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# MUNICIPAL FINANCE—CORPORATE SECURITIES: THE EYE OF A STORM—*Chemical Bank v. Washington Public Power Supply System*, 99 Wash. 2d 772, 666 P.2d 329 (1983)

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MUNICIPAL FINANCE—CORPORATE SECURITIES: THE EYE OF A STORM—*Chemical Bank v. Washington Public Power Supply System*, 99 Wash. 2d 772, 666 P.2d 329 (1983), *cert. denied*, 105 S. Ct. 2154 (1985).

## I. INTRODUCTION

On June 15, 1983, the Supreme Court of Washington invalidated a contract ultimately causing the largest municipal bond default in history.<sup>1</sup> Because the ruling<sup>2</sup> affected at least 78,000 bondholders and the bond<sup>3</sup> default generated approximately 70 lawsuits, a large audience followed the appeal.<sup>4</sup>

*Chemical Bank v. Washington Public Power Supply System*<sup>5</sup> posed the issue whether tax-exempt municipal bonds that the Washington Public Power Supply System (System)<sup>6</sup> had issued to finance the construction of two nuclear power plants to supply electricity to 88 different publicly-owned utilities would be repaid.<sup>7</sup> When the System's inability to obtain further financing forced it to terminate the project,<sup>8</sup> the issue became whether the electric ratepayers or the bond purchasers would pay the architectural, engineering, and construction costs incurred before the date of termination.<sup>9</sup>

This note will explore how the Supreme Court of Washington in

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1. *Chemical Bank v. Washington Pub. Power Supply Sys.*, 99 Wash. 2d 772, 666 P.2d 329 (1983). *See also*, Wall St. J., June 16, 1983, at 3, col. 2.

2. N.Y. Times, July 26, 1983, at D22, col. 6.

3. Alexander, *Whoops! A \$2 Billion Blunder*, Time, August 8, 1983, at 50.

4. On November 6, 1984, the Supreme Court of Washington affirmed its June 15, 1983 decision. 691 P.2d 524 (Wash. 1984).

5. 99 Wash. 2d 772, 666 P.2d 329 (1983).

6. *See infra* notes 11-20 and accompanying text.

7. *Chemical Bank*, 99 Wash. 2d at 777-78, 666 P.2d at 332.

8. *Id.* Moody's Investor Service had suspended credit ratings on the System's bonds. N.Y. Times, July 26, 1983, at D22, col. 5: *see also* Brown, *The Paper World*, Wash. Post, Dec. 5, 1984, at A17, col. 1.

9. Unlike privately-owned utilities, publicly-owned utilities have no stockholders who could share the risk of a terminated project. For a discussion of the issues involved when a private utility cancels a nuclear generating facility, see Note, *Electric Utility Rate Regulation: Regulating The Shock: Abandonment of Nuclear Power Plant Construction*, 7 W. NEW ENG. L. REV. 961 (1985).

Also, the System could not accept the business risk of cancellation because it had no source of revenue apart from payments from the participants. *See infra* notes 27-29 and accompanying text.

*Chemical Bank* resolved the battle between the ratepayers and the bondholders, ignoring a controlling line of cases to reach its result. By freeing the ratepayers from arm's-length contracts that required their suppliers to pay the non-recoverable costs of terminated nuclear power plants, the decision in *Chemical Bank* will prevent the bondholders from receiving \$7.2 billion over a thirty year period.<sup>10</sup>

## II. BACKGROUND

The System is an operating agency<sup>11</sup> and a municipal corporation<sup>12</sup> established under Washington law.<sup>13</sup> In 1983,<sup>14</sup> 23 municipal utilities and public utility districts constituted its members.<sup>15</sup> The legislation governing the operation of the System mandates a board of directors with one representative on the board for each member.<sup>16</sup> It also requires that the board make management and control decisions.<sup>17</sup>

As conceived, the System would enable small publicly-owned utilities to achieve greater market power<sup>18</sup> when purchasing wholesale electricity or building generating facilities, thereby maintaining rates that would be competitive with larger, often privately-owned, utilities.<sup>19</sup> The cost of a particular project could be decreased under en-

10. *Chemical Bank*, 99 Wash. 2d at 776, 666 P.2d at 331.

