

NOTE

INDIANAPOLIS POWER & LIGHT CO. v. PENNSYLVANIA PUBLIC UTILITY COMMISSION

I. INTRODUCTION

Stranded-cost recovery has become a major issue in electric restructuring. In *Indianapolis Power & Light Co. v. Pennsylvania Public Utility Commission*,¹ the Commonwealth Court of Pennsylvania² upheld Pennsylvania's stranded-cost recovery mechanism against a multi-pronged Commerce Clause³ challenge raised by an out-of-state competitor. Certiorari was subsequently denied by the U.S. Supreme Court.⁴ The case may represent one of the first judicial analyses of the issue of stranded-cost recovery as part of an individual state's attempt to comprehensively deal with issues presented by electric restructuring.

A. *Facts of the Case*

In 1996, Pennsylvania enacted the Electricity Generation Customer Choice and Competition Act (Competition Act).⁵ The Competition Act separated the three historic electric utility functions of generation, transmission, and distribution with the express purpose of “[modifying] existing legislation and regulations and to establish standards and procedures in order to create direct access by retail customers to the competitive market for the generation of electricity while maintaining the safety and reliability of the electric system for all parties.”⁶ After implementation, Pennsylvania residents would be able to purchase electricity from Pennsylvania and out-of-state sources, while Pennsylvania utilities would remain responsible for transmission of their own generated energy and distribution of all energy received from any source.

The Competition Act recognized that, in the court's terms, “the former monopolies will be unable to recover substantial expenses and capital costs through market-determined prices.”⁷ Pennsylvania included two mechanisms of stranded-cost recovery in the Competition Act.⁸ First, upon Pennsylvania Public Utilities Commission (PUC) approval, the utility could impose a competition transition charge to be paid by all customers accessing the distribution network. Second, a local utility could apply to the PUC for a “qualified rate order” which would permit all or part of the future transition costs to be “securitized,” thereby converting the utility's right to collect these transition costs over a defined period into a current property right that could be sold or pledged to support “tran-

1. *Indianapolis Power & Light Co. v. Pennsylvania Pub. Util. Comm'n*, 711 A.2d 1071 (Pa. Commw. Ct. 1998), *cert. denied*, 526 U.S. 1005 (1999).

2. Although this is not the highest court in Pennsylvania, this court directly reviews decisions of the Pennsylvania Public Utility Commission.

3. U.S. CONST. art. I, § 8, cl. 3.

4. *Indianapolis Power & Light Co.*, 526 U.S. 1005.

5. 66 PA. CONS. STAT. ANN. §§ 2801-12 (West 1999).

6. 66 PA. CONS. STAT. ANN. § 2802(12) (West 1999).

7. *Indianapolis Power & Light Co.*, 711 A.2d at 1074.

8. The court noted that stranded costs were the “costs prudently incurred by the local utilities that will not be recoverable through market-determined prices.” *Id.* at 1074.

sition bonds.”⁹

Under the Competition Act, PECO Energy (PECO), a Pennsylvania electric utility, sought and obtained a qualified rate order from the PUC that permitted securitization of roughly \$1.1 billion of future transition cost charges. Indianapolis Power & Light (IPL) sought judicial review contending that permitting PECO’s recovery of these stranded costs violated the Commerce Clause of the United States Constitution.

In a lengthy discussion addressing IPL’s numerous contentions and discussing several U.S. Supreme Court precedents, the Commonwealth Court of Pennsylvania upheld the Competition Act, primarily because it found that the Competition Act did not implicate the Commerce Clause as: (1) it did not discriminate against interstate commerce; (2) it was consistent with what the court termed the state’s “traditional ability to regulate retail sales of electricity”;¹⁰ and (3) the need for stranded-cost recovery has been recognized in other forums and the Commerce Clause should not be used to impede Pennsylvania’s “experiment with competition.”¹¹ This note will analyze the court’s decision in those three areas.

B. Analysis of the Decision

IPL was itself a regulated utility in Indiana. In this case, however, IPL was in the position of an out-of-state energy supplier seeking to compete against in-state established suppliers for Pennsylvania customers’ business. IPL argued that allowing Pennsylvania’s local utilities to recover stranded costs as they made the transition from bundled to unbundled service gave these local utilities an unfair economic advantage over out-of-state electricity providers.¹² By recovering stranded costs, PECO is given a huge subsidy that it can use to artificially lower its rates.¹³ An out-of-state supplier would have to price its general output lower while the in-state provider could beat that cost and still be profitable due to stranded-cost recovery. Out-of-state electricity providers, such as IPL, did not qualify for recovery of stranded costs in Pennsylvania.¹⁴ Thus, IPL contended that the stranded-cost provision of the Competition Act unconstitutionally discriminated against out-of-state electricity providers.

