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December 9, 2008

Alderman Robert J. Bauman
4th Aldermanic District
City of Milwaukee
City Hall, Room 205

Re: Resolution Authorizing the Assignment to the City of Mequon of the Water Service Agreement Between the City of Milwaukee and We Energies, CCFN 080850

Dear Alderman Bauman:

By letters dated November 26, 2008 and December 1, 2008 you asked whether the City of Milwaukee is legally obligated to consent to We Energies' proposed assignment of the City's wholesale water sales agreement to the City of Mequon; whether the City has a legal right to withhold its consent; whether the City has the legal right to negotiate consideration for giving its consent; and whether the City could face exposure to damages for failing to consent to the assignment.

As we stated in our prior letter to you on this subject, the City is obligated under its duty of good faith to timely consider the consent request. We conclude that the City of Milwaukee would be required to continue supplying water for distribution to the ultimate end-user customers in the City of Mequon and parts of the Village of Thiensville. *City of Milwaukee v. City of West Allis*, 217 Wis. 614, 258 N.W. 851, 853 (1935) (holding that although Milwaukee terminated the water service agreement with reasonable notice, it could not terminate the *service* to West Allis); *see also City of Milwaukee v. Public Serv. Comm'n*, 241 Wis. 249, 253-54, 5 N.W.2d 800 (1942).

As explained in more detail below, the City is not legally obligated to consent to the assignment but, because the City is acting in its capacity as a regulated water

public utility, the City must be prepared to justify the reason it is withholding consent to the assignment. The Public Service Commission (PSC), which would likely be asked to rule on the City's refusal to consent, has advised that it would likely exercise its "broad jurisdiction" to effect the assignment and a reason for withholding consent will be necessary.

The PSC has previously stated, in formal correspondence, that the City has a legal right to condition its consent to supply water to a new customer on payment (in addition to water rates) only to the extent that the PSC does not find that such a payment implicates its ratemaking authority. The PSC has informally advised that the City cannot condition consent to the proposed assignment on payment from the City of Mequon (e.g. an intergovernmental agreement similar to the New Berlin IGA) because the City currently serves the Mequon end-user customers on a wholesale basis and the assignment will not expand the current water service area. The PSC has not provided any clear guidance as to whether the City can condition its consent on payment from We Energies as consideration for release of We Energies' obligations under the Agreement. The Common Council could consider a substitute resolution conditioning consent to the assignment request on We Energies' payment of money in consideration for the City's consent; however, the PSC might not permit such a payment if it invoked its regulatory jurisdiction.

Finally, unlike a refusal to *consider* the consent request, we do not believe that the City would likely be exposed to monetary damages if it in good faith declined to consent to the assignment. Again, it appears that the PSC will require the City to justify the reason for withholding consent.

Background

Wisconsin Gas Company, d/b/a We Energies Water Services, (We Energies) executed a wholesale water agreement dated December 10, 2003 (Agreement). The Agreement was a renewal of an initial wholesale water services agreement dated November 6, 1998. Pursuant to the Agreement, We Energies purchases all of its water from the City of Milwaukee for retail distribution to ratepayers in the City of Mequon and portions of the Village of Thiensville.

On September 5, 2008, We Energies and the City of Mequon executed an Asset Purchase Agreement in which the City of Mequon would buy the water system currently serving the City of Mequon, Village of Thiensville, and a portion of the Village of Bayside. The Agreement provides for a December 31, 2008 closing date. Voters in the City of Mequon authorized the City's purchase of the water system at a referendum on September 9, 2008. By letter dated September 29,

2008, We Energies submitted a formal request that the City of Milwaukee consent to the assignment of the Agreement to the City of Mequon. A resolution authorizing the City of Milwaukee's consent to the assignment of the Agreement to the City of Mequon was introduced at the Common Council meeting on October 7, 2008.

Article IV(i) of the Agreement provides:

This Agreement and all of the provisions hereof shall be binding upon and inure to the benefit of the parties hereto, but neither this Agreement nor any of the rights, interest[s], or obligations hereunder shall be assigned by either of the parties hereto without the prior written consent of the other party.

Article IV(f) of the Agreement provides that the "parties agree to act in good faith and use due diligence in meeting their respective obligations under this Agreement."

By telephone on October 16, 2008, this office discussed with you the significance of the Agreement's assignment consent clause. We advised that even if the City were to withhold consent to the assignment, the City could not stop supplying water for distribution to the ultimate end-users in Mequon. Given the requirement to continue supplying water, the City's remedy for an unlawful assignment by We Energies would be damages for breach of contract. We advised that without a reason for withholding consent, the City would not likely be able to establish any damages.

In response to your question, we advised that the Agreement did not preclude the City from seeking to negotiate a payment from We Energies in consideration for the City's consent to assignment of the Agreement to Mequon, but that it was not clear that the PSC would allow the City to condition consent on payment, and that the PSC might use its regulatory power to require the City to consent to the assignment. You stated that you did not want the City Attorney to provide a written opinion on these issues.

Subsequently, you indicated to Carrie Lewis, Water Works Superintendent, and our office that you were not planning to schedule the resolution at the December 3, 2008 Public Works Committee because the City's consent was irrelevant as it was your understanding that the PSC was claiming that the City has no ability to refuse consent to the assignment of the Agreement to Mequon.