11. *Id.* An operating agency is a consortium of governmental units formed to provide economic service by pooling resources to achieve increased market power. Ferdon, *Power Utilities Realize Cost Benefits on Joint Agency Take or Pay Contracts*, N.Y.L.J., Mar. 25, 1982, at 17, col. 1.

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

13. *Id.*

14. Alexander, *supra* note 3, at 51.

15. *Id.* A public utility district is a municipal corporation which buys and sells power, and its service territory may encompass several municipalities. WASH. REV. CODE ANN. §§ 54.04.020-.030 (1962).

16. WASH. REV. CODE ANN. § 43.52.370 (1983).

17. *Id.* It is important that the representatives of the ratepayers freely entered agreements in which they knowingly accepted the risk that the plants might have to be terminated especially when considering their responsibility for repaying the bonds. Brown, *supra* note 8, at 1.

18. See Ferdon, *supra* note 11, at 17, col. 2.

19. In *Chemical Bank* the large scale plant took the form of a nuclear power station, a project that the participants would not have been able to construct themselves. Chemical's Reply Memorandum in Support of its Motion for Summary Judgment at 78, *Chemical Bank v. Washington Pub. Power Supply Sys.*, No. 82-2-06840-3 (Wash. Sup. Ct. 1982) [hereinafter referred to as Chemical's Memorandum]; see Ferdon, *supra* note 11, at 17, col. 2.

The idea of promoting competition in the electric utility industry by encouraging the public ownership of generating facilities dates back to 1920. 16 U.S.C. § 800(a)(1976) (granting a preference to public bodies in the licensing of hydroelectric facilities); see also *City of Bountiful, Utah*, Opinion No. 88, 11 FERC para. 61,337 (1980), *aff'd sub nom.*

abling legislation that permits the System to enter into contracts "relating to the purchase, sale, interchange or wheeling of power" with any governmental unit or utility.<sup>20</sup>

With the goal of supplying needed energy at the lowest cost, the System formed in 1957<sup>21</sup> under a statute that authorized operating agencies to generate electricity, employ professional services, and study the development of electric generating facilities.<sup>22</sup> The System decided to begin constructing two additional nuclear generating facilities in 1974.<sup>23</sup> Prior to undertaking the project, however, the System needed approval of a majority of the governing bodies of its members.<sup>24</sup>

Eighty-eight member and non-member utilities subsequently signed participation agreements in which the System promised to provide a specific percentage of project capability<sup>25</sup> and the utilities promised to pay a specific percentage of the project's annual budget.<sup>26</sup> Because the System would finance construction costs for each participant utility until the facility produced power, it drafted the agreement to require each participant to reimburse the System for borrowed funds even if it never completed the project.<sup>27</sup> The System deemed the language necessary because as an operating agency, it could raise capital only through revenues from sales and bonds that would be repaid by the revenue.<sup>28</sup> Further, the provision was equitable because if an

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*Alabama Power Co. v. Federal Energy Regulation Com'n*, 685 F.2d 1311 (11th Cir. 1982), *cert. denied*, 103 S. Ct. 3573 (1983); 16 U.S.C. 936(b)(1)(1976) (directing that 50% of the inexpensive electricity produced at the federally-financed project at Niagara Falls be sold to public bodies for the use of residential customers).

20. WASH. REV. CODE ANN. § 43.52.391 (1983).

21. *Chemical Bank*, 99 Wash. 2d at 773, 666 P.2d at 331.

22. WASH. REV. CODE ANN. § 43.52.300 (1983).

23. *Chemical Bank*, 99 Wash. 2d at 773, 666 P.2d at 331. The System had already begun construction on three others. *Id.* One past president of the System compared the 1970's nuclear expansion with the foresighted hydroelectric development of the Columbia River, exemplified by such projects as the Grand Coulee Dam. Brown, *Darkness to Dawn*, Wash. Post, Dec. 2, 1984, at A21, col. 2.

24. WASH. REV. CODE ANN. § 43.52.360 (1983).

25. 'Project Capability' is defined in section 1(v) of the agreement 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.

*Chemical Bank*, 99 Wash. 2d at 778, 666 P.2d at 332.

26. *Chemical Bank*, 99 Wash. 2d at 777, 666 P.2d at 332.

27. Even in 1976 termination presented a large enough risk to require an agreement to address risk allocation. *Id.*; see Ferdon, *supra* note 11, at 17-18.

