the joint agency may contract to buy from the joint agency power and energy required for its present or future requirements, including the capacity and output of one or more specified projects. As the creation of a joint agency is an alternative method whereby a municipality may obtain the benefits and assume the responsibilities of ownership in a project, any such contract may provide that the municipality so contracting shall be obligated to make the payments required by the contract whether or not a project is completed, operable or operating . . .

S.C. CODE ANN. § 6-23-110 (La. Co-op Supp. 1982). 99 Wash. 2d at 786, 666 P.2d at 336-37. The majority attempts to dismiss this statute on the grounds that it is more

court seems to equate "ownership" solely with "purchase of electricity." Although WPPSS and Pacific Power & Light financially own the property, the Participants "own" the project capability of WNP 4 and 5.<sup>57</sup> Thus, although the court in *Chemical Bank* claims that the Participants fail to "own" WNP 4 and 5, it places on the Participants the sole responsibility for the seven billion dollar cost of the project.

## 2. The "equivalence of an ownership interest" requirement

The court in *Chemical Bank* next stated that the statute requires the "equivalen[ce] of an ownership interest."<sup>58</sup> Under this requirement, the Participants lack statutory authority to construct, acquire, and operate utilities<sup>59</sup> unless they retain an active role in the management of the projects.<sup>60</sup> Interpreting the Agreement as precluding meaningful deliberation by the Participants regarding the management of WPPSS,<sup>61</sup> the court found the Participants Committee to be little more than a rubber stamp.<sup>62</sup>

Contrary to the court's characterization, the Participants' Committee had an important role in the management of WPPSS. The Agreement established this committee specifically to approve or disapprove

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specific than the Washington statute. 99 Wash. 2d at 786-87, 666 P.2d at 336-37. The South Carolina statute merely mentions dry-hole agreements. The action of one state's legislature in explicitly mentioning dry-hole agreements hardly creates a mandate for finding such authority before dry-hole agreements will be upheld. The decisions of other states in upholding dry-hole agreements in the absence of explicit statutory authority supports this conclusion. See *supra* note 48. Because such agreements are widespread, it is hard to believe that Washington had never heard of them when its legislation was drafted.

57. As the Participants must unconditionally purchase the project capability, they clearly "own" the project capability. The Participants possess a greater ownership interest in WNP 4 and 5 from the purchase of project capability than if they agreed to purchase electricity. If the latter situation were the case, then upon failure of WPPSS the participants would be obligated to pay nothing.

58. 99 Wash. 2d at 787, 666 P.2d at 337. The issue becomes whether the participants "retained sufficient control over the project to constitute the equivalen[ce] of an ownership interest." *Id.*

59. See *supra* notes 50-52.

60. 99 Wash. 2d at 787, 666 P.2d at 337. See *Frank v. City of Cody*, 572 P.2d 1106, 1111 (Wyo. 1977) (court upholds an agreement to form a municipal power agency on the ground that the municipality retained its power of "judgment, discretion and management").

61. 99 Wash. 2d at 787, 666 P.2d at 337.

62. *Id.*

of the system's major management decisions.<sup>63</sup> Although such approval or disapproval had to occur within fifteen days,<sup>64</sup> the Committee was quite capable of performing its duty. The Committee was accustomed to making quick decisions on construction budgets and large contracts.<sup>65</sup>

Further, the court's claim in *Chemical Bank* that Participants lacked control is not entirely accurate.<sup>66</sup> Actually, the Participants failed to exercise control. The Participants Committee was clearly a means by which the Participants could exercise control over WNP 4 and 5. Whether the Participants utilized this mechanism<sup>67</sup> is an entirely different issue.

### C. *Independent Sources of Authority*

#### 1. The duty to provide for future power needs

Notwithstanding the *Chemical Bank* court's requirements of ownership interest and sufficient control, the duty to provide future power needs may be an independent source of authority to engage in power projects.<sup>68</sup> Thirty years earlier in a situation nearly identical with WPPSS, the Washington Supreme Court held, in *State ex rel. Public Utility Dist. No. 1 of Pend Oreille County v. Schwab*,<sup>69</sup> that planners' decisions about future load growth must be accepted in the absence of a showing of arbitrary or capricious action.<sup>70</sup> This requirement en-

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63. *Id.* The Participants' committee considers construction budgets, contracts involving more than \$2 million, and proposed bond resolutions. *Id.*

64. *Id.* Unless the Committee made a decision within 15 days on a proposal, the proposal was automatically approved. *Id.*

65. As the project suffered from cost overruns and construction delays from its inception, the Committee was accustomed to dealing with such matters and could easily act within the fifteen day limit. *See supra* note 16.

66. Note, *Chemical Bank v. WPPSS: A Case of Judicial Meltdown*, 5 J. ENERGY L. AND POL'Y 273, 290 (1984).

67. *See id.*

68. *See supra* notes 53-62 and accompanying text.

69. 40 Wash. 2d 814, 246 P.2d 1081 (1952). In *Schwab*, a public utility district proposed to construct hydroelectric facilities. *Id.* at 816, 246 P.2d at 1083. Intervenor sought to enjoin the district from issuing revenue bonds to finance the project. *Id.* at 817, 246 P.2d at 1083-84. The proposed project would supply energy far beyond the actual needs of the community. *Id.* at 826, 246 P.2d at 1088. Similarly, in the WPPSS situation, even without the completion of WNP 4 and 5, the area serviced had sufficient power.

