**Cornell Law Review**

Volume 69
Issue 5 *June 1984*

Article 8

# Chemical Bank v. Washington Public Power Supply System: The Questionable Use of the Ultra Vires Doctrine to Invalidate Governmental Take-Or-Pay Obligations

David P. Wohabe

# *CHEMICAL BANK V. WASHINGTON PUBLIC POWER SUPPLY SYSTEM*: THE QUESTIONABLE USE OF THE ULTRA VIRES DOCTRINE TO INVALIDATE GOVERNMENTAL TAKE-OR-PAY OBLIGATIONS

In *Chemical Bank v. Washington Public Power Supply System*[1] *(WPPSS),* the Supreme Court of Washington released the municipal participants in a nuclear generator construction project from their agreements to unconditionally service the project debt on the ground that the participants did not have the statutory authority to enter into such agreements. The project debt consists of revenue bonds issued by the Washington Public Power Supply System, the joint operating agency[2] responsible for constructing the nuclear plants. The participants had agreed to service the debt, which totalled $2.2 billion in principal and $4.75 billion in interest,[3] in return for an exclusive share of "project capability."[4]

The *WPPSS* case, which sent tremors through the municipal bond market, is thought to threaten the viability of ongoing analogous arrangements in states with similar statutory schemes.[5] Serious flaws in the court's reasoning, however, should significantly undercut the case's precedential value. This Note identifies and explains these flaws and suggests an alternative analysis.

## I
## BACKGROUND

In recent years, numerous state legislatures have enacted joint operating agency (JOA) statutes.[6] These statutes empower municipal entities[7] to conclude intergovernmental agreements under the provisions of

---

1 99 Wash. 2d 772, 666 P.2d 329 (1983).

2 *See infra* notes 6-11 and accompanying text.

3 *See* N.Y. Times, Jan. 23, 1982, at 31, col. 3.

4 *See infra* note 37.

5 Over 30 states have passed enabling legislation for joint operating agencies (JOA's). Ferdon, *Power Utilities Realize Cost Benefits on Joint Agency Take or Pay Contracts,* N.Y.L.J., Mar. 25, 1982, at 17, col. 1; *see, e.g.* LA. REV. STAT. ANN. §§ 33:1321-:1337 (West Supp. 1983);Mo. ANN. STAT. §§ 393.700-.770 (Vernon Supp. 1983).

6 *See supra* note 2.

7 Because the JOA statutes of various states discussed herein authorize several specified types of political subdivisions to operate under their provisions and because the subdivisions so authorized vary from state to state, this Note will use the term "municipal entities" to designate all these various political subdivisions. *See, e.g.,* LA. REV. STAT. ANN. § 33:1332 (West Supp. 1983) ("parishes or municipalities"); WASH. REV. CODE ANN. § 43.52.360 (1983) ("cities or public utility districts or combinations thereof").

the statutes.[8] The JOA statutes authorize the sponsoring entities to create by resolutions of their municipal governing bodies a joint operating agency that acts as the governing bodies' agency or instrumentality.[9] The agency is managed by a board of directors comprised of representatives of the sponsoring muncipal entities. The representatives exercise voting rights in proportion to their municipal entity's interest in the project.[10] The agency so created is deemed a "body corporate."[11]

Because a chief aim of the JOA statutes is to facilitate the development of energy resources,[12] joint operating agencies are particularly useful to municipal entities interested in energy production. A joint operating agency facilitates the finance and construction of billion-dollar generating and transmission facilities by allowing the municipal entities in a project to share the capital costs and risks associated with such facilities.[13] The JOA also allows the municipal entities to obtain significant additional benefits, including high leverage[14] and lower overall capital costs.[15]

The JOA statutes empower the agencies to issue revenue bonds in their corporate names to finance the costs of the construction, acquisition, or improvement of public projects.[16] This relieves the sponsoring municipal entities (members) from compliance with earnings tests, rate covenants, and other bond indenture restrictions that would apply if they issued their own bonds.[17] Furthermore, allowing the JOA's to issue bonds in their own names reduces overall financing costs due to the economy and efficiency of a single large financing as opposed to several smaller financings.[18]

The members are not directly obligated to pay the debt of the joint

---

8 *See, e.g.,* LA. REV. STAT. ANN. §§ 33:1324-:1324.1 (West Supp. 1983); MO. ANN. STAT. § 393.710 (Vernon Supp. 1983).

9 *See, e.g.,* LA. REV. STAT. ANN. § 33:1332 (West Supp. 1983); WASH. REV. CODE ANN. § 43.52.360 (1983).

10 *See, e.g.,* LA. REV. STAT. ANN. § 33:1332 (West Supp. 1983); WASH. REV. CODE ANN. § 43.52.370 (1983).

11 *E.g.,* LA. REV. STAT. ANN. § 33:1332 (West Supp. 1983); *see also* WASH. REV. CODE ANN. § 43.52.360 (1983) ("municipal corporation").

12 *See, e.g.,* LA. REV. STAT. ANN. § 33:1337 (West Supp. 1983); Public Utility Joint Operating Agencies Act of 1957, 1957 Wash. Laws 1171-72 (codified at WASH. REV. CODE ANN. § 43.52.360 (1983)).

13 *See* Worenklein, *Project Financing of Joint Ventures,* PUB. UTIL. FORT., Dec. 3, 1981, at 40-41.

14 "Leveraging" or "trading on the equity" is the use of debt to increase the expected return on equity by employing the borrowed funds at a rate of return higher than their cost. R. BREALEY & S. MYERS, PRINCIPLES OF CORPORATE FINANCE 760 (1981).

15 *See* Worenklein, *supra* note 13, at 40-41.

16 *See, e.g.,* LA. REV. STAT. ANN. § 33:1334(A) (West Supp. 1983); WASH. REV. CODE ANN. § 43.52.3411 (1983).

17 *See* Ferdon, *supra* note 5, at 17.

18 *See id.*

operating agency.[19] Rather, lenders to the agency, the purchasers of the agency's revenue bonds, "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 [agency] and to meet its other expenses."[20] But because of the difficulty a JOA would have in marketing the wholly unsecured bonds of a project that has no history of performance,[21] the members, as well as any other municipal entities participating in the project on a non-member basis (participants), generally provide credit support[22] to secure the debt of the operating agency. This credit support can take various forms, the most significant of which are obligations to provide the capital funds needed to complete the project and obligations to make payment for the capacity and energy provided by the project in an amount sufficient to service the project debt.[23]

If the municipal entities are obligated to make payments for the capacity and energy of a project *under all circumstances,* which is frequently the case,[24] the payment obligation is referred to as "dry-hole risk."[25] In effect, the municipal entities undertaking such an obligation unconditionally guarantee the agency's bonds; if a project is terminated or its operation is curtailed or suspended, payments from the municipal entities involved would remain due in order to service the project debt even though the entities would receive nothing from the project.

Although these "dry-hole" provisions seem onerous, municipal entities are willing to undertake them because the provisions ensure that the agency's bonds are marketable at commercially feasible rates.[26] The "dry-hole" provisions place the several credits of all participating municipal entities behind the bonds, rather than only the single credit of the JOA, and allocate the risk of non-completion to the municipal entities, thus assuring investors of the security of the investment.[27] This credit support also allows the agency to finance the project on a highly

---

19 *See, e.g.,* LA. REV. STAT. ANN. § 33:1334(A), (C) (West Supp. 1983); WASH. REV. CODE ANN. § 43.52.3411 (1983); *see also* Worenklein, *supra* note 13, at 40.

20 Worenklein, *supra* note 13, at 40.

21 *See infra* notes 164-66 and accompanying text.

22 Worenklein, *supra* note 13, at 40. Mr. Worenklein defines "credit support" as "the provision of credit substance (through contractual obligations by creditworthy entities to provide revenues or to assume certain risks) to support the likelihood of timely and complete debt repayment by the [operating agency] (an entity which would otherwise not be creditworthy)." *Id.* at 40 n.3.

23 *See* Worenklein, *supra* note 13 at 40.

24 *See* Ferdon, *supra* note 5, at 18.

25 "Dry-hole risk" is the term adopted by the *WPPSS* court for this type of financing arrangement. Chemical Bank v. Washington Pub. Power Supply Sys., 99 Wash. 2d 772, 785-86, 666 P.2d 329, 336 (1983). The financial community also refers to such payment obligations as "hell-or-high water" or "take-or-pay" obligations. *See* Worenklein, *supra* note 13, at 40. This Note will employ the court's terminology throughout.

26 *See infra* notes 164-66 and accompanying text.