28. WASH. REV. CODE ANN. § 43.52.300(6) (1983). The System, therefore, could not feasibly assume the risk of termination because of its total dependence on the parties

individual participant built a project by itself, it could legally service the debt incurred to finance a terminated facility.<sup>29</sup>

Elected public officials made the power supply decisions for the public utility districts that signed the agreement.<sup>30</sup> Although some officials who served on the governing boards received nominal compensation,<sup>31</sup> they had been delegated the delicate and technical task of searching for and contracting the most inexpensive supply of electricity which would be reliably available in 15 or 20 years.<sup>32</sup>

In 1976, the agreement which the System offered represented a low cost energy supply<sup>33</sup> that the officials believed forecasts of a growing demand for electricity necessitated.<sup>34</sup> The increasing demand rendered the probability of termination small though existent.<sup>35</sup> After reviewing studies, the officials chose what they judged the best product on the market, even with the risk that ratepayers might pay construction costs but ultimately receive no electricity.<sup>36</sup>

The agreement provided the participants with a method of controlling management decisions<sup>37</sup> and each would be guaranteed percentage of the units output if the project were completed.<sup>38</sup> Although the agreement did not precisely follow the procedure for nuclear development delineated in the Washington statutes, it did create a com-

with which it had contracted for construction and operating capital. Ferdon, *supra* note 11, at 17-18. The legislative scheme of an operating agency rendered it little more than a shell composed of governmental units which used it for the financing, construction, and operation of electric generating facilities. Note, *Chemical Bank v. Washington Public Power Supply System*, 69 CORNELL L. REV. 1094, 1116-17 (1984).

29. WASH. REV. CODE ANN. § 43.52.3411 (1983).

30. WASH. REV. CODE ANN. § 54.12.010 (West Supp. 1985). Being elected, a board would theoretically not act contrary to the perceived desires of its ratepayers.

31. Brown, *supra* note 23, at A21, col. 2. The annual revenue of a public utility district determines the compensation scheme for each district's commissioner. WASH. REV. CODE ANN. § 54.12.080 (West Supp. 1985).

32. Brown, *Prophets of Shortage*, Wash. Post, Dec. 3, 1984, at A18, col. 3.

33. Cook, *Nuclear Follies*, Forbes, Feb. 11, 1985, at 84.

34. Brown, *supra* note 32, at A18, col. 1.

35. The main object of the agreement was to generate electric power, even though section 6 provided for payments to the System regardless of whether it completed the projects. *Chemical Bank*, 99 Wash. 2d at 778, 666 P.2d at 332.

36. Apparently, a seller's market existed, since the Bonneville Power Administration (BPA) sent a letter to the participants stating that a constant supply of electricity could be guaranteed only if they accepted the agreements. Brown, *supra* note 32, at A18, col. 1.

37. Note, *supra* note 28, at 1110-12. Section 15 of the agreement mandated the establishment of a participants' committee to oversee the management of the projects. *Chemical Bank*, 99 Wash. 2d at 787, 666 P.2d at 337.

38. The agreement provided that the participant would purchase a share of the "electric power and energy, if any, which the Projects are capable of generating at any particular time." *Chemical Bank*, 99 Wash. 2d at 778, 666 P.2d at 332.

parable relationship.<sup>39</sup> In return for the System's promise to sell a portion of the facilities' capability, each participant promised to collect rates sufficient to service the System's project-related debt.<sup>40</sup> Further, each participant delivered to the System an opinion of its counsel that the agreement was enforceable in accordance with its terms.<sup>41</sup>

On January 22, 1982, the System's directors determined that the System would be unable to obtain financing to complete the facilities and voted to terminate both projects.<sup>42</sup> Prior to termination, the System had issued \$2.25 billion of tax-exempt municipal revenue bonds to finance the cost of architectural, engineering, and construction services associated with the projects.<sup>43</sup> A complex bond resolution that the System's directors adopted on February 23, 1977 governed issuance and repayment of the bonds.<sup>44</sup> Among other matters, it appointed Chemical Bank as trustee for the bondholders.<sup>45</sup>