70. *Id.* at 824, 246 P.2d at 1087. These errors are apparent only in hindsight. The court in *Chemical Bank* rejects *Schwab* on the grounds that in *Schwab* the district re-

sured that such predictions, of which immediate vindication is unavailable, arise from a reliable decisionmaking process.<sup>71</sup> The *Schwab* standard does not impose a requirement of completely accurate prediction. Rather, the standard upholds inaccurate predictions as long as they arise from reasoned judgment.<sup>72</sup>

The WPPSS situation lacks any showing of abuse of discretion on the part of the planners.<sup>73</sup> The planners' forecasts were advisable in light of the circumstances.<sup>74</sup> Clearly, the moral obligation to provide adequate service at any cost provides authority for the project.<sup>75</sup>

## 2. The implied power to pay

A second source of authority to engage in power projects lies in the implied power to pay for services rendered to the municipality. The statutory grant of authority to construct and operate electric utilities<sup>76</sup> would be meaningless in the absence of the implied power to pay for these facilities.<sup>77</sup> When the legislature fails to place limits on the mu-

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tained ownership in and management of the facility. *Chemical Bank*, 99 Wash. 2d at 790, 666 P.2d at 338. *But see supra* notes 56-57 (majority's reasoning regarding ownership is flawed).

71. *Schwab*, 40 Wash. 2d at 824, 246 P.2d at 1087.

72. *Id.* at 827, 246 P.2d at 1088. The court in *Schwab* noted that evidence showing that the commissioners were incorrect in their estimate of future power needs fails to indicate that in making that estimate they acted arbitrarily or capriciously. *Id.* at 830, 246 P.2d at 1090.

73. The inaccuracies on which the planners based their estimates is clear in hindsight. These estimates, however, were reasonable when made.

74. *See supra* note 46.

75. Olsen, *supra* note 9, at 21; *Schwab*, 40 Wash. 2d at 824, 246 P.2d at 1086-87.

76. *See supra* notes 50-52.

77. 2 E. McQUILLIN, *THE LAW OF MUNICIPAL CORPORATIONS* §§ 10.18a, 10.21 (rev. 3d ed. 1979) [hereinafter E. McQUILLIN] (municipal power can be implied from power clearly granted where the implied power is consistent with municipal purposes). *See also State ex rel. City of Memphis v. Hackman*, 273 Mo. 670, 690, 202 S.W. 7, 11 (1918) ("There inheres in a grant of power to a municipal corporation all the necessary incidentals to render the grant effectual."); *Kirkwood Drug Co. v. City of Kirkwood*, 387 S.W.2d 550 (1965); *Willman v. City of Corsicana*, 213 S.W.2d 155 (Tex. Civ. App. 1948).

In *Municipality of Metropolitan Seattle v. City of Seattle*, 57 Wash. 2d 446, 460, 357 P.2d 863, 872 (1960), the court held that with "the power to provide a sewer system there is implied the power to pay for it." The court in *Chemical Bank* agrees with the conclusion of *Metro Seattle* but distinguishes the case on the grounds that in *Metro Seattle* the services were to be paid for as they were provided, while in *Chemical Bank* the Agreement unconditionally obligated the Participants to pay. 99 Wash. 2d at 786, 666 P.2d at 336. In *Metro Seattle*, however, the contract required the city to pay for

municipality's power to form contracts, the municipal authorities must determine the appropriate method of contracting.<sup>78</sup> Unless the Participants abused their discretion by entering into unconditional obligations for payment, the Participants possessed authority to enter into the Agreements.<sup>79</sup>

Although the court in *Chemical Bank* applied a test of legal necessity,<sup>80</sup> the correct test for an exercise of discretion<sup>81</sup> by a municipality is that of reasonableness.<sup>82</sup> In support of its legal necessity test, the *Chemical Bank* court relied on a taxation decision.<sup>83</sup> In earlier police power decisions, however, the court stressed the reasonableness test.<sup>84</sup> Thus, as the Participants possessed the authority to construct and operate generating facilities,<sup>85</sup> a court is powerless to inquire into the details of the Agreement adopted to carry that authority into execution<sup>86</sup>

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sewage disposal solely out of anticipated revenues. 357 P.2d at 871. This is precisely the situation in *Chemical Bank*. See *supra* notes 24, 26. Thus, *Metro Seattle* applies to the WPPSS situation. See *Chemical Bank*, 99 Wash. 2d at 810, 666 P.2d at 348 (Utter, J., dissenting) (municipal authority here must be interpreted broadly to provide the flexibility necessary in furnishing electric power).

78. *Frank*, 572 P.2d at 1117. 2 E. McQUILLIN, *supra* note 77, at § 10.21 (when a municipal corporation acts for the public good, it "is not to be shorn of its power by mere implication"). The majority in *Chemical Bank* attempts to strip the Participants of power by placing requirements of ownership and control on clear statutory language. See *supra* note 53-56 and accompanying text.

79. *Schwab*, 40 Wash. 2d at 831, 246 P.2d at 1090 (where municipality exercises discretion, a court can intervene only when it is shown that the commissioners acted without deliberation or proceeded on improper motives).

80. *Chemical Bank*, 99 Wash. 2d at 792, 666 P.2d at 339.

81. See *infra* notes 94-97 for a discussion of discretionary and proprietary powers.

82. *Frank*, 572 P.2d at 1117. The court in *Frank* states that when the appropriate method of contracting is left to the discretion of the municipality, the test of the contract's validity is whether it is reasonable. *Id.*

83. *Chemical Bank*, 99 Wash. 2d at 792, 666 P.2d at 339-40 (citing *Hillis Homes, Inc. v. Snohomish Co.*, 97 Wash. 2d 804, 808, 650 P.2d 193, 197 (1982)).

84. See, Comment, *A Cry for Reform in Construing Washington Municipal Corporation Statutes—Chemical Bank v. Washington Pub. Power Sys.*, 59 WASH. L. REV. 653, 657 (1984); *Scott Paper Co. v. City of Anacortes*, 90 Wash. 2d 19, 29, 578 P.2d 1292, 1298 (1978) (the power to sell bonds carries with it the authority to enter into contracts for the sale of municipal water, which provide the security for the bonds); *Municipality of Metropolitan Seattle v. City of Seattle*, 57 Wash. 2d 446, 460, 357 P.2d 863, 872 (1960) (with authority to provide sewers there is implied authority to pay for the system). *But see State ex rel. Hill v. Port of Seattle*, 104 Wash. 634, 641-42, 177 P. 671, 674, *modified*, 180 P. 137 (1919) (city's powers are limited by the terms of the act creating it, and it has no power to meet demand in excess of its future requirements).