27 *See id.*

leveraged basis, which lowers the capital contribution that each participating municipal entity must make.[28]

In sum, these "dry-hole" provisions play a key role in facilitating the marketing of the JOA's bonds, thereby allowing the participating municipal entities to enjoy the benefits of using a JOA to finance and construct energy facilities.

## II
## THE CASE

The Washington Public Power Supply System (Supply System) is a joint operating agency established in 1957 pursuant to chapter 43.52 of the Washington Revised Code.[29] The Supply System is an organization of twenty-three Washington municipal entities (members), consisting of nineteen public utility districts (PUD's) and four cities.[30] It is a municipal corporation[31] with authority to construct, acquire, operate, and maintain facilities for the generation and transmission of electricity.[32] The Supply System also has the power to issue revenue bonds payable from the revenues of the facilities it operates.[33]

In 1976, the Supply System entered into identical agreements with eighty-eight municipal entities (participants) in which the Supply System contracted to construct two nuclear power plants, "WNP-4" and "WNP-5."[34] Twenty of the Supply System's twenty-three members were among the eighty-eight participants who entered into these "Participants' Agreements."[35]

The Participants' Agreements provided that the Supply System would own WNP-4 entirely and ninety percent of WNP-5; Pacific Power and Light Company would own ten percent of WNP-5.[36] The Supply System obtained financing for the projects by issuing revenue bonds in the Supply System's name pursuant to a Supply System Bond Resolution adopted in 1977.

Each Participant's Agreement stated that the "Supply System hereby sells, and the Participant hereby purchases, its Participant's

---

28 *See* Worenklein, *supra* note 13, at 40; *see also supra* note 14 (discussing leveraging).

29 WASH. REV. CODE ANN. ch. 43.52 (1983).

30 Chemical Bank v. Washington Pub. Power Supply Sys., 99 Wash. 2d 772, 777, 666 P.2d 329, 331 (1983).

31 WASH. REV. CODE ANN. § 43.52.250 (1983).

32 *Id.* § 43.52.300(2).

33 *Id.* § 43.52.3411.

34 *WPPSS,* 99 Wash. 2d at 776-77, 666 P.2d at 331-32.

35 Motion for Reconsideration of Chemical Bank and Washington Public Power System app. I, at A-1, *WPPSS,* 99 Wash. 2d 772, 666 P.2d 329 [hereinafter cited as Motion for Reconsideration].

36 *See* Washington Public Power Supply System Nuclear Projects Nos. 4 and 5, Participants' Agreement § 25 (1976) (incorporating § 1.1(o) of the Bond Resolution) [hereinafter cited as Participants' Agreement]; *see also infra* note 54 (text of § 1.1(o) of Bond Resolution).

share of Project Capability."[37] Each Agreement also contained a "dry-hole" provision, requiring each participant to make monthly payments of its proportionate share of a "Billing Statement," which reflected project costs and included finance charges on the revenue bonds, whether or not the projects were ever completed, operable, or operating.[38] Termination of the projects established a trigger date for the "dry-hole" payments.[39]

On January 22, 1982, the Supply System terminated the projects due to cost overruns, thus triggering the participants' payment obligations under the "dry-hole" provisions of their Agreements.[40] In response to rumors indicating some participants' unwillingness to honor these obligations,[41] Chemical Bank, the trustee for the bondholders, filed suit on May 20, 1982, in Washington Superior Court.[42] Chemical Bank sought a declaratory judgment affirming the participants' obligation to make their monthly payments to the Supply System to cover the principal and interest due the bondholders.

After the trial court granted Chemical Bank's motion for summary judgment on some issues,[43] the Washington Supreme Court granted discretionary review to decide whether the Washington[44] participants had the necessary statutory authority to enter into the Participants' Agree-

---

37 Participants' Agreement, *supra* note 36, § 5. "Project Capability" is defined in § 1(v) of the Participants' Agreement as:

> [T]he 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 therof 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.

38 Participants' Agreement, *supra* note 36, § 6(d). The provision reads:

> 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 non-performance being limited to mandamus, specific performance or other legal or equitable remedy.

*Id.*

39 Participants' Agreement, *supra* note 36, § 1(a), (g).

40 *See* N.Y. Times, Jan. 23, 1982, at 31, col. 3.

41 See N.Y. Times, May 21, 1982, at D11, col. 6.

42 *See WPPSS,* No. 82-2-06840-3 (Wash. Super. Ct. filed May 20, 1982).

43 *See WPPSS,* No. 82-2-06840-3 (Wash. Super. Ct. summary judgment motion granted, Nov. 16, 1982).

44 The state supreme court's review was limited to the question of whether the Washington participants in the projects had the authority to enter into the Participants' Agreements. The authority of the Idaho, Oregon, Wyoming, and Nevada participants was being litigated concurrently in their respective states. *See WPPSS,* 99 Wash. 2d at 781 n.2, 666 P.2d at 334 n.2.

ments and the Bond Resolution.[45] The municipal participants are "creatures of statute," possessing only those powers conferred on them by their charters or by other laws, and those powers necessarily implied by or incident to their expressly granted powers.[46] Thus, without the requisite statutory authority, the Participants' Agreements and the participants' payment obligations contained in the Agreements would be void. Although the Supreme Court identified three possible statutory sources of authority,[47] it rejected all three, concluding that the agreements were ultra vires.[48]

The first possible source of authority was the provision in the municipal participants' enumerated powers that authorized each participant to buy and sell electricity on behalf of its residents.[49] The court held, however, that the power to purchase electricity did not authorize

---

45 *See id.* at 781, 666 P.2d at 334. The state supreme court limited its review to the statutory authority questions and did not address the other issues presented by the parties, including: the participants' right to a jury; the Supply System's statutory authority to enter into the Participants' Agreements and the Bond Resolution and to issue the bonds pursuant thereto; the constitutional and statutory limitations on the incurring of debt or the lending of credit by the municipal participants; and the interpretation of the agreements as to payment terms.

46 2 E. MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 10.09 (rev. 3d ed. 1979); *see* State v. Krueger, 67 Wash. 2d 673, 409 P.2d 458 (1965) (cities are creatures of sovereign state).

47 The *WPPSS* court also discussed a fourth possible statutory source of express authority in its opinion, WASH. REV. CODE ANN. CH. 54.44 (1983) ("Nuclear, Thermal, Electric Generating Power Facilities - Joint Development"), even though the parties in *WPPSS* did not rely on this statute. The court noted that certain requirements of chapter 54.44 were "notably absent" from the Participants' Agreements, particularly the ownership requirement of § 54.44.020. *WPPSS,* 99 Wash. 2d 794-97, 666 P.2d at 341-42. Additionally, the agreements included a "step-up" provision, whereby the remaining participants would assume the liabilities of any defaulting participant on a prorata basis, which is prohibited by the statute. *See* WASH. REV. CODE ANN. § 54.44.030. 99 Wash. 2d at 794-97, 666 P.2d at 341-42. The court also examined whether the power to enter into a financing arrangement like that at issue in *WPPSS* could be *implied* from the express statutory authority to acquire or construct generating facilities and provide electricity but concluded that it could not. *See id.* at 791-94, 666 P.2d at 339-40.

48 *See id.* at 798, 666 P.2d at 342.

49 The 19 Washington PUD's involved in *WPPSS* are authorized to "purchase, within or without [their] limits, electric current for sale and distribution within or without [their] limits. . . ." WASH. REV. CODE ANN. § 54.16.040 (1962).

The grant of authority applicable to the various Washington municipal *WPPSS* participants varies according to the class of city or town to which each belongs:

> First class cities are authorized to: "provide for lighting the streets and all public places, and for furnishing the inhabitants thereof with gas or other lights . . . ." *Id.* § 35.22.280(15). Second class cities are authorized to: "provide for lighting the streets and all public places of the city and for furnishing the inhabitants of the city with gas, electric or other light. . . ." *Id.* § 35.23.440(45). Third class cities and towns are authorized to "drain, sprinkle and light [streets, sidewalks, alleys, squares and other public highways and places within the city]." *Id.* §§ 35.24.290(3), 35.27.370(4). Code cities are authorized to "provide utility service within and without its limits and exercise all powers to the extent authorized by general law for any class of city or town." *Id.* § 35A.80.010.

the purchase of "project capability," reasoning that the possibility existed that no electricity would ever be generated, and thus that none would actually be "purchased."[50]

The second source of authority the court considered was a statute authorizing the participants to construct or acquire electric generating facilities.[51] The municipal entities "clearly had the authority to build or buy their own plants."[52] The court stated, however, that "[a]s a matter of public policy, the enormous risk to ratepayers [of loss by their municipal entity's involvement in a joint development project] must be balanced by either the benefit of ownership or substantial management control."[53] The court then found that the participants retained no ownership interest in the projects. It based this finding solely on the language of the Bond Resolution,[54] which provided that only the Supply System and Pacific Power and Light Company retained any "ownership interest" in the projects.