As trustee, Chemical Bank brought a declaratory judgment action in the Superior Court for King County, Washington, against the System and each participant seeking a ruling that the participants were contractually obligated to pay the System an amount sufficient to service the principal and interest on the bonds.<sup>46</sup> After reviewing an overwhelming amount of oral and written argument, the trial court ruled in favor of Chemical Bank.<sup>47</sup> Several participants then appealed and the Washington Supreme Court granted review of the participants' statutory authority to enter the agreement that formed the security for the bonds.<sup>48</sup>

Writing for the majority, Justice Brachtenback held that the participants had exceeded their statutory authority because the agreement represented neither a "purchase of electricity" nor an "acquisition of

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39. Under the joint development statute, participants receive an ownership interest, but they still must pay construction costs if a project is cancelled, even though they will never receive electricity. WASH. REV. CODE ANN. §§ 54.55.010-030 (West Supp. 1985).

40. *Chemical Bank*, 99 Wash. 2d at 778, 666 P.2d at 332.

41. See *infra* note 92 and accompanying text.

42. *Chemical Bank*, 99 Wash. 2d at 776, 666 P.2d at 331; See *Brown*, *supra* note 8, at A17, col. 3. Although individuals affiliated with the member publicly-owned utilities control the board, the board's executive committee is specifically required to consider its interest to be the same as the interests of "all ratepayers affected by the joint operating agency." WASH. REV. CODE ANN. § 43.52.374(3) (West Supp. 1985) (emphasis added). The language is broad enough to require the board to analyze the interests of non-member participant ratepayers as well as those of members.

43. *Chemical Bank*, 99 Wash. 2d at 776, 666 P.2d at 331.

44. *Id.* at 777, 666 P.2d at 332.

45. *Id.* at 776, 666 P.2d at 331.

46. *Id.*

47. *Id.* at 780-81, 666 P.2d at 333-34.

48. *Id.* at 781, 666 P.2d at 334.

an electric generating facility” and declared the contracts void.<sup>49</sup> The Court announced its decision on June 15, 1983. On July 25, 1983, the System sent notice to Chemical Bank that it could not fund the next semi-annual interest payment due on the bonds and that it was in default under the terms of the bond resolution.<sup>50</sup>

### III. ANALYSIS

Chapter 43.52 of the Washington Code regulates the formation and operation of governmental agencies such as the System.<sup>51</sup> Under section 391, the System possesses the power to “make contracts for any term *relating to* the purchase, sale, interchange or wheeling of power” with any public body or utility.<sup>52</sup> Under the statute, therefore, the System’s has quite broad authority to contract for the purchase or sale of electricity.<sup>53</sup>

Under Section 43.52.300, operating agencies have the additional power to enter into contracts with any public body for the “construction of all or any part of any electric generating [facility].”<sup>54</sup> The relationship created by the agreement between the System and each participant shows that their purpose was to finance and construct electric generating facilities.<sup>55</sup>

The Supreme Court of Washington has addressed the issue of contractual authority many times. In 1933, the court announced in *Abrams v. Seattle*<sup>56</sup> that it would follow its prior rule and apply the same standard of contract enforceability to a municipal utility as to a private individual.<sup>57</sup> Courts of other states strictly construe contracts in favor of municipalities.<sup>58</sup> In *Seattle*, *Abrams* sought an injunction against the city to prevent payments to private entrepreneurs who had constructed an electric substation on city-owned property, based on

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49. *Id.* at 799, 666 P.2d at 343. Further, the court did not require the participants to pay any restitution or other equitable remedy, leaving the System in a position in which it would be completely unable to meet its contractual obligations to the bondholders.

50. Asinof, *WPPSS Default on \$2.25 Billion in Bonds is Record for Municipal Debt; Suits Seen*, N.Y. Times, July 26, 1983, at 3, col. 4.

51. WASH. REV. CODE ANN. § 43.52.391 (1983); *see generally*, Ferdon, *supra* note 11, at 17-18.

52. WASH. REV. CODE ANN. § 43.52.391 (1983) (emphasis added).

53. Even if the agreements do not represent a purchase of electricity, they undeniably “related to” the purchase of electrical power. *See supra* note 57 and accompanying text.

54. WASH. REV. CODE ANN. § 42.53.300(3) (1983).

55. *Chemical Bank*, 99 Wash. 2d at 782, 666 P.2d at 335.

56. 173 Wash. 495, 23 P.2d 869 (1933).

57. *Id.* at 501, 23 P.2d at 871.