On November 19, Assistant City Attorney Tom Miller spoke with the PSC's attorney and provided a copy of the Agreement. On November 25, the PSC's attorney stated that the PSC would not take a position on whether the City has a contractual right to withhold consent to the assignment, but stated that the PSC would require a reason if the City refused consent. Counsel stated that the PSC believes the asset purchase sale and the assignment of the Agreement are in the best interests of both the City of Milwaukee and the ratepayers in Mequon, that the PSC could use its "broad jurisdiction" to effect the assignment, but that the PSC wants the City and We Energies to resolve the assignment issue. Counsel also made clear that the City must continue to provide water to the end-user customers in Mequon, for which the City would continue to be compensated.

With regard to a payment by We Energies in consideration for the City's consent to assignment, we do not have clear guidance from the PSC. PSC counsel stated that the PSC "probably" lacks jurisdiction if the charge does not implicate the public utility or the end-user, though PSC counsel cautioned that this is not always a bright-line.

On November 26, we sent you a letter concluding that the duty of good faith, both express and implied, requires the Common Council to timely consider We Energies' consent request. On December 1, 2008, Public Works Committee Staff Assistant Terry MacDonald notified us that pending answers to your recent opinion requests the resolution would not be heard at the December 3, 2008 Public Works Committee meeting.

The City's Rights and Obligations Regarding We Energies' Consent Request

The Agreement provides that a party may assign its rights and obligations only with the prior written consent of the other party. Given this contract language, contract principles do not obligate the City to consent to the assignment. However, the City's rights and obligations relating to We Energies' consent request must be considered within the City's role as a regulated public water utility. When the City of Milwaukee executed the 1998 and 2003 wholesale water agreements with We Energies the City was acting in its capacity as a water public utility subject to the rules, regulations, and statutory authority of the PSC. *City of Oak Creek v. PSC*, 2006 WI App. 83, ¶ 9, 292 Wis. 2d 119, 716 N.W.2d 152.

The statutory authority of the PSC to review the reasonableness of a City resolution refusing consent to the assignment is beyond doubt. "Any public utility may file a complaint with the [PSC] on any matter affecting its own product or service." Wis. Stat. § 196.30. Under Wis. Stat. § 196.37(2), the PSC has authority

to “determine and make any just and reasonable order relating to a...practice, act or service” of public utilities found to be unjust or unreasonable by the PSC. *City of Oak Creek*, ¶ 25. Wis. Stat. § 196.58(5) grants the PSC original and concurrent jurisdiction with municipalities to regulate the services of public utilities. *City of Oak Creek*, ¶ 26. Accordingly, the PSC, pursuant to its statutory authority, may determine the reasonableness of the City’s refusal to consent to the assignment and issue an order voiding such resolution if the PSC deems the refusal unreasonable.

Though the PSC may strike a resolution that the PSC deems to unreasonably refuse consent to the assignment, it is our opinion that the City would not likely be exposed to monetary damages for its refusal to consent to the assignment. Wisconsin law has long held that a provision that consent to an assignment will not be unreasonably withheld is a promise for which a party may receive damages in the case of breach. *Rock County Savs. & Trust Co. v. Yost’s, Inc.*, 36 Wis. 2d 360, 364-65, 153 N.W.2d 594 (1967). However, Wisconsin courts have not addressed whether a party’s refusal to consent to an assignment is subject to the duty of good faith and fair dealing in the absence of a provision that “consent may not be unreasonably withheld.” Courts that have considered this question in the dealership, franchise, and landlord-tenant contexts in other jurisdictions have reached conflicting determinations. As we noted earlier, the Agreement explicitly provides that the “parties agree to act in good faith and use due diligence in meeting their respective obligations under this Agreement.” To avoid any possible exposure to damages for breach of good faith, the City should not unreasonably or arbitrarily withhold its consent to the proposed assignment.

We have found nothing in the Agreement or contract law that would preclude the City from negotiating a payment from We Energies in consideration for the City’s consent to We Energies’ request. There may be some value to the release of We Energies from its obligations under the Agreement. Again, the PSC has implied that it would invoke its jurisdiction only if such payment implicated the PSC’s ratemaking authority.

Conclusion

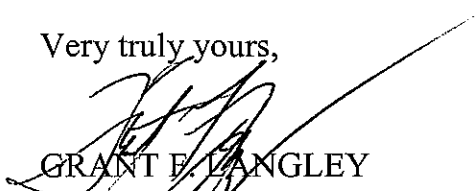
In conclusion, the City must consider We Energies’ consent request. The City must continue to supply water for distribution to the existing end-users in the City of Mequon and parts of the Village of Thiensville. The City is not precluded from conditioning its consent to the assignment on payment from We Energies, though the PSC may void such payment requirement if it determines that the payment would infringe on its ratemaking authority or if it finds the condition unreasonable. If We Energies assigns the Agreement despite the City’s good faith

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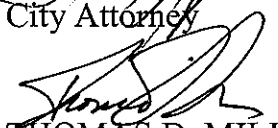
refusal to consent, the City could pursue a claim for breach of contract, although the amount of damages is unclear.

If you have any comments or concerns or require any additional information, please do not hesitate to contact the undersigned.

Very truly yours,



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