---

Although the municipal participants were not expressly authorized to "purchase" electricity, it is generally held that "a [municipal entity] having power to provide light for its streets has implied power to purchase the light of others and to enter into a contract for that service." 2 E. MCQUILLIN, *supra* note 46, § 34.129.

It should be noted that the court concentrated on the narrow language of the power granted to PUD's ("purchase . . . electric current," WASH. REV. CODE ANN. § 54.16.040 (1962)) but disregarded the fact that the powers granted to the other participants are set forth in broader language. *See, e.g.,* WASH. REV. CODE ANN. § 35.23.440(35) (1965) (second class cities granted power "[t]o make all . . . contracts or agreements for the use or benefit of the city"); *id.* § 35.24.410 (third class cities may "contract for supplying the city with water, light, power, and heat for municipal purposes").

50 *WPPSS,* 99 Wash. 2d at 783-84, 666 P.2d at 335.

51 WASH. REV. CODE ANN. § 35.92.050 (1983) provides:

> A city or town may also construct, condemn and purchase, purchase, acquire, add to, 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, and other means of power and facilities for lighting, heating, fuel, and power purposes, public and private, with full authority to regulate and control the use, distribution, and price thereof, together with the right to handle and sell or lease, any meters, lamps, motors, transformers, and equipment or accessories of any kind, necessary and convenient for the use, distribution, and sale therof; authorize the construction of such plant or plants by others for the same purpose, and purchase gas, electricity, or power from either within or without the city or town for its own use and for the purpose of selling to its inhabitants and to other persons doing business within the city or town and regulate and control the use and price thereof.

*See also id.* § 54.16.040 (PUD's authorized to "construct" and "acquire" generating faeilities).

52 *WPPSS,* 99 Wash. 2d at 784-85, 666 P.2d at 335-36.

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

54 *See id.* at 785-86, 666 P.2d at 336.

Section 1.1(o) of the Bond Resolution reads as follows: "The term 'Ownership Share' shall mean the [Supply] System's undivided ownership interest in the WPPSS No. 5 Project . . . and the [Supply] System's complete ownership interest in the WPPSS No. 4 Project."

Although the participants were not direct parties to the Bond Resolution, the Participants' Agreements provided that the Supply System must comply with the Bond Resolution and that the Agreements are subject to the terms of the Bond Resolution. *See* Participants' Agreement, *supra* note 36, § 25.

The court went on to determine whether the participants retained sufficient management control to constitute "the equivalent of an ownership interest."[55] Although the Agreements called for the establishment of a "Participants' Committee" to approve or disapprove major decisions relating to the management of the projects,[56] the court concluded that the "rigid procedural requirements" under which the Committee labored precluded "meaningful deliberation" of Supply System proposals and therefore precluded "significant input" in the management of the projects.[57] Because the participants lacked both a titular "ownership interest" and any "equivalent of an ownership interest" in the projects, the court ruled that the participants were not engaged in the construction or acquisition of an electric generating facility within the meaning of the authorizing statute.

Having found that the participants did not have the authority to enter into the Agreements under the statutory provisions empowering the participants to purchase electricity and to acquire or construct generating facilities, the court turned to the third possible statutory source of authority: the joint operating agency chapter under which the Supply System was created.[58] Phrased in language similar to that used to set out the participants' enumerated powers discussed above, the JOA chapter authorizes the participants to "purchase . . . electric energy" from a JOA.[59] The court interpreted the language of the JOA chapter in the same way it did the enumerated powers provisions and found that the JOA chapter did not authorize the participants to purchase project capability.[60]

Judge Utter, in a dissenting opinion joined by Judge Dolliver, criticized the majority's narrow reading[61] of the participants' authority, contending that the majority placed "constraints on municipalities not

---

55 *WPPSS,* 99 Wash. 2d at 787, 666 P.2d at 337.

For the purposes of this section, the Note retains the court's original terminology, distinguishing between an "ownership interest" and the "equivalent of an ownership interest." In a subsequent section, however, the Note attempts to refute the analysis underlying this terminology, rendering this terminology meaningless. *See infra* notes 111-48 and accompanying text.

56 *See* Participants' Agreement, *supra* note 36, § 15; *infra* notes 123-26 and accompanying text.

57 *WPPSS,* 99 Wash. 2d at 787, 666 P.2d at 337; *see also infra* note 128 (objectionable procedural requirement).

58 *See* WASH. REV. CODE ANN. ch. 43.52 (1983).

59 *Id.* § 43.52.410. This section provides: "Any city or district is authorized to enter into contracts or compacts with any operating agency or a publicly or privately owned public utility for the purchase and sale of electric energy or falling waters."

60 *See* 99 Wash. 2d at 794, 666 P.2d at 340-41.

61 Judge Dore, in a concurring opinion, applied an even more restrictive interpretation of the statute. He rejected the majority's "equivalent of an ownership interest" analysis of the second potential source of statutory authority. Judge Dore asserted that "*both* an ownership interest *and* active participation in the management of the facilities are mandatory" to find that the participants were constructing or acquiring electric generating facilities within the

intended by the Legislature."[62] The dissent argued for a broad reading of the relevant statutes, especially those authorizing the purchase of electricity, "to further their purpose of furnishing power to the people."[63] Judge Utter asserted that courts must provide municipal entities "the flexibility which is absolutely crucial in furnishing such a capital-intensive service."[64] The dissent concluded that to provide this flexibility, courts should review the means by which municipal entities choose to furnish power to their citizens only to the extent that those means are "arbitrary and capricious."[65]

## III
## ANALYSIS

In *Chemical Bank v. Washington Power Supply System* (*WPPSS*),[66] the Washington Supreme Court concluded that none of the three possible statutory sources of authority for the Participants' Agreements authorized the municipal participants to enter into these Agreements. Alternative interpretations of the statutes, however, were both possible and warranted in this case. These alternative interpretations suggest that all three statutory sources of authority examined by the court did authorize the participants to enter into the Participants' Agreements.

First, the court should have liberally construed the statutes empowering the participants to purchase electricity. A broader construction of this power accords with the general rule of statutory construction applicable to municipal proprietary powers.[67] Had the court liberally construed the participants' power to purchase electricity, it would have found statutory authority for the participants' purchase of "project capability."[68]

Second, the court should have employed a more traditional corporate definition of ownership interest rather than a less meaningful titular definition in determining whether the participants were acquiring or constructing facilities within the meaning of the empowering statute.[69]

---

meaning of the empowering statute. *Id.* at 800, 666 P.2d at 343-44 (Dore, J., concurring)(emphasis in original).

The concurrence also addressed the issues of municipal debt limitations and contract interpretation, which the trial court ruled on but which the supreme court majority, exercising its discretionary review power, declined to address. This Note likewise will refrain from addressing these issues.

62 *Id.* at 810, 666 P.2d at 348 (Utter, J., dissenting). The dissent also did not reach the additional issues addressed in the trial court.

63 *Id.* at 811, 666 P.2d at 349.

64 *Id.* at 810, 666 P.2d at 348.

65 *Id.* at 813-14, 666 P.2d at 350.

66 99 Wash. 2d 772, 666 P.2d 329 (1983).

67 *See infra* notes 74-90 and accompanying text.

68 *See infra* notes 91-98 and accompanying text.

69 *See infra* text accompanying note 117.

Under a corporate definition, the participants retained sufficient ownership interest to satisfy any ownership requirement "envisioned in the statutes."[70]

Third, the court's interpretation of the JOA chapter as not authorizing the participants to assume "dry-hole" risk precludes a major source of financing for joint agency development projects.[71] This defeats a major purpose of the JOA chapter and renders it ineffectual in contravention of well-established rules of statutory construction.[72] The court, therefore, should have interpreted the JOA chapter as authorizing the participants to enter into the Participants' Agreements.

### A. The Participants' Power to "Purchase Electricity"

The *WPPSS* court's conclusion that the participants' power to "purchase electricity" did not extend to the purchase of project capability resulted from its strict construction of the authorizing statutes. Generally, courts must strictly construe the powers granted to municipal entities.[73] For the reasons set forth below, however, a liberal construction of the relevant statutes was appropriate in this case. If the court had liberally construed the various empowering statutes, it would have concluded that the statutes authorize the purchase of project capability.