58. *Id.*

the theory that the city's lease for the property was ultra vires.<sup>59</sup> Recognizing the equities of the situation, the court ordered the city to pay the reasonable value of the services rendered on an implied contract theory.<sup>60</sup>

Thirty-two years later, in the textbook case of *Edwards v. Renton*,<sup>61</sup> the court cited the decision in *Seattle* with approval and recognized that Washington would permit recovery against municipal corporations for ultra vires contracts in situations in which other states would not.<sup>62</sup> When the City of Renton had entered an agreement which was ultra vires because of the particular financial arrangement, the court allowed a quasi-contractual recovery, stating that it recognized "ample authority from other jurisdictions which would deny any recovery to plaintiffs" once a municipal contract has been adjudicated ultra vires.<sup>63</sup> Further, the court concluded that, unlike other jurisdictions, Washington would even calculate the recovery based on the value of the services rendered, as opposed to the value of the benefit received.<sup>64</sup>

As recently as 1974, the Washington Supreme Court acknowledged a "developing tendency" to hold public bodies to the "same standards of conduct [as] . . . private citizens."<sup>65</sup> In *Washington v. O'Connell*,<sup>66</sup> the court enforced invalid contracts of publicly-owned electric utilities because the contracts contained "mere procedural irregularities" and because the court recognized that enforcement was "necessary to do justice between the parties."<sup>67</sup>

The *O'Connell* court recognized the general rule that parties contracting with a municipality do so at their own risk, and that the law presumes that a party dealing with the public officer knows the limits of the statutory powers of the office.<sup>68</sup> Because the rule protected the public treasury, the *O'Connell* court established an exception to the

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59. *Id.*

60. *Id.* at 503, 23 P.2d at 872.

61. 67 Wash. 2d 598, 409 P.2d 153 (1965).

62. *Id.* at 606, 409 P.2d at 159.

63. *Id.*

64. *Id.* at 607, 409 P.2d at 159. Importantly, the court's conclusion represents an alternative basis of recovery if a fact finder were to determine that the participants received nothing of value. As unfortunate as it is that no electricity will ever be produced, it does not alter the fact that millions of dollars have nevertheless been spent by the System for engineering, architectural, and contracting services. *Chemical Bank*, 99 Wash. 2d at 776, 666 P.2d at 331.

65. *Washington v. O'Connell*, 83 Wash. 2d 797, 836, 523 P.2d 873, 896 (1974).

66. 83 Wash. 2d 797, 523 P.2d 873 (1974).

67. *Id.* at 835-36, 523 P.2d at 895.

68. *Id.* at 827, 523 P.2d at 892.

rule that contracts should be strictly construed in favor of cities and towns for instances in which municipalities perform a proprietary function which does not represent a substantial threat to the taxpayer.<sup>69</sup> The court reasoned that because operating revenues often fund proprietary contracts, no serious threat existed that an imprudent officer could cause an astronomical increase in property taxes because of a bad business decision.<sup>70</sup>

The *O'Connell* court reaffirmed the production and sale of electricity as a proprietary function<sup>71</sup> and it held that when a party acting in good faith enters a contract with a public officer who has the apparent authority to consummate the proprietary agreement, the private party may recover the reasonable value of the services under the theory of unjust enrichment, even though the contract itself is later held unenforceable.<sup>72</sup> The court concluded that when municipalities cloak their officers with the apparent authority to enter a contract by passing resolutions approving the arrangement and later acquiesce in the contract's performance, they cannot rely on a procedural irregularity to withhold payments for services rendered.<sup>73</sup>

The *O'Connell* decision rested on the policy that voiding municipal contracts often produced inequitable results.<sup>74</sup> Consequently, the court noted the growing trend to treat public bodies the same as private individuals during the adjudication of contractual disputes.<sup>75</sup>

Four years after *O'Connell*, the court reviewed the legality of water contracts which provided security for municipal bonds issued by the City of Anacortes.<sup>76</sup> In the 1978 case of *Scott Paper Co. v. Anacortes*,<sup>77</sup> the city attempted to increase water rates above the contract price, but the court refused to allow the city to renege on its promise.<sup>78</sup>

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69. *Id.* at 828-35, 523 P.2d at 892-95.

