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Messrs. Kramer and Hammer examine those provisions of California law affecting municipal utilities' interest in geothermal exploration, development and exploitation. The various problems encountered by the City of Burbank and the Northern California Power Agency are used as illustrations. In addition, the impact of self-imposed limitations in the form of outstanding bond covenants and other contractual obligations are considered.

THE ROLE OF MUNICIPALITIES IN GEOTHERMAL RESOURCE DEVELOPMENT†

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INTRODUCTION

Publicly owned electric systems play an important role in the electric utility industry of the United States. Generally, municipal electric systems are small operations. Eighty-five per cent serve 15,000 people or less.¹ In the main, these municipal systems have no generation facilities of their own and instead rely on buying wholesale power from private utilities. Nevertheless, approximately 900 publicly owned electrical systems do generate all or a part of their power requirements, and of these, about 125 are located in the western states, where geothermal energy production seems most promising.²

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1. Craig T. Ferris, *Joint-Action Partnerships: Just Good Economic Sense*, The Daily Bond Buyer, Special SIA Public Finance Supplement No. 1, October 28, 1976 at 15.

2. Public Power Weekly Newsletter, No. 71-46, November 26, 1971, at 3.

And, there is evidence of an increasing commitment on the part of publicly owned utilities to acquire their own generating capacity. An annual survey by the American Public Power Association shows substantial increases in plant expenditures by such utilities in 1975 and 1976, with the bulk of such expenditures being dedicated to building generating capacity.³

Municipal activity in geothermal development has progressed beyond the talking stage in California. The Northern California Power Agency, a joint powers agency created by eleven California municipalities, has concluded an agreement with Resource Funding, Ltd. looking to the exploration and development of land under geothermal leases at The Geysers in Lake County, California. The City of Burbank is earnestly developing plans for financing its joint venture with Republic Geothermal to explore for steam in various sites in California and other western states. Certain of these sites are now under lease by the city, jointly with Republic Geothermal, from the federal government.

Further, the interest on the part of municipalities in geothermal development can be measured to some degree by noting the entities which have expressed an interest in the formation and activities of the Public Geothermal Resources Corporation, a non-profit corporation formed to assist publicly owned electric utility systems in geothermal development in the western states. A perusal of the files of the American Public Power Association indicates interest by the following: the City of Eugene, Oregon; the Salt River Project in Phoenix, Arizona; the City of Los Angeles' Department of Water and Power; the Missouri Basin Municipal Power Agency (which includes municipalities from Iowa, Minnesota and South Dakota); the cities of Anaheim and Riverside, California; Seattle City Light; Intermountain Consumer Power Association (which includes Utah and Arizona municipalities and several rural electric cooperatives); the Northwest Public Power Association; the Northern California Power Agency; Arizona Municipal Power User's Association; the Mid-West Electric Power Consumer's Association; and the Raft River Rural Electric Cooperative.

3. THE FIRST BOSTON CORPORATION, 1976 SURVEY OF TAX-EXEMPT ELECTRIC UTILITIES, at 4 - 5 (1976).

From the lawyer's perspective, any analysis of the role a municipally owned utility can play in geothermal development must consider first the constitutional and statutory framework within which that utility operates. State and local governments, in sharp contrast to private corporations, are creatures with limited powers. A private corporation, generally speaking, may engage in any lawful undertaking that advances the purposes of the corporation articulated in its charter or articles of incorporation, subject to any expressed limitations in that charter or the articles, or in the corporation's by-laws. A municipal utility, on the other hand, must find express authority for its undertakings or at least must be able to imply such authority from other expressly granted powers. An example may be useful. A city may not engage in any phase of the electric utility business unless authorized by state law. Conceivably, the requisite constitutional or statutory authorization may be expressed to include only the distribution of electricity to the city's inhabitants. If so, the utility probably would be precluded from engaging in the generation of electricity, and more assuredly, from locating, exploring for, or developing fuel resources such as geothermal steam.

Moreover, a broad expression of power to engage in the electric utility business may not be sufficient to enable the publicly owned utility to participate in exploration activity. If the utility must borrow money to meet its commitments to such an endeavor, then an independently expressed power to undertake the financing must be found. Typically, that power can be found if the issuance of voter-approved, tax-supported general obligation bonds is a viable financing vehicle.⁴ Normally, the relevant statutory authorization permits the issuance of such bonds for "any municipal improvement" of the city. However, tracing the requisite statutory power takes on a rather labyrinthine quality when one considers revenue financing and other more esoteric financing vehicles.

4. Municipal utility projects are typically financed with the proceeds from an issue of the government entity's debt securities. Historically, the preponderance of the electric power projects were financed with general obligation bonds. Those projects, however, were considerably smaller than the typical project today. Now, electric revenue bonds are the principal source of financing. In 1971, only four of the sixty-five separate municipal bond issues for electric power were general obligation bond issues. The Daily Bond Buyer, November 5, 1973 at 1 (report of speech by Frank F. Martin of Halsey, Stuart & Co. Inc.)

This paper explores those provisions of California law affecting municipal utilities' interest in geothermal exploration, development and exploitation. The various problems encountered by the City of Burbank and the Northern California Power Agency are used as illustrations. Further, this paper considers the impact of self-imposed limitations in the form of outstanding bond covenants and other contractual obligations.

PROVISIONS OF STATE CONSTITUTIONS, STATUTES AND
MUNICIPAL CHARTERS AFFECTING PARTICIPATION IN
GEOHERMAL PROJECTS

Generally speaking, apart from the development of hydroelectric resources, municipal utilities have purchased their fuel supplies. Programs to locate and develop geothermal resources, then, raise novel questions as to whether such exploration activity is a proper purpose of a municipal utility and whether the authority to finance such activity exists. In Burbank's case, the City's capacity to issue electric revenue bonds for the purpose of funding the cost of the exploration and development of a geothermal supply first presented questions under its Charter.