#### 1. *Proprietary vs. Governmental Powers*

In construing statutory grants of municipal powers, courts often distinguish between "governmental" powers and "proprietary" powers.[74] Governmental powers are those conferred on the municipal entity as a local agency of limited jurisdiction for the purpose of administering the affairs of the state and promoting the state's interest.[75] In exercising a governmental power, the municipal entity is dispensing or exercising

---

70 *WPPSS,* 99 Wash. 2d at 788, 666 P.2d at 337; *see infra* notes 117-48 and accompanying text.

71 *See infra* notes 163-71 and accompanying text.

72 *See infra* note 171 and accompanying text.

73 *See* City of N. Sacramento v. Citizens Utils. Co., 192 Cal. App. 2d 482, 483, 13 Cal. Rptr. 538, 539 (1961); 2 E. MCQUILLIN, *supra* note 46, § 10.18a.

74 2 E. MCQUILLIN, *supra* note 46, § 10.22; *see also* Puget Sound Power & Light Co. v. Public Util. Dist. No. 1, 17 Wash. App. 861, 863, 565 P.2d 1221, 1223 (1977) (recognizing this distinction in Washington).

75 2 E. MCQUILLIN, *supra* note 46, § 10.05; *see also* Puget Sound Power & Light Co. v. Public Util. Dist. No. 1, 17 Wash. App. 861, 863, 565 P.2d 1221, 1223 (1977) (in its governmental "character," a municipality acts as agency of state); E. YOKLEY, MUNICIPAL CORPORATIONS § 55 (1956). As Yokley explains:

> Among typical governmental functions of a municipality may be mentioned: the levy of properly authorized taxes, the assessment and collection of its proportion of the state tax, police regulations, suppression of crime, protection of the public health, the exercise of eminent domain, the operation of a fire department and the administration of justice.

*Id.*

some element of sovereignty.[76] Because sovereign powers potentially may encroach upon municipal citizens' personal rights and liberties, these powers must be strictly construed so as to minimize such encroachment.[77]

Proprietary powers are "those relating to the accomplishment of private corporate purposes."[78] These powers are conferred for the specific benefit and advantage of the municipal entity's inhabitants.[79] In the exercise of a proprietary power, "the municipality is largely controlled by the rules governing private individuals or corporations,"[80] and its power is "to be construed with liberality, to the end that the purpose of the grant may be fully accomplished."[81] The policy behind this rule is analogous to the policy underlying the "business judgment" rule[82] governing the conduct of directors of private corporations: to encourage entrepreneurial behavior, which benefits all those within the corporation, by leaving much to the discretion and judgment of the decisionmakers.[83]

Courts generally have held that a municipal entity is exercising a proprietary power when it contracts for the supply of water, light, or gas to its inhabitants.[84] In applying the general rule of liberal statutory con-

---

76 2 E. MCQUILLIN, *supra* note 46, § 10.22; *see also* Certain Lots Upon Which Taxes are Delinquent v. Town of Monticello, 159 Fla. 134, 142, 31 So. 2d 905, 910 (1947) (delegated corporate powers that may limit rights of citizens are strictly construed).

77 *See* Certain Lots Upon Which Taxes are Delinquent v. Town of Monticello, 159 Fla. 134, 142, 31 So. 2d 905, 910 (1947); State v. Hackman, 273 Mo. 670, 690, 202 S.W. 7, 11 (1918).

78 2 E. MCQUILLIN, *supra* note 46, § 10.05.

79 *Id.; see also* City of Seattle v. Stirrat, 55 Wash. 560, 565, 104 P. 834, 835 (1909) (proprietary powers are conferred "for the private advantage of the compact community which is incorporated as a distinct *legal personality or corporate individual*") (citation omitted).

80 2 E. MCQUILLIN, *supra* note 46, § 10.22; *see also* Puget Sound Power & Light Co. v. Public Util. Dist. No. 1, 17 Wash. App. 861, 863, 565 P.2d 1221, 1223 (1977) (In its proprietary "character," a municipality "acts as a private business.").

81 Butler v. Karb, 96 Ohio St. 472, 481, 117 N.E. 953, 955 (1917); *see also* Puget Sound Power & Light Co. v. Public Util. Dist. No. 1, 17 Wash. App. 861, 864, 565 P.2d 1221, 1223 (1977) ("In its [proprietary] character, [the municipal corporation] is implicitly authorized to make all contracts and to engage in any undertaking which is necessary to render the system efficient and beneficial to the public."); 2 E. MCQUILLIN, *supra* note 46, § 10.22.

82 *See* H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 242 (3d ed. 1983).

83 *See* Butler v. Karb, 96 Ohio St. 472, 482, 117 N.E. 953, 955-56 (1917) ("[S]uccessful and satisfactory management and operation of a city's utilities could not be accomplished if [the city officials] were hedged about and hampered by detailed, minute, and precise regulations, directions, or restrictions, either legislative or judicial."); *see also* O. POND, A TREATISE ON THE LAWS OF PUBLIC UTILITIES OPERATING IN CITIES AND TOWNS § 11 (1913) ("[T]he discretion of municipal corporations . . . is . . . not subject to judicial control" except in cases of fraud or gross abuse of diseretion.).

84 *See* 2 E. MCQUILLIN, *supra* note 46, § 34.126; *see also* Linne v. Bredes, 43 Wash. 540, 546, 86 P. 858, 860-61 (1906) (citing Appeal of Brumm, 9 Sadler 483, 485, 12 A. 855, 856 (Pa. Mar. 5, 1888) ("A municipal corporation which supplies its inhabitants with gas or water does so in its capacity of a private corporation . . . .").

struction to these specific proprietary powers, "the courts permit and favor the exercise of the fullest discretion in the enjoyment and administration of such [proprietary] powers which are [sic] consistent with the general object of their grant,"[85] and which does not contravene any express limitations on the method of executing the powers contained in their grant.[86] The "general object" of the grant of power to "purchase electricity" is to empower the municipal entity to furnish its residents with electricity.[87] This purpose is broad and comprehensive; the purchase of project capability by a municipal entity is a means consistent with the general object of the grant. Furthermore, the grant of power does not prescribe the mode of contracting to be used to carry out the power.[88] The signing of the Participants' Agreements by the municipal participants in *WPPSS* thus is clearly an exercise of discretion consistent with the general object of the grant of a proprietary power and not in contravention of any express limitations on that grant.

In reviewing a municipal entity's use of its discretion in the exercise of a proprietary power, a court must adopt a standard of reasonableness, invalidating only those actions found to be arbitrary and capricious.[89] A reasonableness standard serves two purposes. First, it prevents a court from substituting its own judgment for that of the municipal entity's elected officials in an area more properly reserved to those officials. Second, a stricter standard of review would unreasonably restrict a municipal entity's discretion in exercising a proprietary power, thus preventing the municipal entity from exercising that power as efficiently as a similarly situated private corporation would. In his dissenting opinion in

---

85 O. POND, *supra* note 83, § 11.

86 *See* 2 E. MCQUILLIN, *supra* note 46, § 10.27.

87 *See* State *ex rel.* PUD No. 1 v. Wylie, 28 Wash. 2d 113, 150, 182 P.2d 706, 726 (1947) ("The primary purpose of the power granted to a public utility district [to 'purchase . . . electric current for sale and distribution' and 'to construct, . . . acquire, . . . and operate' generating facilities] by subsection (d) of § 6, chapter 1, Laws of 1931, Rem. Rev. Stat. § 11610(d), is to furnish the district, and the inhabitants thereof, with electric current . . . .").

88 *See supra* note 49 (text of authorizing statutes).

89 2 E. MCQUILLIN, *supra* note 46, § 10.33; *see also* Lincoln School Township v. Union Trust Co., 36 Ind. App. 113, 116-17, 73 N.E. 623, 624 (1905); State *ex rel.* Public Util. Dist. No. 1 v. Schwab, 40 Wash. 2d 814, 829-31, 246 P.2d 1081, 1089-90 (1952) (In providing for the future energy requirements of the district, PUD commissioners' determinations of the district's prospeetive load growth will be accepted by the courts in passing upon the question of whether a proposed hydroelectric project is unreasonably large unless it is shown that the commissioners acted "arbitrarily or capriciously."). The court in *Lincoln School Township* explained:

> [W]here the grant is of a business or proprietary character, to be exercised in an administrative manner for the benefit of the particular community — as, for instance, entering into a contract for the benefit of the community — while such action may be attacked on the ground of fraud, it cannot be reviewed upon the ground that the local authorities have not contracted prudently and discreetly.