85. See *supra* notes 49-52.

86. 2 E. McQUILLIN, *supra* note 77, at § 10.33; *Frank*, 572 P.2d at 1115.

in the absence of a showing that the Agreement was unreasonable.

#### D. *The Governmental-Proprietary Distinction*

Concluding that the power to purchase electricity fails to include a purchase of project capability,<sup>87</sup> the court in *Chemical Bank* narrowly construed the powers granted to municipal entities.<sup>88</sup> In so concluding, the *Chemical Bank* court failed to recognize that the scope of a municipality's statutory authority turns on the nature of its act.

Courts recognize that municipal corporations have a dual character.<sup>89</sup> The distinction lies between acts characterized as governmental and those deemed private, or proprietary.<sup>90</sup> Governmental powers are those used to administer the affairs of the state and to promote the general welfare.<sup>91</sup> When exercising its governmental power, a municipal corporation possesses the attributes of sovereignty.<sup>92</sup> Courts construe grants of governmental power strictly.<sup>93</sup>

In exercising its private or proprietary powers, the municipal corporation acts for the private benefit of itself and of its inhabitants.<sup>94</sup> Acting for its own benefit rather than for the benefit of the general public, the municipal corporation acts as a legal individual.<sup>95</sup> To afford the municipality discretion in accomplishing the purpose of the statute in question,<sup>96</sup> courts must interpret grants of proprietary power

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87. See *supra* note 41.

88. 2 E. MCQUILLIN, *supra* note 77, at § 10.18a.

89. See generally Comment, *supra* note 9, at 1103.

90. 2 E. MCQUILLIN, *supra* note 77, at §§ 10.18a and 10.05.

91. In general, governmental powers include the construction and maintenance of streets and the power to legislate as to public utilities. *Id.* at § 10.05.

92. *Id.* at § 10.22. *City of Seattle v. Stirrat*, 55 Wash. 560, 564, 104 P. 834, 835 (1909).

93. 2 E. MCQUILLIN, *supra* note 77, at § 10.22.

94. 2 E. MCQUILLIN, *supra* note 77, at § 10.05. See also *City of Seattle v. Stirrat*, 55 Wash. 560, 565, 104 P. 834, 835 (1909) (in its proprietary character, powers are to be conferred "for the private advantage of the compact community").

95. 2 E. MCQUILLIN, *supra* note 77, at § 10.03; *City of Seattle v. Stirrat*, 55 Wash. 560, 565, 104 P. 834, 835 (1909) (proprietary powers are exercised for the advantage of the community "as a distinct legal personality of corporate individual"). Proprietary powers include the power to enter into franchise agreements with utility companies and the determination of the details of a bond issue. 2 E. MCQUILLIN, *supra* note 77, at § 10.05.

96. *Butler v. Karb*, 96 Ohio St. 472, 482, 117 N.E. 953, 955-56 (1917) (successful operation of city's utilities would be thwarted if the city was "hampered by detailed, minute, and precise regulations").

liberally.<sup>97</sup>

Although at times this distinction between governmental and proprietary powers may seem unworkable,<sup>98</sup> the general rule is that a municipality's contracts for the supply of water and light represent the exercise of its proprietary powers.<sup>99</sup> Utility contracts are exercises of proprietary power because the municipality benefits itself and its inhabitants.<sup>100</sup>

Courts must construe the statutory grants of proprietary power liberally to achieve the "general object of their grant."<sup>101</sup> Since the general object of the power to purchase electricity<sup>102</sup> is to provide electrical service to residents,<sup>103</sup> a purchase of project capability serves that broad purpose.<sup>104</sup> Thus, the Agreement is an act of discretion<sup>105</sup> consistent with the purpose of the grant of proprietary power.<sup>106</sup>

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97. 2 E. McQUILLIN, *supra* note 77, at § 10.22; Puget Sound Power & Light Company v. Public Utility District No. 1 of Chelan County, 17 Wash. App. 861, 864, 565 P.2d 1221, 1223 (1977) (in its proprietary power, the municipal entity is authorized to do everything necessary to make the system efficient and beneficial).

98. Northwest Natural Gas Co. v. City of Portland, 300 Or. 291, 298, 711 P.2d 119, 126 (Or. 1985) (governmental/proprietary distinction unhelpful in mass transit case).

99. 2 E. McQUILLIN, *supra* note 77, at § 34.126. *See also* Linne v. Bredes, 43 Wash. 540, 546, 86 P. 858, 860-61 (1906) (a municipal corporation furnishes water to its inhabitants in the "capacity of a private corporation, and not in the exercise of . . . local sovereignty"); Frank v. City of Cody, 572 P.2d 1106, 1110 (Wyo. 1977) (operation of an electric utility is a proprietary function of the city).

100. Seattle v. Stirrat, 55 Wash. 560, 566, 104 P. 834, 836 (1909) (the power to lay streets, sewers, and water pipes is proprietary because it was for the private advantage of the city regardless of any benefit to the entire public); Puget Sound Power & Light Company v. Public Utility District No. 1 of Chelan County, 17 Wash. App. 861, 863, 565 P.2d 1221, 1223 (1977) (municipal entity's decisions regarding the sale or production of electricity is within its proprietary character); City of Joliet v. Alexander, 194 Ill. 457, 465, 62 N.E. 861, 864 (1902) (city, in enlarging water system, is engaged in proprietary power).

101. O. POND, A TREATISE ON THE LAWS OF PUBLIC UTILITIES OPERATING IN CITIES AND TOWNS § 11 (1913).

102. *See supra* note 40 for the text of this statute.

103. State *ex rel.* PUD No. 1 v. Yllie, 28 Wash. 2d 113, 150, 182 P.2d 706, 726 (1947).

104. Comment, *supra* note 9, at 1105.

105. *See supra* note 96. *See* Comment, *supra* note 9, at 1105.