The City of Burbank accepted the privilege of home rule under Sections 3 and 5 (formerly Sections 6 and 8) of Article XI of the California Constitution through the adoption of its Charter, giving it plenary powers over all municipal affairs, except as limited by the Charter and the Constitution.⁵ In the municipal affairs area, the provisions of a "freeholder" charter are viewed as a limitation rather than a source of

5. Santa Monica v. Grubb, 245 Cal. App. 2d 718, 54 Cal. Rptr. 210 (1966). Section 3 of the Burbank City Charter provides:

The City of Burbank, by and through its Council and other officials, Board [sic], Commissions, Committees and employees, shall have and may exercise all powers necessary or appropriate to a municipal corporation and the general welfare of its inhabitants, which are not prohibited by the constitution and which it would be competent for this charter to set forth particularly or specifically; and the specification herein of any particular powers shall not be held to be exclusive or any limitation upon this general grant of powers.

The relevant provision of the California Constitution provides:

It shall be competent in any city charter to provide that the city governed thereunder may make and enforce all ordinances and regulations in respect to municipal affairs, subject only to restrictions and limitations provided in their several charters and in respect to other matters they shall be subject to general laws. City charters adopted pursuant to this Constitution shall supersede any existing charter, and with respect to municipal affairs shall supersede all laws inconsistent therewith. CAL. CONST. art. XI, § 5.

power, in that cities operating under such charters have plenary power over municipal affairs even though those powers are not spelled out with any degree of specificity, subject however to any express limitations in the charter. Any question that supplying utility services to municipal residents is a municipal affair is resolved by reference to Section 9 of Article XI in the California Constitution. That section reads, in part, as follows:

A municipal corporation may establish, purchase, and operate public works to furnish its inhabitants with light, water, power, heat, transportation, or means of communication. It may furnish those services outside its boundaries, except within another municipal corporation which furnishes the same services and does not consent.

The conduct of the city's electric utility is unquestionably a municipal affair.⁶ Moreover, it is clear that this plenary power over municipal affairs may be exercised to some degree beyond the city's own boundaries, even though the charter does not expressly contemplate such extraterritorial effect, unless of course there is a limit to the contrary expressed in the charter.⁷

Finding no other provisions in the Constitution restricting the city's capacity to participate in the project, one turns to the provisions of the city's Charter itself. Section 3.5 of the Charter provides:

The city shall have the power to contract with any governmental entity, regulated public utility, or other public or private corporation, to perform such services or to acquire, construct or administer jointly such public works, public utilities, or other facilities, either inside or outside the City Limits, as are beneficial to its citizens or the consumers of its utilities.

No other provisions of the Charter restrict the city's participation in the project.

6. *Los Angeles Gas & Elec. Corp. v. Los Angeles*, 188 Cal. 307, 205 P. 125 (1922).

7. *South Pasadena v. Pasadena Land & Water Co.*, 152 Cal. 579, 93 P. 490 (1908); *North Sacramento v. Citizens Util. Co.*, 192 Cal. App. 2d 482, 13 Cal. Rptr. 538 (1961); *Mill Valley v. Saxton*, 41 Cal. App. 2d 290 (1940).

In pursuance of its home rule powers, the city adopted a procedural ordinance for the issuance of revenue bonds. The ordinance, codified in Article 12 of Chapter 14 of the city's Municipal Code, provides in part as follows:

The council . . . may, when the public interest and necessity require, by resolution or resolutions issue revenue bonds for the following purposes: (a) additions to and extensions and improvements of the electric energy system of the City and related facilities, (b) additions and extensions and improvements of the water system of the City and related facilities, and (c) the acquisition, construction, extension or improvement of any other revenue producing system or facility of the City.

No California cases have been found discussing the question whether exploration for fuel resources falls within the meaning of the phrase "additions to and extensions and improvements of the electric energy system of the City and related facilities", or similar language. It would seem, however, that the phrase can reasonably be construed to include such exploration.

Some comfort in this analysis can be drawn by analogy from provisions of the California Public Utilities Code concerning the issuance of securities by investor-owned utilities. Under subsections (b) and (c) of Section 817 of the Public Utilities Code, a utility may issue securities for the "construction, completion, extension or improvement of its facilities" and for the "improvement or maintenance of its service." The question here would be whether a securities issue to finance expansion into innovative areas of the energy business may properly be justified as being for an "extension of facilities" or "improvement of service." The few State Public Utilities Commission decisions found relating to these subsections deal with routine issuances for plant expansion and construction and are not helpful beyond suggesting that "public utility" is to be read into Section 817. That is, debt issues are proper if for extension of "public utility facilities" or improvement of "public utility service." Financing geothermal steam plants would appear to have a fairly direct utility purpose and thus fall within the "public utility" business if such terms are defined broadly as providing energy to the public. Section 217

of the Public Utilities Code supports such an expansive reading by defining "electric plant" to include "all real estate, fixtures and personal property owned, controlled, operated or managed in connection with or to facilitate the production, generation, transmission, delivery or furnishing electricity for light, heat or power, or other devices, materials or property used or to be used for the transmission of electricity for light, heat, or power." Financing the exploration and production of geothermal steam facilitates production and generation and, therefore, would appear to be a proper purpose for issuing securities to the extent that the resulting energy is used in the utility's business.⁸

Some further comfort can be taken from the broad grants of power to municipalities in the utility field found in Sections 10001-04 of the California Public Utilities Code. There, "public utility" is defined broadly to include supplying the inhabitants of a municipal corporation with water, light, heat, power, transportation or communication.⁹ A municipal corporation is expressly authorized to acquire, construct, own, operate or lease public utilities,¹⁰ and, for such purposes:

[M]ay acquire, own, control, sell, or exchange lands, easements, licenses, and rights of every nature within or without its corporate limits . . . when necessary to supply the municipality, or its inhabitants, or any portion thereof, with the service desired.¹¹

The undertaking by the Northern California Power Agency presents somewhat different questions of analysis. Both general law and charter cities comprise the agency. Each of the charter cities involved, like Burbank, has broad powers to engage in the municipal utility business. The general law cities have similarly broad powers. The leases in question, however, were owned by private entities. Seemingly, there was no question once the fields were proven that the NCPA would have the power to purchase, on behalf of its participating mem-

8. Difficult questions are raised in the situation where part of the energy generated, or some of the materials used in the processing, are sold to other enterprises, even other utilities, for their own use. As to the portions used in the utility's own business, the issuance of securities under Section 817 would seem to be permissible. But as to that portion which the utility intends to sell to others, the financing of the fuel development likely would have to come from other resources, for example, on capitalized earnings. A similar analysis would obtain in the case of financings by municipal utilities.