II. THE COMMERCE CLAUSE

An extended analysis of Commerce Clause jurisprudence is beyond the scope of this note. Nevertheless, some brief discussion will help to set the stage

9. “Securitization” of transition costs is an approach that has been proposed in several, but not all, states addressing these questions. For a general discussion of the concept, see Steven B. Schoen, *Securitization of Stranded Costs of Utilities*, 759 COM. L. & PRAC. 337 (1997). A discussion of this concept as well as the arguments pro and con is beyond the scope of this note.

10. *Indianapolis Power & Light Co.*, 711 A.2d at 1077.

11. *Id.*

12. *Indianapolis Power & Light Co.*, 711 A.2d at 1075.

13. *Id.* at 1076.

14. It should be noted as well that there is no statutory provision in Indiana that allows stranded-cost recovery to electricity providers.

for further analysis of this case.

The Commerce Clause gives Congress the exclusive power to “regulate Commerce . . . among the several States.”¹⁵ Clearly, outright acts of Congress to regulate interstate commerce are not frequently challenged. However, so-called “dormant” or negative aspects of the Commerce Clause have been the subject of more frequent and intense scrutiny and come into play when Congress has not expressly acted with respect to the Commerce Clause. Sometimes Congress’ power is exclusive in this respect; at other times, the powers of Congress and the states overlap.¹⁶ The Supreme Court has made a wide variety of decisions in this area to determine whether a state has violated the dormant Commerce Clause.¹⁷

In order to determine if there is a violation of the Commerce Clause, the Supreme Court has developed a variety of tests. One test relevant here is the per se test. A state law that is discriminatory on its face or in its effects is virtually a per se violation of the Commerce Clause unless the state can show a legitimate local concern. For example, in *Hunt v. Washington State Apple Advertising Commission*,¹⁸ the Supreme Court struck down a North Carolina law requiring all apples to have an USDA label on them. Though not facially discriminatory, the law had discriminatory effects. Washington State had its own labels, which used higher testing standards than the USDA. Thus Washington apples lacking a USDA label could be excluded from North Carolina markets. The law served no legitimate local purpose, and North Carolina failed to show a lack of legitimate alternatives.¹⁹

Although a state law may be discriminatory on its face or in its effects, by application of the per se test, a state or local law may yet be held as constitutional if there are no other means of advancing a legitimate local interest. For example, in *Maine v. Taylor*,²⁰ Maine passed a law prohibiting importation of live baitfish. Though the law was discriminatory on its face, the Supreme Court upheld the law. The Court reasoned that Maine’s interest was a unique and unusual resource it was seeking to protect and thus served a legitimate local interest.²¹

III. PENNSYLVANIA’S COMMONWEALTH COURT DECISION

A. *The Competition Act is not a Violation of the Dormant Commerce Clause*

The court used a number of different analyses in this section in order to support its reasoning that the Competition Act does not violate the Commerce

15. U.S. CONST. art. I, § 8, cl. 3.

16. Compare *City of Philadelphia v. New Jersey*, 437 U.S. 617 (1978) (New Jersey law prohibiting importation of waste collected outside New Jersey struck down) with *Exxon Corp. v. Governor of Md.*, 437 U.S. 117 (1978) (Maryland law prohibiting oil producers to operate or own retail gas stations within the state upheld).

17. See *Tracy v. General Motors Corp.*, 519 U.S. 278 (1997), see also Adam C. Buck, Note, *General Motors Corp. v. Tracy*, 20 ENERGY L.J. 345 (1999).

18. *Hunt v. Washington State Apple Adver. Comm’n*, 432 U.S. 333 (1977).

19. *Id.* at 353-54.

20. *Maine v. Taylor*, 477 U.S. 131 (1986).

21. *Id.* at 150-51.

Clause. The first was that the purpose of the Competition Act, in general, is to promote interstate commerce, not to impede it.²² The second was based on the boundaries of stranded-cost recovery.²³ The third involved an analysis of *West Lynn Creamery, Inc. v. Healy*,²⁴ specifically distinguishing the case from the present situation.²⁵

The court began by noting that the overall purpose of the Competition Act is to promote interstate commerce.²⁶ The Competition Act orders the local utilities to unbundle their services to make way for out-of-state utilities to provide the same service, in competition with local utilities. In simple terms, because both out-of-state and local utilities could become competitors, the Competition Act was seen to promote interstate commerce. The consumer would be the ultimate beneficiary, having more choices in who is to provide electricity to the home. Thus, the court reasoned that since the "practical effect" as a whole of both the stranded-cost provisions and the Competition Act itself is to promote interstate commerce, the Competition Act does not fall within Commerce Clause concerns.

The court's reasoning that the "practical effect" of the Competition Act is to promote interstate commerce seems sound. The Competition Act allows out-of-state electricity providers to compete with local utilities where previously the local utilities had a monopoly. However, the court may not have carried its analysis far enough. The court simply swept the stranded-cost provisions under its reasoning because they were part of the Competition Act. No explanation was given as to how the stranded-cost recovery provisions of the Competition Act independently promoted interstate commerce, and such an analysis may be problematic.