106. Comment, *supra* note 9, at 1105. The reasonableness test, discussed *supra* notes 80-86 and accompanying text, should be applied to any exercise of a municipality's proprietary power. Thus, a municipality's proprietary act will be upheld absent a showing of abuse of discretion.

#### IV. STATE DEBT LIMITATION

In the late nineteenth century, heavy municipal borrowing in order to finance improvements such as canals and railroads caused financial panic.<sup>107</sup> To remedy this problem, states enacted statutes limiting the amount of debt a municipality could incur.<sup>108</sup> These debt limitation provisions soon proved too conservative, stifling even modest growth.<sup>109</sup> Therefore, municipalities devised various methods to circumvent the debt restrictions.<sup>110</sup>

##### A. *The Special Fund Doctrine*

One such method of circumventing debt restrictions is the special fund.<sup>111</sup> A special fund is a source of revenue that is fed by funds related to the particular project being financed.<sup>112</sup> As long as it does not obligate the general funds<sup>113</sup> of the municipality, a special fund

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107. Williams & Nehemkis, *Municipal Improvements as Affected By Constitutional Debt Limitations*, 37 COLUM. L. REV. 177, 178 (1937); see also Heil, *supra* note 24.

108. For example, the Washington constitution provides:

No county, city, town, school district, or other municipal corporation shall for any purpose become indebted in any manner to an amount exceeding one and one-half per centum of the taxable property in such county, city, town, school district, or other municipal corporation, without the assent of three-fifths of the voters therein voting at an election to be held for that purpose. . .

WASH. CONST. art. VIII, § 6. Similarly, the Idaho requirement is:

No county, city, board of education, or school district, or other subdivision of the state, shall incur any indebtedness, or liability, in any manner, or for any purpose, exceeding in that year, the income and revenue provided for it for such year, without the assent of two thirds ( $\frac{2}{3}$ ) of the qualified electors thereof voting at an election to be held for that purpose. . .

IDAHO CONST. art. VIII, § 3. In Oregon, each city, in its charter, provides for its debt limitation. See *DeFazio v. Washington Public Power Supply System*, 296 Or. 550, 570, 679 P.2d 1316, 1329 (1984).

109. Williams & Nehemkis, *supra* note 107, at 180-82. For example, a debt limitation based on a percentage of the assessed value of property fails because there is no relationship between that value and the municipality's need for public improvements or its ability to finance such improvements. *Id.* at 182.

110. See generally Williams & Nehemkis, *supra* note 107, at 182. Two such devices are special assessments and sale-leaseback agreements. *Id.*

111. *Id.* at 186-87.

112. Heil, *supra* note 24, at 81.

113. The "general funds" of a municipality include tax revenues. Williams & Nehemkis, *supra* note 107, at 187. In *Fjeldsted v. Ogden City*, 83 Utah 278, 287, 28 P.2d 144, 151 (1933), the court recognized two limitations on the special fund exception. The special fund exemption is violated if: 1) the municipality must "feed" the special fund from general revenues in addition to those arising solely from the improve-

evades definition as debt, and consequently falls outside the debt limitation provisions.<sup>114</sup> There are two types of special funds. A broad special fund is one that is payable from sources merely related to the project funded.<sup>115</sup> A restricted or narrow special fund exists when an obligation is payable solely from the revenues of the particular project financed.<sup>116</sup> Although some courts hold that a broad special fund creates debt, all courts agree that a narrow special fund does not.<sup>117</sup> If the obligation created does constitute debt, then the requirements of the debt limitation provision must be fulfilled.<sup>118</sup>

In another case arising from the WPPSS situation, the Supreme Court of Idaho held in *Asson v. City of Burley*<sup>119</sup> that the Participants' Agreements to pay WPPSS created debt.<sup>120</sup> In *Asson*, five cities entered into agreements with WPPSS to purchase project capability.<sup>121</sup> The Agreement provided that if WPPSS either failed to secure financing or failed to complete the project, the Participants remained bound to pay WPPSS for project capability.<sup>122</sup> The Agreement also required the Participants to maintain a special fund which would be generated by revenues from the operation of their local utility systems.<sup>123</sup> The Participants could use only that special fund to make their payments to WPPSS.

The court in *Asson* included in the special fund exemption any self-supporting undertaking that failed to obligate the city's general fund.<sup>124</sup> With the plants incomplete, however, the cities were required

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ment contemplated; or 2) the municipality suffers a loss because the special fund is insufficient to pay the obligation incurred. *Id.* See *City of Joliet v. Alexander*, 194 Ill. 457, 62 N.E. 861 (1902).

114. Heil, *supra* note 24, at 81.

115. *Id.* at 82.

116. *City of Joliet v. Alexander*, 194 Ill. 457, 465, 62 N.E. 861, 864 (1902) (court applying a narrow special fund theory, held that the plan created debt because the special fund was fed by existing property of the city).

117. See Heil, *supra* note 24, at 87-88.

118. In general, the statutes impose a requirement of voters' assent before a municipality can incur debt. See *supra* note 108.

119. 105 Idaho 432, 670 P.2d 839 (1983).

120. *Id.* at 443, 670 P.2d at 850.

121. *Id.* at 434, 670 P.2d at 841. These agreements are the same Participants' Agreements considered by the court in *Chemical Bank*. See *supra* notes 16-18.

122. *Asson*, 105 Idaho at 436, 670 P.2d at 843.

123. *Id.* at 437, 670 P.2d at 844; see *supra* note 16.