9. CAL. PUB. UTIL. CODE § 10001 (West 1965).

10. CAL. PUB. UTIL. CODE § 10002 (West 1965).

11. CAL. PUB. UTIL. CODE § 10004 (West 1965).

bers, the steam output.¹² The private developer, however, was interested in utilizing the financial resources of the NCPA to provide needed capital to finance the development. Such a vehicle was found in a carefully constructed agreement under which the NCPA, using resources other than bond financing, paid in advance for the purchase of steam. Before discussing such agreement, however, it is useful to consider the limitations the agency would have faced had it owned the resources that it wished to develop.

The Joint Powers Agency itself has limited authority to finance the exploration and development of fuel supplies, including geothermal resources. The Joint Exercise of Powers Act contains its own provisions for the issuance of revenue bonds by such agencies. Under such provisions, if such an entity "has the power to acquire, construct, maintain or operate . . . public buildings¹³ [such agency] may issue revenue bonds pursuant to this Article to pay the cost and expenses of acquiring or constructing a project for any or all of said purposes."¹⁴ The legislative history of the Act¹⁵ and other, relat-

12. The power of a general law city and thus of NCPA to purchase steam or rights to steam or to participate as a joint venturer, with an undivided interest in a defined share of the steam or the rights thereto, can be seen from the following provisions: CAL. GOV'T CODE § 39792 (West 1968) provides that for the purpose of constructing or operating any facility (defined to include any works, power plant, or other necessary works or structures, "the city may lease or acquire by purchase, condemnation or otherwise, and hold and use, any land, rights of way, water, water rights, quarry, gravel bed, other mineral deposits, or any other necessary property, within or without the city or the county where the city is located." CAL. GOV'T CODE § 39732 (West 1968) authorizes a legislative body to acquire, own, construct, maintain and operate works for light, power and heat. CAL. GOV'T CODE § 40404 (West 1968) authorizes a city to acquire private property by condemnation or otherwise when necessary to take such property for purposes authorized by law. Cf. CAL. GOV'T CODE § 34724 authorizing the board of supervisors to assume control of and to continue to administer all electric power and all systems of other public utilities owned by a city at the time of its disincorporation. The Eminent Domain Law also is relevant. Compare CAL. CIV. PROC. CODE §§ 1235.170, 1240.020, 1240.050, 1240.125, 1240.130 and 1240.140 (West 1972) with former §§ 1238(3), (12), (15) & (17) of the CODE OF CIVIL PROCEDURE.

13. If authorized by the parties to the joint powers agreement in order to exercise their common power. CAL. GOV'T CODE § 6502 (West 1966).

14. CAL. GOV'T CODE § 6546 (West 1966); cf. CAL. CONST. art. XI, § 9(a) (quoted in the text); CAL. PUB. UTIL. CODES §§ 10001-04 (West 1965). The constitutional provision is interpreted to be self executing and does not require enabling state legislation to be effective. In *North Sacramento v. Citizens Utilities Co.*, *supra* note 7, the power of a general law city to condemn a water system serving a territory only twenty-five per cent of which was within the city's boundaries was implied from the express grant, former Section 19 of Article XI of the California Constitution, which was substantially identical to the present Section 9, and the various general eminent domain provisions in the Government Code and in the Code of Civil Procedure. In *Mill Valley v. Saxton*, *supra* note 7, the issue was the validity of bonds to finance the acquisition of a bus line running from the city to San Francisco and providing service to intermediate communities. The authority to issue such bonds, though not expressed, was found in former Section 19, The Municipal Corporations Act, and The Municipal Bond Act of 1901.

15. Former CAL. GOV'T CODE § 6546 (West 1966) said that joint powers agencies

ed provisions¹⁶ clearly suggest that joint powers entities may only issue bonds to finance the construction of "public buildings," except in the case of regional park facilities. Arguably, a generation facility is not a "public building." More clearly, the drilling, production and gathering facilities comprising a geothermal development seemingly would not qualify as "public buildings."

Likewise, prior to 1974, the Revenue Bond Law of 1941, which provides general authority for municipalities and other local agencies to issue bonds for the acquisition, construction or improvement of any "enterprise,"¹⁷ was of little utility. Under that law, joint powers agencies were not among the "local agencies" enumerated as authorized to undertake such financing.¹⁸ Moreover, "enterprise" was so defined to exclude "the generation, production, transmission, and distribution of electric energy for lighting, heating, and power for public or private users," as well as "the generation, production, transmission and distribution of gas."¹⁹

In 1974, the NCPA secured passage of amendments²⁰ to the Revenue Bond Law of 1941 adding a provision defining "local agency" to include any joint powers agency created for the generating, producing or transmitting of electric ener-

with the "power to acquire, construct, maintain or operate [(a) exhibition or fair buildings, (b) coliseums, stadiums and other, presumably similar, public buildings or] (c) any other public buildings; may issue revenue bonds" to finance acquisition or construction of "a structure or structures or facility or facilities which may include any or all of said purposes." In 1967, the words "any one or more of the following projects" were added after "operate" and before the enumerated items and the words "a project for" were substituted for "a structure . . . facilities which may include". 1967 CAL. STATS., Chap. 1229, § 2. Later, a further enumerated "project" was added as subparagraph (d), namely, a regional park or recreation area with "facilities and improvements related thereto" in counties with a population exceeding four million. 1968 CAL. STATS., Chap. 959, § 1. It is only in the very limited case of such regional parks that the capacity to finance facilities which are not public buildings is clear.

16. CAL. GOV'T CODE § 6548 (West 1966) says, in part, "revenue bonds may be issued to provide all or any part of the funds required for the acquisition, construction and financing of said project. . . ." Former Government Code § 6545 defined "project" to mean "the building or other structure or structures or improvements and all facilities appurtenant thereto or provided therefor to be financed by revenue bonds issued pursuant to [the act]." 1955 CAL. STATS., Chap. 329, § 2. The definition was amended in 1967 with the intention that the amendment was clarifying only and declaratory of existing law. 1967 CAL. STATS., Chap. 1229, § 3. Section 6545 now defines "project" to mean "buildings, structures, improvements and all facilities appurtenant thereto or provided therefor together with land and off-street parking facilities necessary therefor to be financed by revenue bonds issued pursuant to [the act]."