36 Ind. App. at 116-17, 73 N.E. at 624.

*WPPSS,* Judge Utter recognized the dangers of abandoning the reasonableness standard and pointed out the clear need to provide municipal entities with "the flexibility which is absolutely crucial in furnishing such a capital-intensive service" as nuclear energy.[90]

If the court in *WPPSS* had applied a reasonableness standard, it would have upheld the participants' purchase of project capability. First, the participants were faced with what they believed to be the prospect of insufficient energy resources to meet the needs of their residents.[91] The Participant's Agreements entered into in July 1976 offered the participants the opportunity to obtain a block of energy capacity that they could control at cost, with no markup or profit to the constructing entity.[92] Furthermore, the participants could acquire this capacity without expending any of their own capital until the projects were either operating or terminated.[93] Second, the risk of a "dry-hole" that so concerned the *WPPSS* court was a risk that each participant would have borne in any event; if each participant had undertaken a separate, smaller project rather than participating in one larger project through the Supply System, it would have had to shoulder the "dry-hole" risk for its own project alone.[94] Third, the participants knew that the Supply System would have no significant source of funds to pay project and construction costs aside from bond sale revenues.[95] Thus, each participant covenanted to charge and collect rates sufficient to pay the Supply System its "Participant's Share" of all project costs, including debt service.[96] Fourth, the participants knew that bond purchasers would require a guarantee of payment if the bonds were to be sold at a price that would be commercially feasible for the Supply System.[97] Finally, the participants had bargained for and secured significant rights to oversee and control project development through the Participants' Committee.[98]

All of these factors suggest that the participants' actions were reasonable and thus were beyond judicial reproach. The court should have

---

90 99 Wash. 2d at 810, 666 P.2d at 348 (Utter, J., dissenting).

91 "Participant City of Ellensburg, for example, concluded that 'without participation in WNP-4 and 5, it would have 25% less power than required to serve the anticipated electricity needs of its customers after 1983.' " Brief of Washington Public Power Supply System Re Statement of Case, Motion to Strike Brief, and Jury Issue at 10-11, *WPPSS,* No. 82-2-06840-3 (Wash. Super. Ct. filed May 20, 1982) (quoting affidavit of Robert Walker, filed in support of Ellensburg's motion and memorandum).

92 *See* Participants' Agreement, *supra* note 36, § 1.

93 *Id.* §§ 1(g), 6(a).

94 The size of a loss resulting from a "dry-hole" in a smaller project of course would be proportionately smaller.

95 *See infra* notes 168-69 and accompanying text.

96 *See* Participants' Agreement, *supra* note 36, §§ 5, 6(c).

97 *See infra* notes 164-66 and accompanying text.

98 *See infra* notes 123-31 and accompanying text.

held, therefore, that the participants' power to purchase electricity authorized them to purchase project capability.

2. *Cases in Other States*

The decisions of several courts in other states support the proposition that statutory authority to purchase electricity should be broadly construed to permit project capability purchases.[99] Each decision addressed the question of whether a JOA and a municipal participant had the authority to enter into contracts that involved the purchase of power from a plant not yet constructed. In each case, the municipal entities had promised to pay the costs of the new project, whether it produced power or not, in return for a share of project capability. The statutes involved, worded similarly to the Washington authorizing statutes, empowered the participants to purchase electricity but did not explicitly authorize them to purchase electricity in the form of project capability.[100] Nevertheless, the courts liberally construed the various authorizing statutes and uniformly upheld the municipal entities' purchase agreements.[101]

For example, in *Frank v. City of Cody,*[102] a Wyoming city brought suit to compel its mayor to sign an agreement with a JOA on behalf of the city. Among other things, the agreement provided that the city would pay project costs in return for a share of project capability. The city was authorized by statute to "purchase electric current."[103] In defense of his refusal to sign the document, the mayor asserted that the city lacked specific statutory authority to enter into such an agreement.[104]

In rejecting this defense, the Supreme Court of Wyoming stated:

> It is apparent that [the city] . . . must get [its] electrical energy from some source. *Where there are no limitations or restrictions as to a mode of contracting provided by the legislature to carry out a power plainly and expressly bestowed upon a municipality, the appropriate method is left to the discretion of municipal authorities with the usual test of the validity being whether the con-*

---

99 *See* Board of Comm'rs v. All Taxpayers, Property Owners, and Citizens, 360 S.2d 863 (La. 1978); State *ex rel.* Mitchell v. City of Sikeston, 555 S.W.2d 281 (Mo. 1977) (en banc); State *ex rel.* Grimes County Taxpayers Ass'n v. Texas Mun. Power Agency, 565 S.W.2d 258 (Tex. Civ. App. 1978); Frank v. City of Cody, 572 P.2d 1106 (Wyo. 1977).

100 *See, e.g.,* LA. REV. STAT. ANN. § 33:4164 (West 1966) ("[m]unicipalities may obtain . . . electric current under contract . . . from private persons"); MO. ANN. STAT. § 91.030 (Vernon 1971) ("[c]ities may purchase light and power"); WYO. STAT. ANN. § 15-7-204 (1980) ([a]ny city or town may . . . [p]urchase electric current").

101 The fact that the validity of the financial arrangements in these cases was litigated before, rather than after, a default under the arrangements should not affect the precedential value of these cases. The policy reasons cited by the courts in upholding these arrangements are equally compelling in instances where a default occurs before the litigation commences.

102 572 P.2d 1106 (Wyo. 1977).

103 WYO. STAT. ANN. § 15-7-204 (1980).

104 *Frank,* 572 P.2d at 1117.

*tract is reasonable.*[105]

The court went on to find the contract reasonable, noting that the city's usual source of electrical power had "reached its capacity to supply [such] energy beyond its present commitments," and that no alternative sources existed.[106] Further, the agreement left the city in a position to "program its long-range electrical needs and avoid catch-as-catch-can procurement on the open market."[107]

3. *Washington Statutes*

The *Frank* court drew additional support for its conclusion that the Wyoming statute authorized the purchase of project capability from a provision in the Wyoming constitution requiring a liberal construction of the powers granted to cities and towns.[108] Similar mandates exist in the Washington Code with reference to the powers granted to several of the municipal participants in the *WPPSS* projects.[109]

These statutes evidence Washington's legislative policy of giving the largest possible measure of self-government to cities and towns, and any construction of the municipal entities' authorizing statutes must conform to this policy.[110] By adopting a strict construction of the municipal participants' powers, the *WPPSS* court clearly failed to adhere to this established policy.

B. The Participants' Power to Acquire Electric Generating Facilities

The *WPPSS* court found "[a]s a matter of public policy"[111] that the

---

105 *Id.* (emphasis added).

106 *Id.* at 1118.

107 *Id.*

108 *Id.* at 1115 (citing WYO. CONST. art. XIII, § 1).

109 *See* WASH. REV. CODE ANN. § 35A.01.010 (1983) (code cities are to exercise the "broadest powers of local self-government consistent with the Constitution of this state"); *id.* 35A.11.050 (Special Pamphlet 1983) (powers conferred on code cities "shall be construed liberally in favor of such cities"); WASH. REV. CODE ANN. § 35.21.600 (1965) ("Any city of ten thousand or more population shall have all power to conduct its affairs consistent with and subject to state law."); *id.* § 35.22.900 (1965) (powers of first class cities are to be liberally construed); *see also* WASH. REV. CODE ANN. § 43.52.910 (1983) (specifically requiring liberal construction of JOA statutes).

110 *See* 2 E. MCQUILLIN, *supra* note 46, § 10.21. In the past, Washington courts have consistently adhered to these requirements of liberal construction. *See* Bayha v. Public Util. Dist. No. 1, 2 Wash. 2d 85, 98, 97 P.2d 614, 620 (1939) ("The legislature has seen fit to vest the commissioners of a public utility district with almost unlimited powers relative to the construction, purchase, etc., of utilities, and in the sale of utility revenue bonds to finance such operations."); Rumbolz v. Public Util. Dist. No. 1, 22 Wash. 2d 724, 728, 157 P.2d 927, 929 (1945) (powers conferred upon the commissions of PUD's are "extremely broad"); Puget Sound Power & Light Co. v. Public Util. Dist. No. 1, 17 Wash. App. 861, 864, 565 P.2d 1221, 1223 (1977) (Districts are "implicitly authorized to make all contracts and to engage in any undertaking which is necessary to render the system efficient and beneficial to the public.")