70. For example, the agreement between the System and the participants provided that their payments can only come from revenues derived from the sale of electricity, not tax dollars. Memorandum of Washington Public Power Supply System in Support of Chemical Bank's Motion for Summary Judgment, and in Opposition to the Motions for Summary Judgment by Various of the Defendant Participants at V-16, *Chemical Bank v. Wash. Pub. Power Supply Sys.*, No. 82-2-06840-3 (Wash. Sup. Ct. 1982) [hereinafter referred to as System's Memorandum]; see generally, Ferdon, *supra* note 11, at 17.

71. *O'Connell*, 83 Wash. 2d at 834, 523 P.2d at 895.

72. *Id.*

73. *Id.*

74. *Id.* at 836, 523 P.2d at 896.

75. *Id.*

76. *Scott Paper Co. v. Anacortes*, 90 Wash. 2d 19, 27-28, 578 P.2d 1292, 1297 (1978).

77. 90 Wash. 2d 19, 578 P.2d 1292 (1978).

78. *Id.* at 31, 578 P.2d 1298.

Emphasizing the importance of the agreements for the marketability of the city's bonds, the court enforced the contract.<sup>79</sup> Writing for the majority, Justice Horowitz stated that the authority to sell bonds would be "meaningless" without the "necessarily implied power" to do "whatever is reasonably and lawfully necessary to make such bonds sound and salable."<sup>80</sup> *Scott Paper Co.* represents further evidence of the trend toward enforcing municipal contracts.

The courts of Washington have also enforced ultra vires municipal contracts when the person contracting with the municipality acted in good faith.<sup>81</sup> The most recent case that awarded recovery to a good faith contracting party is the 1982 *Noel v. Cole*,<sup>82</sup> which involved a suit to enjoin the sale of timber from public land without preparation of an environmental impact statement.<sup>83</sup> In *Noel*, the majority opinion determined that the governmental unit possessed the general authority to sell the timber, but "merely . . . exercised it in an irregular manner or by unauthorized procedural means."<sup>84</sup> Consequently, the court held that if a statutory violation involved a procedural irregularity and the activity was not *blatantly* against public policy, "a private party acting in good faith may recover to the extent necessary to prevent 'manifest injustice' or unjust enrichment."<sup>85</sup>

The above cases indicate that the common law of Washington has developed several exceptions to the general rule that municipal contracts should be strictly construed. By placing the risk of termination on the bond purchasers, contrary to the terms of the participation agreement, the court in *Chemical Bank* ignored both the law of Washington and the realities of the market for municipal bonds. The court refused to enforce the agreement between the System and the participants because it could find no express statutory authority for the participants to assume the risk of termination nor any compelling reason to imply such a power.<sup>86</sup> It could have authorized the agreement either as a contract relating to the sale of electricity or for the con-

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79. *Id.*

80. *Id.* at 29, 578 P.2d at 1298. In 1971, the court had recognized the need for financing flexibility. *Public Util. Dist. No. 1 v. Taxpayers & Ratepayers*, 78 Wash. 2d 724, 726, 479 P.2d 61, 63 (1971).

81. See e.g. *Renton*, 67 Wash. 2d at 603, 409 P.2d at 157; *Bremerton v. Kitsap Cty. Sewer Dist.*, 71 Wash. 2d 689, 698-99, 430 P.2d 956, 962 (1967); *Public Util. Dist. No. 1 v. Taxpayers & Ratepayers*, 78 Wash. 2d 724, 731, 479 P.2d 61, 64 (1971); *O'Connell*, 83 Wash. 2d at 804, 523 P.2d at 880; *Anacortes*, 90 Wash. 2d at 26, 578 P.2d at 1296.

82. 98 Wash. 2d 375, 655 P.2d 245 (1982).

83. *Id.* at 377, 655 P.2d at 247.

84. *Id.* at 381, 655 P.2d at 249-250.

85. *Id.* (citations omitted).