17. CAL. GOV'T CODE §§ 54300 *et seq.* (West 1966).

18. CAL. GOV'T CODE § 54307 (West 1966).

19. Former CAL. GOV'T CODE § 54310 as added by 1949 CAL. STATS., Chap. 81, § 1.

20. 1974 CAL. STATS., Chap. 953.

gy for lighting, heating, and power for public or private uses.²¹ And the definition of "enterprise" was amended to include "the generation, production, or transmission [but not distribution] of electric energy for lighting, heating, and power for public or private uses."²² The question under such legislation would be whether the words "generation, production or transmission of electric energy" can reasonably be construed to include the exploration for and acquisition of fuel supplies. Certainly these words are more restrictive than the provisions in the Burbank Charter and procedural ordinance discussed above. Research in both the municipal and public utility areas has failed to produce any useful statutory or judicial definition of the scope of these terms. In the absence of such precedents, one can only speculate as to how a court would interpret the language. A court might be persuaded to adopt a liberal construction, on the theory that fuel is a *sine qua non* in the generation of electricity and, in the context of today's energy crisis, the high cost of fuel virtually demands that it be paid for out of borrowed funds rather than out of operating revenues.²³ A strong argument, on the other hand, can be articulated that "generation of electricity" — a revenue producing activity — does not include "exploration for steam" — a risk taking venture which may or may not be revenue producing.

Another possibility would be for the cities to finance their respective shares independently. In the case of the general law cities, however, the only power found is the rather

21. CAL. GOV'T CODE § 54307.2 (West 1966). The Revenue Bond Law of 1941 requires that the bond proposition be submitted to a popular vote. The affirmative vote of a majority of all voters voting is required. Section 54307.2 also provides that in lieu of holding an election within the joint powers agency, upon adoption by the agency of an authorizing resolution, each member public agency of the joint powers agency whose revenues are to be pledged to secure the bonds shall implement such resolution by conducting an election within its own boundaries. The proposition authorizing the bonds is deemed adopted if it receives the affirmative vote of a majority of all the voters voting on the proposition within each of the member public agencies. CAL. GOV'T CODE § 44307.2 (West 1966).

22. CAL. GOV'T CODE § § 54309(j) and 54310 (West 1966).

23. Some help can be found in the definition of "enterprise" in Section 54309 and the definition of the scope of the enterprise in Section 54309.1. The definition of "enterprise" reads, in part: "a revenue-producing improvement, building, system, plant, works, facilities, or undertaking used for or useful for any of the following purposes: . . . (j) The generation, production or transmission of electric energy. . . ." Section 54309. Section 54309.1 provides that " 'enterprise' includes, but is not limited to, all parts of the enterprise, all appurtenances to it and: (a) Lands, easements, rights in land, water rights, contract rights and franchises; . . . (g) All buildings, structures, improvements, equipment, ditches, canals, and facilities whatsoever appurtenant or relating to the enterprise."

equivocal power to issue revenue bonds provided in the Revenue Bond Law of 1941. The charter cities, of course, could find such power under the municipal affairs analysis discussed earlier.

This suggests the possibility that one of the charter cities might issue its own electric revenue bonds, under the charter, to finance the entire project. Here again, an unqualified answer would not be possible; although good affirmative arguments could be articulated. The difficulty lies in characterizing such a project and for that matter the generation facilities themselves, or more narrowly, the financing of such projects, as a municipal affair. Support can be found in *South Pasadena v. Pasadena Land and Water Co.*²⁴ That case concerned the acquisition by Pasadena, a charter city, of an existing water system, one-third of which was in Pasadena and the rest in the adjacent City of South Pasadena. It was contended that continued service of water to South Pasadena residents was not a municipal affair within the meaning of the "home rule" provisions and thus, that such service would be subject to certain general laws regarding the sale by cities of surplus water. The court responded to such argument in part as follows:

The supplying of water to outside territory being necessarily a matter incidental to the main purpose of supplying water to its own inhabitants, is as much a municipal affair of Pasadena, as is the main purpose, which is conceded to be such, and therefore, the charter provisions relating thereto prevail over general laws, if inconsistent therewith.²⁵

The difficulty in making the municipal affairs argument is that here, unlike the South Pasadena situation, the project is regional and involves the active cooperation of several cities. Such project may not be a municipal affair under the holding in *Santa Clara v. Von Raesfeld*.²⁶ There, the California Supreme Court held that a regional water pollution control project involving the efforts of several cities was not a municipal affair. Thus, the court concluded, the procedures whereby Santa Clara would issue revenue bonds to finance its share

24. *Supra* note 6.

25. *Id.* at 594.

26. 3 Cal. 3d 239, 474 P.2d 976, 80 Cal. Rptr. 877 (1970).

of the project were controlled by applicable state law. However, the case does not necessarily mean that Santa Clara lacked altogether the power to finance reasonable projects by the issuance of bonds under its charter. Rather, the case may only mean such power is, in the words of Section 5, Article XI of the California Constitution, "subject to general laws" as to the applicable maximum interest rate.²⁷

Alternatively, the necessary authority to issue bonds might be found apart from the charter in the general laws as implied from the Joint Exercise of Powers Act. Section 6504 of the Government Code authorizes the parties to a joint powers agreement to make contributions from their treasury and otherwise to advance public funds. Section 6512.1 provides for repayment or return to the contributing party any contributions, payments or advances made to finance the acquisition, construction or operation of a revenue producing facility. The cases support the conclusion that one city may advance all of the needed funds for the joint projects.²⁸ Moreover, a charter city undoubtedly can finance its share of the project from revenue bonds.²⁹ Since a charter city could contribute all of the funds and could clearly issue revenue bonds