111 *WPPSS,* 99 Wash. 2d at 788, 666 P.2d at 337.

participants' power to "construct" or "acquire" generating facilities[112] did not authorize them to enter into the Participants' Agreements. According to the court's analysis, the participants lacked both an ownership interest in the projects and sufficient involvement in project management, one of which is necessary to "satisfy the type of ownership control envisioned in the statutes."[113] In so finding, the court ignored the realities of the situation, misconstrued the statute, and substituted its judgment for that of the legislature in determining the state's public policy.[114]

1. *Actual Ownership Interest and Control*

The *WPPSS* court found that only the Supply System and Pacific Power & Light Company retained any ownership interest in the projects.[115] The court based this finding solely on the express terms of the Supply System's Bond Resolution.[116] In so doing, the court relied on a titular definition of ownership, rather than on a traditional, and more meaningful, corporate definition[117] of ownership. The court's titular definition of ownership is inferior to the corporate definition because a titular definition fails to identify where the rights commonly associated with a proprietary interest lie.

Under a corporate definition, the proprietary interests in a corpora-

---

112 *See supra* note 51 (quoting authorizing statute).

113 99 Wash. 2d at 787, 666 P.2d at 337. The concurrence's assertions that the retention of "an ownership interest is an *absolute* requirement when acquiring or constructing generating facilities," *id.* at 799-800, 666 P.2d at 343 (Dore, J., concurring); *supra* note 61, seem unsupported by the authority upon which it implicitly relies. The two cases the majority cited in support of its position that the supreme court had "never found authority [under the participants' power to construct or acquire facilities] for a project in which the participants did not have an ownership interest," 99 Wash. 2d at 785, 666 P.2d at 336, quoted by the concurrence, *id.* at 799, 666 P.2d at 343, are inapposite. In Roehl v. Public Util. Dist. No. 1, 43 Wash. 2d 214, 261 P.2d 92 (1953) and State *ex rel.* Public Util. Dist. No. 1 v. Schwab, 40 Wash. 2d 814, 246 P.2d 1081 (1952), the issue was not ownership but rather whether the municipal participants had the authority to construct facilities that would supply power well beyond the needs of the participants. Furthermore, the Missouri case of State *ex rel.* Mitchell v. City of Sikeston, 555 S.W.2d 281 (Mo. 1977) (en banc), provides an example where, although the participants held no ownership interest at all, the court did not even question the participants' authority to enter into the power sales contracts.

114 In so finding, the *WPPSS* court may also have violated the due process requirements of the Washington and United States Constitutions. Due process requires that a party not be deprived of his property without having had an opportunity to be heard. *See* J. NOWAK, R. ROTUNDA, J. YOUNG, HANDBOOK ON CONSTITUTIONAL LAW 476-77 (1978). Given that the parties in the *WPPSS* action had not directly addressed the issues of control and management, the parties disadvantaged by the *WPPSS* decision were deprived of their property without having had an opportunity to be heard on those issues. *See* Motion for Reconsideration, *supra* note 35, at 44. The Washington Supreme Court should have remanded these issues to the trial court in order to allow the parties to be heard.

115 *WPPSS,* 99 Wash. 2d at 785, 666 P.2d at 336.

116 *Id.* at 785, 666 P.2d at 336; *see supra* note 54.

117 *See* H. HENN & J. ALEXANDER, *supra* note 82, § 157.

tion are divided into units termed "shares."[118] Share holders retain a three-fold proportionate interest in the corporation consisting of control of the corporation, earnings of the corporation, and net assets of the corporation upon its dissolution.[119] Although the shareholders do not technically "own" the assets of a corporation, their three-fold interest in the corporation extends to its assets which are deemed to be held in trust for them by the corporation.[120] The participants in *WPPSS* retained with respect to the projects all the elements of the shareholders' three-fold interest. Viewing the *WPPSS* projects as assets of the Supply System, the participants had an ownership in the projects in much the same way shareholders of a corporation have an ownership interest in the assets of the corporation.[121]

a. *Control of the Corporation.* In a corporation, shareholder control generally consists of the power to vote at shareholder meetings, or to give written consents, with respect to (i) shareholder resolutions, including ratification of actions of the directors; (ii) extraordinary corporate matters; (iii) election and removal of the directors; and (iv) adoption, amendment, and repeal of the by-laws.[122]

The *WPPSS* participants, acting through the Participants' Committee,[123] possessed voting power with regard to the equivalent, in this context, of shareholder resolutions and extraordinary corporate matters. The Agreements authorized the Participants' Committee to advance its own proposals if Committee members representing twenty percent or more of the participants' shares approved of the proposal.[124] This power is analogous to corporate shareholders' power to formulate resolutions. The Participants' Committee also possessed a supervisory veto power over major decisions relating to the management of the projects. Committee members representing twenty percent or more of the participants' shares could disapprove Supply System proposals by notice of disapproval.[125] The Agreements explicitly required that various items be referred to the Participants' Committee, including construction

---

118 *See* MODEL BUSINESS CORP. ACT § 2(d) (1979).

119 *See* H. HENN & J. ALEXANDER, *supra* note 82, § 157.

120 *See* W.F. Boardman Co. v. Petch, 186 Cal. 476, 481, 199 P. 1047, 1050 (Cal. 1921) (a corporation is the creature of its stockholders and holds its property in trust for them, the stockholders, as between themselves and the corporation, being the beneficial owners).

121 It is important to note that the interest that the participants held as "shareholders" of the Supply System extends only to the corporate undertaking surrounding Projects 4 and 5. The participants retained no interest in the Supply System's other projects or ventures as a result of the 1976 Participant's Agreements.

122 *See* H. HENN & J. ALEXANDER, *supra* note 82, § 188.

123 *See* Participants' Agreement, *supra* note 36, § 15(a).

124 *See id.* § 15(e).

125 *See id.* § 15(d). A vote of disapproval by Committee members representing 20% or more of the participants' shares would force review of the proposal by a "Project Consultant" (mediator). *Id.* § 15(e). If the Supply System proposal could be shown to be imprudent in a hearing before the Project Consultant, that action was to be terminated. *Id.* § 16(b).

budgets, contracts involving more than $2 million, and proposed bond resolutions.[126] In this context, these items are clearly "extraordinary corporate matters."

The *WPPSS* court recognized the Participants' Committee's supervisory veto power[127] but concluded that the "procedure for committee consideration of [Supply System] proposals . . . precludes meaningful deliberation on the part of the committee."[128] In reaching this conclusion, the court apparently ignored several provisions contained in the Participants' Agreements that were designed to facilitate "meaningful deliberation." First, the Agreements obligated the Supply System to furnish the Participants' Committee "itemized cost estimates and other details sufficient to support a comprehensive review" of those Supply System proposals subject to Committee review.[129] Second, the Agreements afforded the participants a right of access to the Supply System's books and records concerning WNP-4 and WNP-5 for the purpose of inspection and audit.[130] Third, and perhaps most significantly, the Agreement authorized the Participants' Committee to engage, at the Supply System's expense, independent "engineering, accounting, legal and professional personnel . . . to monitor and audit the Projects, to make periodic reports to the Committee and to perform such other reasonable services as may aid the Committee in the performance of its review functions."[131]

Given these provisions, the participants' right of review of the Supply System's decisions in extraordinary corporate matters was "real and readily exercisable";[132] it clearly was not a mere "rubber stamp," as the

---

126 *See id.* § 15(c).

127 *See WPPSS,* 99 Wash. 2d at 787, 666 P.2d at 337.

128 *Id.,* 666 P.2d at 337. The court found especially objectionable, in light of the "complexities" of the various items the Committee would be called upon to consider, the procedure requiring that 20% of the participants register their *disapproval* of any Supply System proposal within 15 days or that proposal " 'shall be deemed approved.' " *Id.,* 666 P.2d at 337 (quoting Participants' Agreement, *supra* note 36, § 15(c)).

129 Participants' Agreement, *supra* note 36, § 15(c).

130 *See id.* § 8(c).

131 *Id.* § 15(g). Furthermore, the court's apparent concern over time constraints on the Committee's deliberation was needless because a vote of disapproval by participants holding 20% of the projects' shares who wished more time to study a proposal would provide additional time for such review. *See id.* § 15(e).

132 Motion for Reconsideration, *supra* note 35, at 36. The participants proved this point on numerous occasions. The participants' disapproval in August 1981 of a proposal to continue financing on the projects led directly to the projects' termination. They disapproved both the 1983 and 1984 Supply System budgets for WNP-4 and WNP-5, thereby forcing a review of those budgets by a Project Consultant. *See supra* note 125 (describing consultant's role). Further, the participants disapproved a contract settlement proposed by the Supply System. *See* Motion for Reconsideration, *supra* note 35, at 36-37.