86. *Chemical Bank*, 99 Wash. 2d at 798, 666 P.2d at 342.

struction of an electric plant.<sup>87</sup> The fact that most of the participants used the System merely as a financing mechanism for their chosen business contracts which included a known business risk strengthens the argument in favor of enforcement.<sup>88</sup>

Historically, the courts of Washington have implied contractual authority to municipalities when necessary to provide security for bonds and when the contracting municipal officer had the apparent authority to bind the municipality.<sup>89</sup> Moreover, Washington has voluntarily labeled itself a state which will enforce municipal contracts to the same extent as private contracts.<sup>90</sup> The *Chemical Bank* court, therefore, should have decided differently because the agreement was necessary to make the bonds saleable.<sup>91</sup> Support for a contrary decision rests on two facts: counsel for the participants represented that they had full legal power to enter into the agreement,<sup>92</sup> and the governing bodies of the participants passed resolutions binding their organizations to the terms of the agreement.<sup>93</sup> In addition, both *Seattle* and *Renton* represent situations in which the city had the power to perform the acts required by the contract, but a court held it ultra vires because of a procedural irregularity.<sup>94</sup> The court in *Chemical Bank* implied that it would have enforced the agreement if the "procedure" for participant control of project management had been more extensive.<sup>95</sup> Although the agreement provided for such a procedure, the court held that it was "insufficient to allow the participants to control their risk."<sup>96</sup> The court's conclusion violates its own precedent

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87. At least five other courts have allowed such contracts. *See generally* Johnson v. Piedmont Mun. Power Agency, 277 S.C. 345, 287 S.E.2d 476 (1982); Texas v. Texas Mun. Power Agency, 565 S.W.2d 258 (Tex. Civ. App. 1978); Commissioners of Louisiana Mun. Power Comm'n. v. All Taxpayers, Property Owners & Citizens, 355 So.2d 578 (La. Ct. App. 1978); Frank v. Cody, 572 P.2d 1107 (Wyo. 1977); Thompson v. Mun. Elec. Auth., 238 Ga. 19, 231 S.E.2d 720 (1976). The *Chemical Bank* court cites statutes in Maine, Massachusetts, North Carolina, Vermont, and Virginia which specifically authorize municipal utilities to accept the risk of termination. *Chemical Bank*, 99 Wash. 2d at 784, 666 P.2d at 337.

88. System's Memorandum, *supra* note 70, at II-11; *see generally*, Ferdon, *supra* note 11.

89. *See supra* notes 78-86 and accompanying text.

90. *See supra* notes 63-77 and accompanying text.

91. System's Memorandum, *supra* note 70, at V-16; Ferdon, *supra* note 11, at 17-18.

92. System's Memorandum, *supra* note 70, at V-30 to 31.

93. *Id.*

94. *Renton*, 67 Wash. 2d at 602, 409 P.2d at 157; *Seattle*, 173 Wash. at 500, 23 P.2d at 871.

95. *Chemical Bank*, 99 Wash. 2d at 784, 666 P.2d at 337.

96. *Id.*

and the public policy enunciated in *Seattle and Renton*.<sup>97</sup>

In *Chemical Bank*, surprisingly little mention was made of the agreements serving as security for \$7.2 billion in municipal revenue bonds.<sup>98</sup> The requirement of paying for plants that will never produce electricity transformed the issuance of bonds from a favored tool for public financing to a point of contention for local ratepayers.<sup>99</sup> The realities of the arrangement suggest that because the System had no revenue independent of sales to the participants, the bonds would not have been salable if the System had had to bear the risk of termination.<sup>100</sup> Further, the System performed no forecasting or planning services for either members or non-members.<sup>101</sup> It makes less sense, therefore, for the System to bear the risk of termination, even if it were possible for the System to do so, since the participants were completely responsible for estimating their own future power requirements and contracting to fulfill those requirements.<sup>102</sup>

Throughout the opinion in *Chemical Bank*, the court placed no weight on the good or bad faith of the bondholders, even though the ratepayers were described as "unsuspecting individuals."<sup>103</sup> The court should have acknowledged that the bondholders were unsuspecting as well. The bondholders purchased securities with the belief that the bonds were secured by the promises of participating municipal utilities to collect rates sufficient to service the interest and principal due on the bonds.<sup>104</sup> Similarly, the bond purchasers were aware of the System's promise to collect charges for electricity from the participants sufficient to repay the bonds.<sup>105</sup> While the ratepayers could control the governing boards of the participants<sup>106</sup> and the participants could

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97. See *supra* notes 56-64 and accompanying text.

98. In one of the courts few references to the bonds, it merely stated that "[t]he Bond Resolution in turn . . . requires [the System] to collect and set aside funds sufficient to make payments on the bonds." *Chemical Bank*, 99 Wash. 2d at 777, 666 P.2d at 332.