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27. There is a second, though conceptually more difficult aspect of the home rule argument. It may be that a charter city derives power from its charter to deal with matters which are not strictly municipal affairs to the same extent that there is power over municipal affairs unless and until that power has been superseded by general law. At present, the Constitution can be read to suggest that as to such matters, charter cities, like general law cities, derive their powers solely from general law. However, the history of predecessor constitutional provisions argues for a different analysis. This concept, referred to as residual home rule power, appears in the cases although there is no clear holding on the point. See *Civic Center Assoc. v. R.R. Comm'n*, 175 Cal. 441, 166 P. 351 (1917); *Bishop v. San Jose*, 1 Cal. 3d 56, 460 P.2d 137, 81 Cal. Rptr. 465 (1969); *Brougher v. Bd. of Public Works*, 205 Cal. 426, 271 P. 487 (1928); *Ex Parte Galusha*, 184 Cal. 697, 195 P. 406 (1921). See also, *Baron v. Los Angeles*, 2 Cal. 3d 535, 469 P.2d 353, 86 Cal. Rptr. 673 (1970); *Pipoly v. Benson*, 20 Cal. 2d 366, 125 P.2d 482 (1942). No general laws are readily apparent which would supersede or limit a charter city's residual power in the matter here discussed, if that power can otherwise be established. While the Revenue Bond Law of 1941 provides the authority to issue revenue bonds for electric power purposes, the powers conferred by that Act "are in addition to, and the limitations imposed . . . do not affect, the powers conferred by any other law" (CAL. GOV'T CODE § 54302 (West 1966)). See *Redondo Beach v. Taxpayers*, 54 Cal. 2d 126, 137-38, 352 P.2d 170, 5 Cal. Rptr. 10 (1960) (dictum). It is not clear from the cases whether, or to what extent, the charter must expressly contemplate the exercise of this residual power. There is some suggestion, albeit obscure, that as to affairs not strictly municipal in character, the extent to which a charter city has residual power must be particularized.
28. *San Francisco v. Boyle*, 191 Cal. 172, 215 P. 549 (1923); *Amador v. Huberty*, 203 Cal. App. 2d 664, 21 Cal. Rptr. 816 (1962). In both these cases, the party advancing the money enjoyed directly or indirectly most of the benefits of the project.
29. *Oakland v. Williams*, 15 Cal. 2d 542, 103 P.2d 168 (1940); see also *Santa Clara v. Von Raesfeld*, *supra* note 26.

to obtain at least some of the funds, arguably it follows that it could issue revenue bonds to obtain all of the needed funds.³⁰

These latter provisions of the Joint Exercise of Powers Act, authorizing the parties to a joint powers agreement to make contributions for the purposes set forth in the agreement, in fact provided the basis to generate the funds necessary to enable the agency to meet its financial commitments under the proposed development agreement. Each of the public agencies that were the parties to the agreement forming NCPA were distributors of electric power. None, however, owned generation or transmission facilities. The express purpose in forming the agency was to make more efficient the use of the powers of the individual cities in the purchase, generation, transmission, distribution, sale, interchange and pooling of electrical energy and capacity. NCPA was following a diversified program to discover and develop various sources of energy: conventionally-fueled plants, nuclear plants and geothermal projects. Various joint ventures with other public and private utilities were contemplated. However, the agency's share of the cost of those projects was quite substantial and the member cities were either unable or preferred not to make pro rata contributions for the entire undertaking of the outset. Instead, the cities desired to enter into a contract with NCPA whereby each was obligated to make payments to a Development Fund of the NCPA over a period of years and only out of otherwise unrestricted revenue derived from the operation of their respective electric distribution systems. NCPA in turn promised to immediately enter into joint ventures, like that with Resource Funding, to explore new energy sources and to give the participating cities preferred status to receive electrical power to be generated in the future as a result of those ventures.

30. Two other possibilities should be mentioned in passing. There is of course express statutory authority for a city to issue general obligation bonds for "municipal improvements", including "light and power works or plants . . . and other works, property or structures necessary or convenient to carry out the objects, purposes and powers of the city." CAL. GOV'T CODE §§ 43601-02 (West 1966); CAL. CONST. art. XVI, § 18. Further, there is the possibility that a municipal utility district could be formed pursuant to the Municipal Utility District Act., CAL. PUB. UTIL. CODE §§ 11501 *et seq.* (West 1965). Such a district would not have the power to issue revenue bonds until it was in existence 8 years. CAL. PUB. UTIL. §§ 12850-51 (1965); *see also* §§ 13071 *et seq.* (West 1965) However, general obligation bonds can be issued by such districts upon a majority vote. §§ 12841 and 13211. And, the revenues from the facilities for which the bonds were issued may be pledged to pay the principal and interest on the bonds. CAL. GOV'T CODE §§ 53500 *et seq.* (West 1966).

The validity of the Development Fund contribution proposal had to be analyzed in light of the constitutional restrictions on the lending of the credit of any city in aid of or to any association corporation, municipal or otherwise,³¹ and under the related constitutional proscriptions against gifts of public funds.³²

The so-called "lending of credit" proscriptions are similar to provisions in other state constitutions which were enacted in response to flagrant abuses on the part of states and cities in the nineteenth century whereby governments incurred indebtedness well beyond their financial capacity to repay, frequently on behalf of private corporations, particularly railroads. When coupled with the normal constitutional limitations on the amount of bonded indebtedness which may be incurred without voter approval,³³ such provisions tended to restore stability to the financial affairs of state and local government. The dimensions of the prohibitions against lending of credit have been the source of much debate and, unfortunately, relatively little resolution. However, the California cases suggest that the proscription only becomes relevant once the state or local government has incurred a "debt" and then causes the proceeds of that debt to be loaned to another. In the situation at hand, unless the cities' payment obligations constituted "debts", the proscription would not void the contributions agreement. All of the California cases finding an impermissible lending of credit have done so in context of the issuance of bonded indebtedness. Decisions suggest a distinction between the lending of money as opposed to the lending of credit, and some courts have approved the former even in situations where the government obligated itself to make future payments by appropriating revenues yet to be received.³⁴ In the instant case, the cities incurred no

31. Section 6 of Article XVI of the CALIFORNIA CONSTITUTION provides, in part: The Legislature shall have no power to give or to lend, or to authorize the giving or lending, of the credit of . . . any city . . . in aid of or to any . . . corporation, whether municipal or otherwise, or to pledge the credit thereof, in any manner whatever, for the payment of the liabilities of any . . . municipal or other corporation whatever . . .