It should also be noted in this regard that under the Agreements, the participants retained recourse to "mandamus, specific performance, or other legal or equitable remedy" in the event of non-performance by the Supply System. *See* Participants' Agreement, *supra* note 36, § 6(d). Although not technically providing "management control," this provision ac-

*WPPSS* court suggested.[133] In addition, more elaborate procedures for Committee consideration of Supply System proposals would have been neither feasible nor expedient in view of the number of participants involved in the projects.[134]

In addition to the power to vote on shareholder resolutions and extraordinary corporate matters that all participants held, the twenty participants who were also members[135] of the Supply System retained the power to elect the directors and adopt the by-laws of the Supply System. Each Supply System member was required by statute to appoint a representative to the Supply System's board of directors.[136] These representatives exercised voting rights in proportion to their respective municipal entity's interest in the projects.[137] The representatives were to "adopt rules for the conduct of [the board's] meetings and the carrying out of its business,"[138] which effectively constituted the by-laws of the municipal corporation. In substance, these twenty "member-participants" possessed all four forms of shareholder control: the power to vote on shareholder resolutions; the power to review extraordinary corporate decisions; the power to elect directors; and the power to adopt by-laws.[139]

b. *Earnings of the Corporation.* Traditionally, the goal of a for-profit corporation is to generate earnings for the exclusive benefit of its shareholders. The shareholders are entitled to the corporate earnings in proportion to their share ownership.[140]

Although the corporate undertaking in *WPPSS* was not designed to produce "earnings" per se, it was created to generate energy for the exclusive benefit of its participants. The participants were entitled to a share of any energy generated in proportion to their "investment" in the projects, which was measured by the amount due from them under the

---

knowledged the fiduciary duty the Supply System owed to the participants, a duty analogous to that owed by a corporation to its shareholders. As in the case of corporations, the availability of judicial remedies for breach of this duty serves as a deterrent to and a remedy for instances of improper management on the part of managers, here the Supply System. *See* Frank v. City of Cody, 572 P.2d 1106, 1118 (Wyo. 1977)(retention of right to sue for improper management held to be significant control over joint agency by municipal participant).

133 *WPPSS,* 99 Wash. 2d at 788, 666 P.2d at 337.

134 *See supra* text accompanying note 34 (88 municipal participants).

135 *See supra* text accompanying note 30 (incorporators of Supply System).

136 *See* WASH. REV. CODE ANN. § 43.52.370(1) (1983).

137 *Id.*

138 *Id.*

139 In addition to the control over the projects they exercised as shareholders, the member-participants, through their appointed representatives on the Supply System's board of directors, also exercised managerial control as directors over day-to-day corporate matters and general policy concerns. Given that these 20 member-participants held 96% of the project shares at issue in *WPPSS* and comprised 88% of the voting power on the Supply System's board, their control over the projects is clear. *See* Motion for Reconsideration, *supra* note 35, app. I, at A1.

140 *See* H. HENN & J. ALEXANDER, *supra* note 82, § 72.

terms of the Billing Statement.[141] In this sense, the participants' interest in the projects was similar to a shareholder's interest in the earnings of a corporation.

c. *Net Assets Upon Dissolution.* Generally, when a corporation liquidates, its shareholders participate ratably in the assets that remain after satisfaction of all creditors' claims.[142] The Participants' Agreements explicitly adopted this rule, allowing the participants to share in the distribution of the projects' assets upon termination of the projects.[143]

In summary, an examination of the extent to which the *WPPSS* participants exhibit the traditional corporate indicia of ownership significantly undermines the *WPPSS* court's conclusion that the participants lacked an ownership interest in the projects. The court's titular definition of ownership fails to identify where the rights commonly associated with a proprietary interest lie and thus is inferior to a corporate definition. If the court had performed the analysis required under a corporate definition of ownership, it would have concluded that the participants' retention of significant control in the Supply System as well as their interests in the Supply System's "earnings" and net assets upon dissolution constituted a sufficient ownership interest in the projects to satisfy any requirements contained in the authorizing statutes.

2. *Equivalence of an Ownership Interest*

The court in *WPPSS* indicated that even if the participants did not possess actual ownership of the projects, their actions would be valid under the authorizing statutes if they retained the "equivalent of an ownership interest" in the project.[144] Under the court's approach, the participants would have retained the "equivalent of an ownership interest" if they had retained significant control over the projects.[145] The court found, however, that the participants' role in project management was too limited to "satisfy the type of ownership control envisioned in the statutes."[146]

Traditional analysis of ownership interest does not include a distinction between an "ownership interest" and the "equivalent of an ownership interest"; thus, contrary to the *WPPSS* court's approach, a corporate definition of ownership does not equate control with "the equivalent of an ownership interest," but rather makes control one indicia of an "ownership interest."[147] Even if one assumes that the court's novel analysis is correct, however, the participants' significant control in

141 *See supra* text accompanying note 38.
142 H. HENN & J. ALEXANDER, *supra* note 82, § 383.
143 *See* Participants' Agreement, *supra* note 36, § 13(a)(iii).
144 *WPPSS,* 99 Wash. 2d at 787, 666 P.2d at 337.
145 *See id.,* 666 P.2d at 337.
146 *Id.,* 666 P.2d at 337.
147 *See supra* notes 118-19 and accompanying text.

the key areas[148] described above demonstrates that the court's conclusion was ill considered. Thus, even under the court's approach, the foregoing examination of the participants' role in the management of the projects yields the conclusion that the participants' power to acquire and construct generating facilities authorized them to enter into the Participants' Agreements.

3. *Strict Construction*

Even assuming that the *WPPSS* court was correct in finding that the participants lacked both an ownership interest and sufficient management control to constitute the equivalent of an ownership interest, it does not necessarily follow that the participants lacked authority to enter into the Participants' Agreements. Although the court found that the requirement of "ownership control" was "envisioned in the statutes,"[149] this finding apparently resulted from the court's strict construction of the statutory language.[150] Because a municipal entity is generally held to be exercising a proprietary power[151] when it undertakes the construction or acquisition of generating facilities,[152] a liberal construction of the statute would have been more appropriate.[153]

If the court had employed a more liberal construction, it would have concluded that the participants' purchase of project capability was authorized by the statutes. Financing the construction of generating facilities through the purchase of project capability is a means consistent[154] with the general objective of the authorizing statute to empower municipal entities to furnish electrical energy to municipal inhabitants, securing energy sources to satisfy future needs, and obtain energy at cost.[155] Given the perceived unavailability of alternative sources of

148 *See supra* notes 123-38 and accompanying text.

149 *WPPSS,* 99 Wash. 2d at 787, 666 P.2d at 337.

150 The majority's reliance on the statutory scheme to demonstrate a legislative intent "that cities and PUD's *should* retain significant control over the use of any facilities acquired," *id.* at 788, 666 P.2d at 337 (emphasis added), is misplaced. The Code merely assures the PUD full authority "to sell and regulate and control the use, distribution, rates, service, charges, and price" of any power generated "free *from the jurisdiction and control of the public service commission.*" WASH. REV. CODE ANN. § 54.16.040 (1962) (emphasis added). The clear implication of the statutory langnage is that the legislature intended to grant the municipal entities freedom from governmental supervision, not that it intended to mandate that the entities retain a requisite quantum of power over the projects.

151 *See supra* notes 78-79 and accompanying text.

152 2 E. MCQUILLIN, *supra* note 46, § 35.27.

153 *See supra* notes 80-83 and accompanying text.

154 *See supra* text accompanying note 85 (discussing consistency requirement).

155 *See* State *ex rel.* PUD No. 1 v. Wylie, 28 Wash. 2d 113, 150, 182 P.2d 706, 726 (1947)("The primary purpose of the power granted to a public utility district [to 'purchase . . . electric current for sale and distribution' and to 'construct, . . . acquire, . . . and operate' generating facilities] by subsection (d) of § 6, chapter 1, Laws of 1931, Rem. Rev. Stat. § 11610(d), is to furnish the district, and the inhabitants thereof, with electric current."); *id.* (PUD would be warranted under the same authorizing statute to acquire generating facilities

power,[156] the participants' purchase of project capability to finance the construction of the projects may have been not only a reasonable[157] means of carrying out the authorizing statute's purposes, but also a necessary means.

Furthermore, if the court's strict construction of the statutes was dictated solely by its "public policy" concern that "the enormous risk to ratepayers"[158] be balanced by a requirement of ownership or substantial management control, the court's approach was clearly inappropriate. The court's view of Washington's public policy in this area is at odds with that set forth by the state legislature in recent amendments to the JOA statutes. In the amendments, the legislature acknowledged the participants' authority to "participate in," that is, to purchase the project capability of, an electrical generator construction project.[159] It is well settled that the court may not ignore express legislative policy or substitute for that policy one of the court's own making.[160] The state legislature explicitly considered the risk to ratepayers of their municipal entity's "participation" in a joint development project;[161] the legislature

---

"to adequately meet present and future ascertainable needs of the district and the inhabitants thereof.").