99. The same participants who objected to the agreement in *Chemical Bank* have financed several other projects with agreements in which they specifically accepted the risk of termination. System's Memorandum, *supra* note 70, at V-14 to 18; see generally, Ferdon, *supra* note 11.

100. Chemical's Memorandum, *supra* note 19 at 27; System's Memorandum, *supra* note 70, at VI-34; Ferdon, *supra* note 11, at 17-18; see *supra* note 28 and accompanying text.

101. System's Memorandum, *supra* note 70, at V-15.

102. See affidavit of Glendale B. Horowitz, System's Memorandum, *supra* note 70, at V-15 to 16.

103. *Chemical Bank*, 99 Wash. 2d at 784, 666 P.2d at 342.

104. See *supra* note 40 and accompanying text.

105. System's Memorandum, *supra* note 70, at V-16.

106. See *supra* note 30 and accompanying text.

control the management of the project,<sup>107</sup> the bondholders were powerless with respect to day-to-day decisions.<sup>108</sup> The only reason most bondholders associated themselves with the System and the participants was because of the appearance of a conservative, tax-free investment.<sup>109</sup>

Thus, the ratepayers chose to enter the electric utility business and delegate management decisions to the expertise of board members,<sup>110</sup> while the bondholders were merely financiers looking for a low-risk, tax-free investment, secured by the ratemaking authority of municipal utilities.<sup>111</sup> Because the participants were in the utility business, the bondholders could reasonably assume that if the participants' committee later decided that financing would not be available to complete the facility, the participants would nevertheless honor their contracts and collect rates to fund the repayment of the bonds.<sup>112</sup> The court should not have forced the bondholders, therefore, to bear the risk of termination.

#### IV. CONCLUSION

Enabling legislation granted the System the power to enter contracts relating to the supply of electricity and it authorized the participants jointly to finance the construction of generating facilities.<sup>113</sup> Based on the enabling legislation, adequate statutory authority existed for the Supreme Court of Washington to enforce the agreement between the System and the participants.

The Supreme Court of Washington has enforced municipal contracts otherwise ultra vires when necessary to provide security for bonds, and when the municipal officer had the apparent authority to execute the contract.<sup>114</sup> The facts surrounding *Chemical Bank* indicate that the agreements were necessary to sell bonds and that the officers who signed the agreements had apparent authority.<sup>115</sup> The court in *Chemical Bank*, however, refused to enforce the agreement.

When a public contract is void because of a procedural error, the courts of Washington nevertheless uniformly allow at least partial re-

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107. See *supra* note 37 and accompanying text.

108. System's Memorandum, *supra* note 70, at II-2, V-6.

109. *Id.*

110. See *supra* note 36 and accompanying text.

111. System's Memorandum, *supra* note 70, at V-16; Ferdon, *supra* note 11, at 17-18.

112. Brown, *supra* note 8 at A16, col. 2.

113. See *supra* note 20 and accompanying text.

114. See *supra* notes 78-86 and accompanying text.

115. See *supra* notes 98-99 and accompanying text.

covery to a party acting in good faith.<sup>116</sup> The court in *Chemical Bank* implied that it would have enforced the participation agreements if the procedure for participant control of project management had been more meaningful.<sup>117</sup> The *Chemical Bank* court, therefore, failed to follow mandatory authority.

Finally, because the bondholders expected a secured investment while the ratepayers chose to take the risk of entering the utility business, the shortcomings as well as the benefits of the risk should have fallen on the ratepayers.<sup>118</sup> The participants freely signed contracts in which they knowingly accepted the risk of termination.<sup>119</sup> By refusing to enforce the agreement, the court in *Chemical Bank* also failed to give any recognition to the good faith of the bondholders,<sup>120</sup> although one reason cited for not enforcing the agreement was the good faith of the ratepayers.<sup>121</sup> The permanence of the court's break with precedent and common sense must await future cases. One can only hope that the court will reread its earlier cases before it blindly relies on *Chemical Bank*.

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116. See *supra* notes 89-94 and accompanying text.

117. See *supra* notes 101-02 and accompanying text.

118. See *supra* notes 42-45 and accompanying text.

119. See *supra* note 17 and accompanying text.

120. See *supra* notes 27 & 36 and accompanying text.

121. See *supra* note 103 and accompanying text.

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