124. *Asson*, 105 Idaho at 438, 670 P.2d at 845. See also 15 E. McQUILLIN, *supra* note 77, at § 41.31; *Goreham v. Des Moines Metropolitan Area Solid Waste Agency*,

to satisfy the WPPSS bonds without reliance on the revenue-producing property that the Agreement contemplated.<sup>125</sup> The only way to satisfy this obligation, the court claimed, was for each Participant to impose a surcharge on all electric power users, including rate-paying residents.<sup>126</sup> The court in *Asson* asserted that such a surcharge would violate the special fund exemption because it was, in effect, a tax.<sup>127</sup>

Disagreeing with *Asson*,<sup>128</sup> the Oregon Supreme Court in *DeFazio v. Washington Public Power Supply System*<sup>129</sup> considered whether the raising of rates to pay off WPPSS violates the special fund doctrine.<sup>130</sup> After reviewing the history of debt limitation provisions, the court concluded that the purpose of such provisions was "to forestall irresponsibly imposed tax burdens."<sup>131</sup> As long as the special fund fails to obligate tax revenues, it remains within the statutory exemption.<sup>132</sup> Both taxes and utility charges have a similar economic impact on the individual by reducing his disposable income.<sup>133</sup> While everyone must

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179 N.W.2d 449, 458 (Iowa 1970) (to constitute debt against the city, there must be an obligation which the city must meet with its funds or property); *Johnson v. Piedmont Municipal Power Agency*, 277 S.C. 345, 353, 287 S.E.2d 476, 480 (1982) (bonds issued by joint operating agency payable solely from revenues derived by the JOA from the sale of electricity to the municipalities do not create a general obligation).

125. *Asson*, 105 Idaho at 440, 670 P.2d at 847.

126. *Id.* The court's conclusion finds support in the Agreement which obligates the Participants to maintain their own rates high enough to meet the costs of WPPSS. *See supra* note 24.

127. *Asson*, 105 Idaho at 440, 670 P.2d at 847. The court in *Asson* states, "To the extent this surcharge imposes an obligation on the rate payer unrelated to the quantity of electricity used, it could constitute a tax." 105 Idaho at 440 n.17, 679 P.2d at 847 n.17. The court takes this argument to its logical end, by the court's own admission, "fanciful" conclusion, stating that if there were only one ratepayer that ratepayer alone would be forced to pay the entire obligation to WPPSS. *Id.*

128. In *Asson*, Justice Bakes dissented. 105 Idaho at 443, 670 P.2d at 850.

129. 296 Or. 550, 679 P.2d 1316 (1984).

130. 296 Or. at 575, 679 P.2d at 1333. *See also Barnes v. Lehi City*, 74 Utah 321, 279 P. 878 (1929); *Winston v. City of Spokane*, 12 Wash. 524, 41 P. 888 (1895).

131. *DeFazio*, 296 Or. at 574, 679 P.2d at 1332; *see Barnes v. Lehi City*, 74 Utah at 340, 279 P. at 885.

132. *Id.* *See also Frank v. City of Cody*, 572 P.2d 1106, 1114 (Wyo. 1977) (no debt against the municipality is created when amounts due are payable from a special fund not fed by taxes); *State ex rel. Mitchell v. City of Sikeston*, 555 S.W.2d 281 (Mo. 1977) (where municipalities entered dry-hole agreements with city for the supply of power, obligating themselves to pay only from revenues of their elective system, municipalities need not pay from tax monies).

133. *DeFazio*, 296 Or. at 574, 679 P.2d at 1332.

pay taxes, charges for electricity are escapable.<sup>134</sup> If the price of electricity becomes too high, consumers are free to switch to alternative sources.<sup>135</sup> Thus, the inevitable rate increases due to the failure of WPPSS remain within the special fund doctrine because they do not implicate tax revenues.<sup>136</sup>

B. *Was the Construction of WNP 4 and 5 an Ordinary and Necessary Expense?*

Even if the Participants' obligations to WPPSS do constitute an indebtedness, the obligations may be exempt from the debt limitation requirement as ordinary and necessary expenses. Although most states have such an exemption,<sup>137</sup> few are phrased as explicitly as that in the Idaho constitution.<sup>138</sup> An expense is "ordinary" if, in the ordinary course of the transaction of municipal business, or in the maintenance of municipal projects, the expense becomes necessary.<sup>139</sup> Generally, "ordinary" means "often recurring" and "necessary" means "indispens-

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134. *Id.* Barnes v. Lechi City, 74 Utah at 341, 279 P. at 885.

135. *DeFazio*, 296 Or. at 574, 679 P.2d at 1333.

136. In Board of Comm'rs. of Louisiana Mun. Power Comm'n. v. All Taxpayers, Property Owners, and Citizens, 360 So. 2d 863, 868 (La. 1978), the court held that a dry-hole agreement for the provision of electricity was payable only from the revenues of the municipalities' utilities. The obligation failed to implicate the cities' general funds, even though customers may be subject to increased charges if the project fails. *Id.* Moreover, while possible loss to the cities' general funds of net utility revenues may affect solvency, it fails to "convert a charge against utility revenues to a charge against other income and revenues." *Id.* See also Frank v. City of Cody, 572 P.2d 1106, 1114 (Wyo. 1977) (municipality fails to create debt where obligations are payable from a special fund created from service charges only collected from users).

137. *Morrow v. Durham*, 210 N.C. 564, 187 S.E. 752, 753 (1936) (plan for refunding of county bonds to create lower interest rate held to be a necessary expense); *Love v. King County*, 181 Wash. 462, 465, 44 P.2d 175, 177 (1935) (debt limitation provisions do not include ordinary and necessary expenses); *Sainer v. Thurston County*, 181 Wash. 552, 556-57, 44 P.2d 179, 180 (1935) (indebtedness created for indigent relief falls outside debt limitation provision); *Davis v. Lenoir County*, 178 N.C. 668, 101 S.E. 260 (recognizing the exemption for public roads); *Bramham v. City of Durham*, 171 N.C. 196, 199, 88 S.E. 347, 348 (1916) (recognizing the exemption for building and repair of streets and sidewalks); *Martin v. City of Raleigh*, 208 N.C. 369, 375, 180 S.E. 786, 790-91 (1935) (recognizing the exemption for tax to provide for medical care of the indigent).