32. Section 6 of Article XVI of the California Constitution provides, in part: . . . nor shall [the Legislature] have power to make any gift or authorize the making of any gift, of any public money or thing of value to any . . . municipal or other corporation whatever. . . .

33. See, e.g., Sections 1 and 18 of Article XVI of the CALIFORNIA CONSTITUTION.

34. A full examination of this principle might start with the following cases: *People v. Pacheco*, 27 Cal. 175 (1865); *Veterans' Welfare Bd. v. Riley*, 188 Cal. 607, 206 P. 631 (1922); *Veterans' Welfare Bd. v. Jordan*, 189 Cal. 124, 208 P. 284 (1922); and *Riley v. Johnson*, 219 Cal. 513, 27 P.2d 760 (1933).

debt on behalf of the NCPA but rather were arranging to defer payments of their own contractual obligations on an installment basis. Further, while the cities were obligating themselves to make future payments they were presently appropriating future revenues to cover such payments and limiting the source of such payments to unrestricted surpluses in funds created from sources directly related to the distribution of electric power, the very purpose to be fostered by the contract with NCPA.

The proscription on the gift of public funds would be applicable if the consideration received from NCPA in exchange for the cities' promises to pay specified sums to the Development Fund were legally insufficient. This too did not seem to be the situation for NCPA was obligating itself to incur two legally sufficient detriments. First, the agency promised to enter into arrangements with other utilities to search for new sources of energy. Second, the agency pledged to member cities a first call on any energy sources developed. A detriment suffered is sufficient consideration.³⁵ And, there is no requirement of adequacy to make the contract enforceable in an action of law.³⁶ Moreover, even if a court were to find the consideration "insufficient" in the legal sense, the constitutional proscription is not violated if the appropriation is deemed expended primarily for a "public" purpose³⁷ of the appropriating agency, notwithstanding incidental private benefit. The purpose for entering into the contract was to assure that the cities would be able to continue providing electrical power to their respective customers. As discussed above, a variety of constitutional and statutory provisions serve to satisfy the public purpose requirement.³⁸

It was also contemplated that this contribution agreement between the cities and the agency would itself provide a basis for financing. In the event that the initial incremental payments for the cities proved inadequate to enable the agency to enter into joint ventures with other entities, the agency

35. CAL. CIV. CODE § 1605; RESTATEMENT OF CONTRACTS § 75 (1932).

36. RESTATEMENT OF CONTRACTS § 81 (1932).

37. *California Housing Finance Agency v. Elliott*, 17 Cal. 3d 575 (1976); *Bd. of Supervisors v. Dolan*, 45 Cal. App. 3d 237, 119 Cal. Rptr. 347 (1975); *County of Alameda v. Carleson*, 5 Cal. 3d 730, 488 P.2d 953, 97 Cal. Rptr. 385 (1971); *Winkelman v. City of Tiburon*, 32 Cal. App. 3d 834, 108 Cal. Rptr. 415 (1973).

38. See particularly Section 9 of Article XI of the California Constitution.

would consider assigning its right to future payments under the contract to a bank, which in turn would discount such payment obligations and give the agency the present value of the contract. Provisions in the contract directed the member cities to make payments directly to any assignee. Again, the relevant constitutional limitations appeared to be the provisions proscribing the pledge of credit of the member cities "in any manner whatever, for the payment of the liabilities of any . . . municipal or other corporation whatever." In this situation, there was no liability on the part of NCPA beyond its pledge of revenues derived from the contract of the cities, with NCPA's rights to such payments having been assigned to the bank. Since NCPA would not be pledging its full faith and credit but only assigning contract rights, NCPA, and the participating cities, would not be pledging their full faith and credit to secure the obligations of another.

The constitutional and statutory ramifications in a municipal utility participating in the exploration for and development of geothermal resources, and the financing of such project, apply equally to the consideration and the participation in financing of the construction of generation, transmission and distribution facilities. The analysis, however, is made somewhat easier by the fact that such purposes — generation, transmission and distribution — are unquestionably traditional and legitimate public purposes.

LIMITATIONS IMPOSED BY COVENANTS OR OTHER RESTRICTIONS FOUND IN OUTSTANDING BOND INDENTURES

Publicly owned utilities may also be limited in their powers to engage in the financing of a project by the restrictions and limitations contained in the proceedings authorizing outstanding obligations. Typically, municipal utilities issue bonds payable out of the revenues of the utility system and expressly secured by a lien on the revenues of the total utility system. The pledged revenues might be the gross revenues or net revenues after payment of operation and maintenance expenses. So too, the typical proceedings authorizing a series of bonds will permit the issuance of additional bonds on a parity basis to finance the cost of new facilities provided certain historical earnings tests are met. Under such a test, a municipal

electric utility would have to demonstrate sufficient historic revenues to cover by a prescribed margin existing debt service and the debt service on the additional bonds to be issued. Such tests are quite common and reflect the fact that in the past capital additions were small in comparison with the existing system. However, with today's large capital construction programs and construction periods ranging up to ten years, application of the "historical" tests would often require raising existing rates in a politically and economically excessive manner. As a result, many issuers, as old bond resolutions are closed, have articulated "projected" tests in authorizing new debt under new resolutions. Such tests rely heavily upon opinions and conclusions of independent engineers and accountants to establish economic and technical feasibility of the facilities financed with additional bonds both alone and when integrated into the agency's existing system. Such tests typically consider whether wholesale power purchasers have a need and an ability to pay for output, whether the generating facility to be constructed, when integrated into the agency's existing system, will satisfy the power supply requirements; and that the facility is technically feasible, being of a proven design with assurances of fuel availability and its projected revenues, once the new facility is operational, are sufficient to cover with some margin the projected total system debt service.³⁹