156 *See supra* note 91.

157 *See supra* text accompanying note 89 (discussing reasonableness standard).

158 *WPPSS,* 99 Wash. 2d at 788, 666 P.2d at 337.

159 The 1983 amendment to § 43.52.410 reads:

> Any city or district is authorized to enter into contracts or compacts with any operating agency or a publicly or privately owned public utility for the purchase and sale of electric energy or falling waters: *provided,* That no city or district may enter into a contract or compact with an operating agency to purchase electric energy, or to purchase *or participate in* a portion of an electrical generating project, that commits the city or district to pay an amount in excess of an express dollar amount in excess of an express rate per unit of electrical energy received.

WASH. REV. CODE ANN. § 43.52.410 (Supp. 1984-85) (emphasis added).

A 1981 amendment to § 43.52.550 provides:

> Any municipal corporation, cooperative or mutual which has entered into a contract with an operating agency *to participate in the construction or acquisition of an energy plant* as defined in chapter 80.50 RCW shall annually adopt a plan for the repayment of its contractual share of any operating agency obligation which matures prior to the planned operation of the plant.

WASH. REV. CODE ANN. § 43.52.550 (1983) (emphasis added); *cf. id.* ch. 54.44 (providing for ownership interest by contracting utility in generating project).

As further evidence of the legislature's view of public policy in this area, it should be noted that the legislature, with full awareness of the provisions of the Participants' Agreements in the projects, repeatedly acquiesced in the Participants' Agreements. *See* Motion for Reconsideration, *supra* note 35, at 19-24 (citing I *Senate Energy and Utilities Committee, Causes of Cost Overruns and Schedule Delays on the Five WPPSS Nuclear Power Plants* ch. 5 (Jan. 1981) and *Report to the Washington State Legislature on Projects 4 and 5, Independent Review of WPPSS Nuclear Plants 4 and 5* (Mar. 1982)).

160 *See* Gazzan v. Building Sev. Employees Int'l Union, Local 262, 29 Wash. 2d 488, 188 P.2d 97 (1947); Cook v. Clallam County, 27 Wash. 2d 793, 180 P.2d 573 (1947); *In re* Peterson's Estate, 182 Wash. 29, 45 P.2d 45 (1935).

161 *See supra* note 159.

evidently concluded either that an ownership or management control requirement was unnecessary in light of the specific safeguards incorporated into the amendments or that other interests outweighed the benefit of such a requirement. Thus, the court could not properly use this risk as a justification for denying the municipal participants' authority to enter into the Participants' Agreements. Based on the legislature's recently declared view of public policy, the court should not have voided the Participants' Agreements.

### C. The JOA Statutes

The JOA statutes authorized the participants to "enter into contracts or compacts with any operating agency or a publicly or privately owned public utility for the purchase and sale of electric energy or falling waters."[162] The *WPPSS* court held that this language did not authorize the participants to assume "dry-hole" risk. In so holding, the court effectively precluded a major means of financing for these joint projects and thereby threatened to defeat the major purpose of the JOA statutes: to encourage the joint development and provision of future power sources.[163]

In a JOA project financing, a "dry-hole" provision serves primarily to ensure the marketability of the JOA's bonds.[164] By placing the respective credits of all the participants behind the bonds, rather than only that of the issuing agency, the market receives the bonds favorably.[165] As one commentator has explained:

> [F]rom a financial standpoint the primary source of revenue for payment of debt service [by the JOA] is payments received under the power sales contracts with the municipal utilities. Consequently, the agency's bonds could not be readily marketed if receipt by the agency of amounts under the power sales contracts was conditional, since there could be no assurance that there would be a continuing source of revenue to service the bonds.[166]

A "dry-hole" provision thus assures investors that the participants are fully "locked into" the financing plan and will be accountable in the event of an emergency.

A "dry-hole" provision further enhances the marketability of a JOA's bonds by imposing the risk of non-completion of the projects on the participants and not on the bondholders.[167] Because prospective

---

162 WASH. REV. CODE ANN. § 43.52.410 (1983).

163 *See* Public Utility Joint Operating Agencies Act of 1957, 1957 Wash. Laws 1171 (codified as amended in scattered sections of WASH. REV. CODE ANN. ch. 43.52 (1983)).

164 *See* Ferdon, *supra* note 5, at 18.

165 *See id.*

166 *Id.*

167 *Id.*

bondholders have other investment options, they would be unwilling to invest in a JOA project financing absent such an allocation of risk.

These attributes of dry-hole provisions are particularly important to those, like the *WPPSS* participants, who have no alternative means of financing available. Earlier Supply System projects' funds and revenues generally were pledged to those projects' lenders and thus could not be used to secure new projects' debt.[168] Further, mortgage financing was not feasible in light of Supply System resolutions accompanying the financing of prior projects that prohibited the Supply System from encumbering its existing assets.[169] Finally, one of the participants' principal purposes in entering into the Agreements was to avoid financing the capital cost of the projects from their current resources.[170] The participants' assumption of "dry-hole" risk was the only available means by which they could provide the necessary security to investors in Supply System projects. Thus, the "dry-hole" provisions in the Participants' Agreements were the only means available to the *WPPSS* participants of carrying out the purposes of the JOA statutes.

To apply such a narrow construction to the JOA statutes as to effectively prevent financing of the projects would defeat the purpose of the JOA statutes and render them useless. Such a construction contravenes the established rule that a statute is to be construed in such a manner as to carry out, rather than defeat, its manifest purpose.[171] Therefore, the *WPPSS* court should have held that the JOA statutes authorized the participants to enter into the Participants' Agreements.

## IV
## RECOMMENDATIONS

The Washington State Legislature enacted its joint operating agency statutes with the goal of increasing economy and efficiency by encouraging the joint development of the state's power resources. The financial community has consistently viewed the "dry-hole" provision as a commercially reasonable and necessary means of facilitating joint energy development and thereby achieving the legislature's ultimate goal. The *WPPSS* court, adopting a paternalistic attitude towards its in-state

168 Revenues derived from the Supply System's ownership and operation of the Hanford and Packwood Projects, WNP-1, WNP-2, and WNP-3, had been separately committed and pledged under agreements and bond resolutions relating to those projects. Further, those agreements prohibited the Supply System from encumbering any of its assets, thus precluding mortgage financing. *See* Brief of Washington Public Power Supply System re Statement of Case, Motion to Strike Brief, and Jury Issue at 27, *WPPSS,* 99 Wash. 2d 772, 666 P.2d 329.

169 *See supra* note 168.

170 *See supra* note 93 and accompanying text.

171 *See* Roza Irrigation Dist. v. State, 80 Wash. 2d 633, 637-38, 497 P.2d 166, 169 (1972); *see also* 2 J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 46.05 (4th ed. 1973).

ratepayers, has jeopardized the legislature's long-term goals in order to bestow upon these ratepayers a short-term benefit by voiding these provisions.[172]

More importantly, the *WPPSS* court, in straining to find the Participants' Agreements ultra vires and therefore unenforceable, overstepped the bounds of its own authority and placed "constraints on municipalities not intended by the Legislature."[173] Courts should leave a great deal of discretion to the elected officials of municipal entities contemplating entering into these extremely complex transactions. In the final analysis, such transactions are *business* transactions that are made in the municipal entity's proprietary capacity and pose little if any danger to municipal residents' substantive rights and liberties. Constant judicial oversight of these transactions only serves to impede efficient decisionmaking by municipal entities' elected officials. When confronted with controversy concerning the merit, legality, or advisability of such a transaction, the courts should allow the municipal entity, as they allow the private enterprise, to fail or succeed as it will, absent any evidence of fraud or self-dealing in the transaction. Should any other constraints be needed, they should come from the legislature.

*David P. Wohabe*

172 Any "benefits" in-state ratepayers may have derived from the outcome of the *WPPSS* case may already be outweighed by the adverse effects of the decision. Washington municipal entities, even those unaffiliated with projects WNP-4 and WNP-5, are now frequently forced to pay higher rates in the municipal bond market. *See WPPSS Bond Ruling Threatens Financing in Northwest Region,* Wall St. J., June 17, 1983, at 1, 14.

173 99 Wash. 2d at 810, 666 P.2d at 348 (Utter, J., dissenting).