138. See Moore, *infra* note 139.

139. *Dexter Horton Trust and Savings Bank v. Clearwater County*, 235 F. 743, 752 (D. Idaho 1916); Moore, *Constitutional Debt Limitations on Local Government in Idaho—Article 8, section 3, Idaho Constitution*, 17 IDAHO L. REV. 55, 79 (1980). See *Hanson v. City of Idaho Falls*, 92 Idaho 512, 514, 446 P.2d 634, 636 (1968) (weekly or monthly compensation of police officers is an ordinary and necessary expense). The

sable."<sup>140</sup> Ordinary and necessary expenses do, however, include infrequent necessities.<sup>141</sup> In holding that an expenditure for the repair or improvement of city property is an ordinary and necessary expense, the court in *Hickey v. City of Nampa*<sup>142</sup> recognized that even infrequent expenditures may be ordinary and necessary expenses.<sup>143</sup>

The projects authorized by the Participants' Agreements fall within the ambit of these definitions. In the ordinary course of providing for the electric supply of their inhabitants, the Participants purchased shares of future power supply from WPPSS. This appears to be the type of "infrequent necessity" falling squarely within the exemption. Moreover, the project clearly was necessary, or indispensable, as the planners of WPPSS foresaw power shortages without the project.<sup>144</sup>

The majority in *Asson*, however, held that the Participants' indebtedness was outside the "ordinary and necessary expenses" provision of the Idaho constitution.<sup>145</sup> The court concluded that although repair is an ordinary and necessary expense, the construction or the purchase of new facilities falls outside the exemption.<sup>146</sup> Acknowledging that the decisions to build WNP 4 and 5 may have been necessary in light of the circumstances,<sup>147</sup> the court refused to find that the construction of WNP 4 and 5 was an ordinary expense because of its colossal size and risk.<sup>148</sup>

In reaching its conclusion, the majority in *Asson* glossed over *City of Pocatello v. Peterson*,<sup>149</sup> placing it within the "repair or maintenance" line of cases.<sup>150</sup> In *Peterson*, the court held that a contract for the ex-

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periodic compensation in *Hanson* is clearly analogous to the periodic payments by the Participants to WPPSS.

140. *City of Pocatello v. Peterson*, 93 Idaho 774, 778, 473 P.2d 644, 648 (1970).

141. *Id.* at 778, 473 P.2d at 648.

142. 22 Idaho 41, 124 P. 280 (1912).

143. *Id.* at 45-46, 124 P. at 281.

144. *See supra* note 46.

145. *Asson*, 105 Idaho at 443, 670 P.2d at 850.

146. *Id.* *See also* *Dunbar v. Board of Comm'rs of Canyon County*, 5 Idaho 407, 49 P. 409, 411 (1897) (the payment of bounties for rabbit scalps fails to be an ordinary and necessary expense of a county).

147. *Asson*, 105 Idaho at 442-43, 670 P.2d at 849-50.

148. *Id.*

149. 93 Idaho, 774, 473 P.2d 644 (1970).

150. *Asson*, 105 Idaho at 442, 670 P.2d at 849. After reviewing the facts of *Peterson*, the court in *Asson* notes that "the [*Peterson*] court's emphasis on the obsolescence and

pansion of an airport was an ordinary and necessary expense.<sup>151</sup> The court based its decision on the presence of several factors also present in the WPPSS situation. First, the city possessed statutory authority to build the project,<sup>152</sup> as did each Participant in WPPSS.<sup>153</sup> Second, the city of Pocatello operated an airport for more than twenty years before deciding to expand and improve it.<sup>154</sup> Similarly, the perceived inadequacies of WPPSS led to efforts to improve and expand WPPSS by constructing WNP 4 and 5 in 1974.<sup>155</sup> Third, the existing airport in *Peterson* was inadequate to serve the perceived needs of the city.<sup>156</sup> Moreover, the court in *Peterson* stressed that the improvement of the airport was essential for the growth and development of the entire region.<sup>157</sup> Likewise, without the electricity that WNP 4 and 5 would produce, the planners predicted great shortages for areas of five states, with a concomitant stultifying effect on regional growth.<sup>158</sup> The decision by WPPSS to build WNP 4 and 5 was made to redress the perceived future electrical shortages of the region. Based on a consideration of the *Peterson* factors, the construction of WNP 4 and 5 is an ordinary and necessary expense.

### C. *Should A Broad or Narrow Special Fund Doctrine Be Applied?*

In applying the special fund doctrine, courts distinguish between narrow and broad special funds.<sup>159</sup> The distinction lies in the extent to which the special fund is self-supporting. Under a broad special fund, no debt arises as long as the source of repaying relates to the project funded and no tax revenues are involved.<sup>160</sup> A narrow special fund

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unsafe conditions of the . . . facility place it within the 'repair or maintenance' line of case authority." *Id.*

151. *Peterson*, 93 Idaho at 779, 473 P.2d at 649.

152. *Id.* at 777, 473 P.2d at 647.

153. *See supra* notes 49-52.

154. *Peterson*, 93 Idaho at 778, 473 P.2d at 648.

155. *See supra* note 46 and text accompanying notes 1-11.

156. *Id.* at 649; *see also Hickey*, 22 Idaho at 43-44, 124 P. at 280-81.

157. *Peterson*, 93 Idaho at 779, 473 P.2d at 649.

158. *See Lloyd Corporation v. Bannock County*, 53 Idaho 478, 481, 25 P.2d 217, 220 (1933) (emergency warrants issued in payment of ordinary and necessary county expenses authorized by court). In *Lloyd*, unforeseen circumstances arose, making necessary the expenditure of more money to meet certain ordinary and necessary expenses. *Id.* This was the situation in WPPSS.

159. *See supra* notes 115-17.