It was the presence of such self-imposed limitations that presented the major problems to Burbank in structuring a financing to raise the risk capital for geothermal steam exploration. The city had an outstanding issue of electric revenue bonds. The resolution authorizing the issuance of such bonds, which resolution constitutes a contract between the city and the holders of the first issue of bonds, did provide that parity bonds might be issued under certain conditions. However, such bonds by definition under the resolution were required to be "revenue bonds, revenue notes or other evidence of indebted-

39. For a good, brief general discussion of the new utility issues, particularly joint action issues, see *Austin V. Koenen, "A New Wave of Bonds for Utilities on the Way,"* *The Daily Bond Buyer* (Special SIA Public Finance Supplement No. 1) (October 28, 1976) at 1. For a concise summary of the provisions relating to the security, rate covenants and additional bond covenants in the bond resolutions of some 26 of the largest and financially most active tax exempt electric utilities, including several joint action projects, see *THE FIRST BOSTON CORPORATION, 1976 SURVEY OF TAX EXEMPT ELECTRIC UTILITIES* (June, 1976).

ness hereafter issued for the acquisition, construction and financing of additions to, extensions of, and improvements of the enterprise." "Enterprise" was in turn defined as "the entire system and facilities of the City for the generation, transmission and distribution of electric energy . . . as said electric system now exists and including all additions, extensions and improvements later constructed or required."

The words "generation, transmission and distribution of electric energy" may not comfortably contemplate geothermal, or any fuel supply, development. On the one hand, a court might be persuaded to adopt a liberal construction on a theory that fuel is integral to the generation of electricity. On the other hand, as noted earlier a strong argument to the contrary can be made. In the context of the bond covenants, the issuance of parity bonds for exploration purposes would in fact expose present bondholders to the dilution of their security for a project that might prove totally unproductive of additional revenues. A court under such circumstances might be unwilling to sanction such exposure.

Of course, the city would be free to issue "second lien" bonds, payable out of any surplus as defined under the resolution providing for the earlier issue of revenue bonds. Whether or not such an issue would be marketable is the principal question in such an instance. Other possibilities exist which bear mentioning. First, relevant provisions of the authorizing resolution could be amended with the consent of the bondholders. Typically, however, consent by sixty per cent or more of the outstanding bondholders is required and the process is cumbersome. Another alternative would be to refund the existing bond issue thus discharging the earlier resolution. This would permit the issuance of geothermal bonds on a parity with the refunding debt under an entirely new resolution.

RELATED CONSIDERATIONS WHEN NON-PROFIT CORPORATION IS CHOSEN A FINANCING VEHICLE

Another possible method of financing available to Burbank would involve the creation of a private, non-profit corporation which would issue bonds to finance the exploration and development. Bonds would be issued on behalf of the

city and would be serviced out of periodic payments made to the corporation by the city. To avoid the constitutional debt limitations, the source of payments by the city could be limited to surplus electric revenues. The corporation's bonds, in such event, however would be no more secure and probably less marketable than second lien revenue bonds of the city itself.

The non-profit corporation vehicle raises an additional level of concern. In order for the corporation's bonds to enjoy tax exempt status, the transaction would have to meet the requirements of Revenue Ruling 63-20. That ruling, among other things, requires that title to the facilities vest in the "sponsoring" municipality at the end of the financing. It may be difficult in the case of geothermal exploration to identify any capital asset capable of vesting in the city. Furthermore, the Internal Revenue Service is presently studying the availability of tax exempt financing under Revenue Ruling 63-20 particularly in the case of joint public-private power projects. It is understood that the IRS has delayed the issuance of private rulings in this area pending the adoption of new regulations defining when a non-municipal entity is deemed to be borrowing "on behalf of" a municipal entity and therefore entitled to the same tax exempt treatment of the interest on its debts.

Parenthetically, the Northern California Power Agency has also formed a non-profit corporation under the California Non-Profit Corporation Law. If the agency decides not to finance its generation and transmission facilities with an issue of revenue bonds under the Revenue Bond Law of 1941, described above, it contemplates in the alternative that revenue bonds will be issued by the non-profit corporation. Such bonds would be secured by take or pay contracts with the member municipalities. The NCPA, however, faces slightly different problems under the Internal Revenue Code. We understand the IRS declined to issue a favorable ruling on a proposed bond issue of a non-profit corporation formed to finance power facilities on behalf of several midwestern municipalities. Apparently, the position of the Service is that Revenue Ruling 63-20 requires a single "sponsor" and cannot be

utilized by multiple political subdivisions. Consequently, the NCPA must satisfy the Internal Revenue Service that the agency itself qualifies as a political subdivision. The Internal Revenue Service has stated that the three generally recognized sovereign powers of states are "the police power, the power to tax, and the power of eminent domain".⁴⁰ Strong arguments can be made that the NCPA has both police power and the power of eminent domain.⁴¹

The City of Burbank is proceeding to use the non-profit corporation as a financing vehicle for its joint venture. Current plans are for a non-profit corporation to issue bonds which will finance approximately seventy-five per cent of the cost of development. The remaining money will come from city funds. The city, on behalf of the corporation, has applied for a federal guaranty through the Energy Research and Development Administration under the provisions of the Geothermal Energy Research, Development and Demonstration Act of 1974.⁴² However, the issuance of bonds by a non-profit corporation, backed by the federal guaranty, raises questions not customarily encountered by municipal issuers. Of principal concern are the registration or other requirements with respect to the issuance of bonds found under the federal securities laws, the California Corporate Securities Law, the Public Utilities Code, and the Federal Power Act.

The non-profit corporation in question would not be formed with the provisions of Revenue Ruling 63-20 in mind. Therefore, the corporation is not considered to be issuing bonds on behalf of the public entity. Indeed, under the terms of the loan guaranty program, the interest on the non-profit corporation's securities must be taxable.⁴³ Therefore, one

40. Revenue Ruling 73-563 citing *Alexander J. Shamberg*, 3 T.C. 131 (1944), *acq.*, 1945 C.B. 6, *aff'd*, *Commissioner of Internal Revenue v. Shamberg's Estate*, 144 F.2d 998 (2d Cir. 1944), *cert. denied*, 323 U.S. 792 (1945).