160. *See supra* notes 116-18; *see also Heil, supra* note 24, at 82.

allows payments to be made only from the proceeds of the particular project.<sup>161</sup>

In *City of Joliet v. Alexander*<sup>162</sup> the Illinois Supreme Court recognized the narrow special fund doctrine. In *Joliet*, the city passed an ordinance providing for the enlargement of the water system.<sup>163</sup> The city proposed the issuance of certificates to finance the enlargement.<sup>164</sup> Upon completion of the project, all revenues from the water system were to go into a special fund which alone was liable for the certificates.<sup>165</sup> The court concluded that this special fund was a debt because it provided for repayment of the certificates from property already owned by the city.<sup>166</sup> The court in *Joliet* established the theory that although "a pledge of the revenue created by or allocable to the part itself" fails to create debt, "a pledge of all the revenues of the existing utility to pay for only a part of that utility does create debt."<sup>167</sup>

Thus, when an addition or enlargement is made on a pre-existing facility, a narrow special fund exists if it is possible to segregate the earnings of the enlargement from the revenues of the pre-existing facility. WNP 4 and 5 can be seen as an extension of WPPSS itself. To fall within the narrow special fund doctrine, the revenues from WNP 4 and 5 must be separable from those of the rest of WPPSS.<sup>168</sup>

The proponents of the narrow special fund agree that constitutional debt limitations refer to debts payable from taxation. They maintain, however, that an obligation which deprives the general municipal funds of proprietary revenue (a broad special fund) is a burden on the taxpayer and is thus a debt.<sup>169</sup> The answer to this argument is that constitutional debt limitations apply only to obligations for the payment of which a levy of taxes can be required.<sup>170</sup> The converse is also

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161. Heil, *supra* note 24, at 98; Williams & Nehemkis, *supra* note 107, at 195; Fjeldsted v. Ogden City, 83 Utah 278, 292-94, 28 P.2d 144, 150-51 (1933).

162. 62 N.E. 861 (Ill. 1902).

163. *Id.* at 862.

164. *Id.*

165. *Id.*

166. *Id.* at 864.

167. Williams & Nehemkis, *supra* note 107, at 194.

168. If the revenues are separable, then the project evades definition of debt. Even if the revenues are not separable, WNP 4 and 5 may still fall within the broad special fund doctrine.

169. Williams & Nehemkis, *supra* note 107, at 185. A narrow special fund fails to do this and is thus not debt.

170. *Id.*

true: an obligation for the payment of which taxation cannot be required is not debt.<sup>171</sup> Thus, a broad special fund obligation merely deprives the taxpayer of the use of proprietary revenue to satisfy debts that are properly chargeable to taxation.<sup>172</sup> Such debts are those for municipal government services, which clearly should not be paid by municipal utility rates.<sup>173</sup>

A second argument against the narrow special fund doctrine is that it is impracticable to segregate earnings to a part of a utility system.<sup>174</sup> A restricted special fund would preclude additions to existing facilities because of the difficulty in determining what part of the revenues of the expanded utility should be applied to the bonds issued for the improvement.<sup>175</sup> One commentator, however, claims that segregation of revenues is practical.<sup>176</sup>

The foregoing analysis of the narrow special fund indicates its unpopularity. This general disfavor leads most courts to apply the broad special fund doctrine.<sup>177</sup> Consequently, more projects evade the debt limitation provisions than if the narrow special fund were generally accepted.

## V. ANALYSIS

The court's decision in *Chemical Bank* placed the burden of default on the individual investors. A different interpretation of the statutes at issue in *Chemical Bank* leads to the more equitable result of placing the burden on the cities. First, although clear statutory authority to purchase electricity<sup>178</sup> and to build and operate generating facilities<sup>179</sup> existed, such authority failed to mandate the supply of electricity by

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171. *Id.*

172. *Id.*

173. *Id.* But see Note, *Constitutional Restrictions Upon Municipal Indebtedness*, 1966 UTAH L. REV. 462, 476.

174. Williams & Nehemkis, *supra* note 107, at 196; see *supra* note 167 and accompanying text.

175. Note, *supra* note 173, at 476-77; Williams & Nehemkis, *supra* note 107, at 196.

176. Note, *supra* note 173, at 477.

177. Williams & Nehemkis, *supra* note 107, at 195. These commentators state, "The fact that only one reported decision [*Bell v. City of Fayette*, 325 Mo. 75, 28 S.W.2d 356 (1930)] has been found in which a restricted special fund has been sustained inspires suspicion of the merit of the doctrine." *Id.*

178. See *supra* note 40.

179. See *supra* notes 49-52.

the Participants.<sup>180</sup> The fulfillment of these statutes was entirely within the discretion of the Participants.<sup>181</sup> When the Participants acted on this discretionary authority, they did so within their proprietary power.<sup>182</sup> Therefore, the Participants were free to choose any means necessary to fulfill the statutes granting them authority.<sup>183</sup> The only limit imposed was that of the test of reasonableness.<sup>184</sup> Within this scope of authority, the Participants reasonably<sup>185</sup> chose to supply electricity by purchasing project capability instead of electricity itself. As the Participants possessed authority to enter into the Agreements, they must be held to the Agreements and the consequent liability.

Second, the municipality's ability to purchase project capability is essential to municipal growth. The court in *Chemical Bank* frustrates that goal by requiring express legislative or judicial proof of authority before allowing a municipality to act.<sup>186</sup> This requirement is contrary to the general rule that a municipality can act in the absence of explicit authority.<sup>187</sup> With the application of the *Chemical Bank* rule, municipalities would be hesitant to issue bonds and spur development.<sup>188</sup> Moreover, municipalities would be less likely to implement innovative solutions to their energy needs.<sup>189</sup>

The court in *Chemical Bank* concluded that the Participants' payment obligations to WPPSS constituted debt.<sup>190</sup> Finding that the Participants violated the debt limitation provisions, the court held that the Participants lacked the authority to enter into the Agreement.<sup>191</sup> Accordingly, the court placed the burden of default on the investors. For several reasons, however, the Participants' obligations to WPPSS failed to constitute debt.

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180. See Note, *supra* note 66, at 286.

181. See *supra* notes 73-74 and accompanying text.

182. See Note, *supra* note 66, at 286.

183. State *ex rel.* City of Memphis v. Hackman, 202 S.W. 7, 11 (Mo. 1918) ("There inheres in a grant of [proprietary] power to a municipal corporation all the necessary incidentals to render the grant effectual.").