41. Parenthetically, the State of Colorado solved these problems by adopting specific legislation. The Platte River Power Authority is a separate governmental entity and political subdivision of the State of Colorado established by four municipalities under a Colorado law which authorizes any combination of cities and towns which own and operate electric systems to contract with each other to establish a separate governmental entity for the development of electric energy resources, and the production and transmission of electric energy in whole or in part for the benefit of the inhabitants of the contracting cities or towns, and to issue bonds for that purpose.

42. Public Law No. 93-410; see also Energy Reorganization Act of 1974, Public Law No. 93-438, which created ERDA.

43. 10 C.F.R. § 790.4(c) (1976).

must deal with threshold questions whether such obligations are subject to the registration and other provisions of the federal securities laws.

Section 3(a)(2) of the Securities Act of 1933 exempts from registration and certain other provisions of the Securities Act "any security issued or guaranteed by the United States." A similar exemption is present in Section 3(a) (12) of the Securities Exchange Act of 1934. Inasmuch as the bonds will only be issued if they are guaranteed by the federal government through the ERDA program, it appears that if the non-profit agency issues bonds, that issue will be exempt from most of the provisions of the 1933 Act. However, what constitutes the guaranty for the purposes of Section 3(a) (2) has not been a subject of extensive commentary or case law. Congress apparently intended that this exemption be interpreted broadly,⁴⁴ although the legislative history does not indicate that Congress focused on what type of governmental guaranty would bring a security within the scope of the exemption. Further, the SEC has taken no position on the meaning of the term "guaranty" in any of its rules or regulations. Nevertheless, while there are apparently no cases which discuss that term, there are "no-action" letters which indicate that securities guaranteed by federal agencies are exempt under Section 3(a) (2) so long as the full faith and credit of the United States supports the guaranty.⁴⁵ These no-action letters suggest for the exemption to obtain, the guaranty must be operative in all circumstances. The federal government, through the proposed ERDA regulations, has placed certain limitations on the availability of the guaranty. Since these limitations relate to the standard of care of the lender and failure to commence the project and do not limit the types or circumstances of default to which the guaranty extends, under the no-action letters discussed above, the exemption would seem to be available.

Section 25100(a) of the California Corporation Code exempts from requirements of qualification with the Commis-

44. 1 Loss, *SECURITIES REGULATION* 562 (2d ed. 1961).

45. See *Investors Diversified Services*, available November 29, 1971 (mortgage participation certificates guaranteed by the Government National Mortgage Association); *Small Business Administration*, available April 7, 1975 (relating to sales by private lenders of portions of loans guaranteed by the SBA); *Farmers Home Administration*, available January 7, 1976 (sales of loans guaranteed by the Farmers Home Administration).

sioner of Corporations "any security (including a revenue obligation) issued or guaranteed by the United States. . . ." There is apparently no stated authority on the meaning of "guaranteed by the United States"; however, it is likely that, because this provision is similar to the 1933 Act provision, if the security were exempt under the federal acts, it would be exempt under state law.

The Public Utilities Commission of the State of California has broad jurisdiction over all aspects of public utility service. Section 216 of the Public Utilities Code seemingly defines "public utility" in a way which would include the joint venture between Republic Geothermal, the non-profit corporation and the City of Burbank. That term is defined in part as "any person or corporation [which] performs any service or delivers any commodity to any person, private corporation, municipality or other political subdivision of the State, which in turn, either directly or indirectly, immediately performs such service or delivers such commodity to or for the public or some portion thereof. . . ." Since the joint venture will be performing a service of finding and developing geothermal fields, it will be performing a service which ultimately is hoped to result in electrical power for the residents of the city.

As part of its regulatory duties, the PUC regulates the issuance of securities by public utilities.⁴⁶ However, even if the non-profit corporation is under the jurisdiction of the PUC, the Public Utilities Code provides an exemption. The PUC's jurisdiction over issuance of securities does not

apply to any person or corporation which transacts no business subject to regulation under this part, except performing services or delivering commodities for or to public utilities or municipal or other public corporations primarily for resale or use in serving the public or any portion thereof . . .⁴⁷

If the entire output of the geothermal development goes to the city's utility systems, then the issuance of the bonds should be exempt from the jurisdiction of the Public Utilities Commission.

46. CAL. PUB. UTIL. CODE § 816-30 (West 1975).

47. CAL. PUB. UTIL. CODE § 816-30 (West 1975).

Moreover, the jurisdiction of the Public Utilities Commission over public utilities does not extend to those utilities operated by municipal corporations.⁴⁸ Thus, because the non-profit corporation would apparently be formed and operate on behalf of the City of Burbank, it would not be subject in any event to regulation by the Public Utilities Commission.

The Federal Power Act,⁴⁹ gives the Federal Power Commission jurisdiction over the transmission, sale and development of electric power. That jurisdiction includes the issuance of securities by electric companies.⁵⁰ However, the jurisdiction of the FPC is limited. Part I of the Act, originally the Federal Water Power Act, enacted in 1920, provides for the licensing of hydro-electric projects, but does not apply to the development of thermal-electric power.⁵¹ Parts II and III of the Act give the Federal Power Commission jurisdiction over different aspects of transmission and sale of electrical power, regardless of the source of the power.⁵²

Although Section 824c applies to any public utility, that term is defined in Section 824(e) as any person who owns or operates facilities subject to the jurisdiction of the FPC. Section 824(b) provides that the Federal Power Commission "shall not have jurisdiction . . . over facilities used for the generation of electric energy or facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter." Moreover, Section 824(c) provides that electric energy is transmitted in interstate commerce if it is "transmitted from a state and consumed at any point outside thereof . . ." Since the development and transmission of any energy by Burbank or the joint venture would take place wholly within the State of California, and would be for the use of that city, the Federal Power Commission would appear to be without jurisdiction. Therefore, the provisions of Section 824c of Title 16 seem without application.

48. 41 CAL. JUR.2d, *Public Utilities* § 99 (1958).

49. 16 U.S.C. §§ 791a *et seq.* (1970).

50. 16 U.S.C. § 824c (1970).

51. *Chemehuevi Tribe of Indians v. Federal Power Comm.*, 420 U.S. 395 (1975).