184. See *supra* note 82.

185. See *supra* note 46.

186. The court interprets statutes narrowly.

187. Frank v. City of Cody, 572 P.2d 1106, 1115 (Wyo. 1977) (municipality can act even though the legislature has not provided "every little detail").

188. See Comment, *supra* note 84, at 667.

189. *Id.*

190. See *supra* note 118.

191. See *supra* note 126.

First, the construction of WNP 4 and 5 fell within the ordinary and necessary expenses exception to the debt limitation provisions. Based on the planners' belief of future power inadequacies, the expense was clearly necessary.<sup>192</sup> Moreover, as improvements essential for the growth and development of the region, WNP 4 and 5 were ordinary expenses.<sup>193</sup>

The majority in *Asson*, however, refused to recognize the construction of WNP 4 and 5 as an ordinary expense because of its great size and risk.<sup>194</sup> Application of this rationale would place all but the most insignificant municipal undertakings beyond the parameters of the ordinary and necessary exemption. Most major municipal projects within the scope of ordinary municipal business are large. As the legislature created the ordinary and necessary exemption specifically for such projects, the court's interpretation in *Asson* would frustrate the purpose of the exemption.

Second, by providing that payments be made to WPPSS solely from the revenues generated by WNP 4 and 5, the Agreement created a special fund.<sup>195</sup> The WPPSS obligations may<sup>196</sup> eventually force the Participants to raise their utility rates. Since raising rates does not always implicate tax revenues,<sup>197</sup> it does not violate the purpose of the debt limitation provisions, which is to avoid irresponsibly imposed tax burdens.<sup>198</sup>

Whether the special fund here is a debt also depends on the type of special fund applied. A narrow special fund is inappropriate because it would exclude the special fund revenues derived from raised utility rates.<sup>199</sup> As such, the narrow special fund places the risk of noncompletion on the investors. The increased risk results in higher interest rates on the bonds and slower municipal growth.<sup>200</sup> Moreover, the narrow special fund is a weak doctrine that lacks precedential

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192. See *supra* note 147.

193. See *supra* note 24.

194. See *supra* note 148.

195. See *supra* note 24.

196. The possibility still exists that other cities may "buy out" the Participants' share and pay off WPPSS. Olsen, *supra* note 9, at 25.

197. See *supra* notes 133-34 and accompanying text.

198. See *supra* notes 131-322 and accompanying text.

199. *Id.* But see *supra* notes 16-73 and accompanying text.

200. Heil, *supra* note 24, at 102.

support.<sup>201</sup>

Although a broad special fund would necessitate rate increases, it places the risk of default where it should be—on the cities. After all, the cities entered the Agreements, not the bondholders. Moreover, the cities were in a better position to assess the risk of noncompletion than were the individual investors.

Clearly, the correct legal result would place the burden of default on the municipalities and their ratepaying citizens. Social policy, however, dictates a different result. Both the ratepayers and the investors should be absolved from the burden of WPPSS. Although the ratepayers elected the local officials responsible for entering into the Agreements,<sup>202</sup> the ratepayers/voters were ordinary citizens who knew less about nuclear power economics than did the WPPSS planners.<sup>203</sup> Similarly, the investors were innocent citizens induced into their purchases by the promise of a sound investment.<sup>204</sup>

One noted authority suggested that the taxpayers of the United States should bear the burden of the WPPSS default.<sup>205</sup> A federal agency (The Bonneville Power Administration) was instrumental in selling WPPSS to the unwitting consumers of the Northwest.<sup>206</sup> Therefore, the federal government should take responsibility by appropriating from the general tax revenues enough money to pay off the burden of the WPPSS default.<sup>207</sup>

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201. See *supra* notes 169-77 and accompanying text.

202. Olsen, *supra* note 9, at 23. Olsen believes that the ratepayers should be held responsible for failing to exercise political control over these local officials at the ballot box. See Note, *Municipal Antifraud Liability Under the Federal Securities Laws Upon Issuance of Tax-Exempt Industrial Development Bonds*, 24 WASH. U.J. URB. & CONTEMP. L. 193, 211 (1983).

203. The planners of WPPSS did not know how to plan the economics of nuclear power plants. Olsen, *supra* note 9, at 20. Therefore, it would be unreasonable to expect the ratepayers to exercise effective political control over the planners when the ratepayers, as ordinary citizens, were not conversant with the planning of nuclear plants. It would be inequitable to place the burden on the ratepayers who knew even less about what they were getting into than did the planners of WPPSS who convinced them to enter the Agreements. Interview with John N. Drobak, Professor of Law, Washington University School of Law in St. Louis, Missouri (March 19, 1987).

204. *Id.* Part of the blame for the investors' decisions to purchase the WPPSS bonds lies on the law firms who recommended WPPSS as a sound investment. *Id.*

205. *Id.*

206. See generally Comment, *supra* note 69.

207. Interview, *supra* note 203. Allocating the loss to the federal government would be beneficial. First, the huge burden of WPPSS would be borne by all the citizens of the United States instead of by a few in the Northwest. Second, other terminated nuclear

## VI. CONCLUSION

The WPPSS situation presents the dilemma of who should bear the burden of default. While the correct legal result would place the burden on the municipalities, social policy dictates a compelling counter-argument. What is clear from the litigation arising from the WPPSS fiasco is that courts must interpret statutes to place the burden of any similar situation on all federal taxpayers.

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projects such as Shoreham in Long Island, New York, would be paid off. This would alleviate great financial drains on the regions in which these stagnant nuclear projects exist. Finally, the federal government is in large part responsible for the failure to follow through on its sales pitch of nuclear power to the American consumer. Federal agencies are responsible for inducing consumer acceptance of nuclear power in specific instances, such as WPPSS. See *supra* note 206 and accompanying text. When a project fails, the federal government should not shirk its duty to pay off the monster it created. Interview, *supra* note 203.

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