The sole beneficiary of the Competition Act's stranded-cost provisions is a local utility. Out-of-state utilities and/or electricity providers are not qualified for stranded-cost recovery in Pennsylvania. Since this provision benefits only local utilities, it does not promote interstate commerce. Moreover, the court did not analyze to any extent the components of PECO's stranded costs. The recovery mechanism is tied to access to the distribution system. Predominately, stranded costs result from *generation* plant production that cannot be sold at market prices. Thus, the court did not address the question between the source of the stranded cost and its recovery.

The stranded-cost provision allows local utilities to recover costs incurred in expectation that they would continue to have a monopoly on electricity generation. However, the recovery mechanism is tied to the distribution system, which is still regulated. Therefore, PECO will receive stranded-cost recovery from anyone who uses its distribution system. If IPL services customers using PECO's distribution system, IPL would be competing with PECO on an uneven playing field. PECO could set a lower market rate in-state because it could sell

22. *Indianapolis Power & Light Co.*, 711 A.2d at 1077.

23. *Id.* at 1078.

24. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994).

25. *Indianapolis Power & Light Co.*, 711 A.2d at 1078.

26. *Id.* at 1077.

its generation output out-of-state below market rate. The out-of-state market sales (not subject to the distribution surcharge) would cover the cost of a lower market price in-state, and PECO would still be recovering its stranded costs in-state. IPL, with no stranded-cost recovery and no Indiana statute allowing stranded-cost recovery, would have an economic disadvantage both out-of-state and in-state due to PECO's stranded-cost recovery. Therefore, IPL would be discriminated against in Pennsylvania. Instead of encouraging out-of-state providers to compete with utilities such as PECO, the Competition Act arguably discourages out-of-state participation and, therefore, is not a promotion of interstate commerce.

The court then moved from a more general line of reasoning to a focus on the stranded-cost provisions. The court stated that stranded-cost recovery provides "equitable" relief to local utilities as the transition is made from bundled to unbundled services.²⁷ Costs are limited in amount and duration of recovery.²⁸ The costs must be "just and reasonable."²⁹ Therefore, the court found that IPL mischaracterized the stranded-cost recovery as a subsidy when it should be characterized instead as restitution to local utilities.³⁰

The court's characterization of stranded-cost recovery as an equitable remedy to local utilities is problematic. The court was certainly correct when it stated that stranded-cost recovery is limited in amount and in the time period during which it can be recovered. The Competition Act lays out the specific costs allowed.³¹ The Competition Act also only allows recovery "not to exceed nine years."³² The stranded-cost provisions even imposes a duty on local utilities to mitigate their transition costs.³³ Thus, the Competition Act does limit stranded-cost recovery. It defines stranded-cost recovery, taking it from an abstract principle to something readily definable.

However, the abstract principle involved is the court's use of the word "restitution" to characterize stranded-cost recovery. Restitution is "[a]n equitable remedy under which a person is restored to his or her original position prior to loss or injury, or placed in the position he or she would have been, had the breach not occurred."³⁴ The first part of this definition fits the purpose of allowing stranded-cost recovery in the Competition Act. If stranded-cost recovery is allowed, the local utilities would be put in their original position had the unbundling of services not occurred. However, restitution, as an equitable remedy, implies a breach of some kind. This implication begs the question as to where the breach originated and what was breached.

The breach may have originated in the state legislature who sought to break up the monopoly owned by local utilities. The "contract" that was breached may

27. *Indianapolis Power & Light Co.*, 711 A.2d at 1078.

28. 66 PA. CONS. STAT. ANN. § 2808(b)(c) (West 1999).

29. 66 PA. CONS. STAT. ANN. §§ 2803, 2804(13) (West 1999).

30. *Indianapolis Power & Light Co.*, 711 A.2d at 1078.

31. *Indianapolis Power & Light Co.*, 711 A.2d at 1074 n.4; 66 PA. CONS. STAT. ANN. §§ 2803, 2808(c)(1) (West 1999).

32. 66 PA. CONS. STAT. ANN. § 2808(b) (West 1999).

33. 66 PA. CONS. STAT. ANN. § 2808(c)(4)-(5) (West 1999).

34. BLACK'S LAW DICTIONARY 1313 (6th ed. 1990).

be between the regulator and the regulated. PECO (the regulated utility) is entitled to a reasonable return on its shareholders' investment. The regulator (the state) is then entitled to reliable service within the state. This type of agreement is not a true contract where the law provides a remedy. Furthermore, stranded-cost recovery is not recovered from the state as the entity that committed the "breach." Instead, it falls on the consumer, which the Competition Act was meant to serve. Therefore, under the Competition Act, PECO is entitled to an unenforceable remedy paid for by the citizens, who are not a party to the "contract."

Stranded-cost recovery as "restitution" for deregulating the electricity generation market may also imply that though utilities such as PECO are not legally entitled to a remedy, it is an equitable remedy and thus raises a question of fairness. Most stranded-cost recovery comes from the building of nuclear power plants.³⁵ Nuclear power plants have low generating costs but high capital costs. The shareholders of utilities, such as PECO, were obviously aware of the costs in building a nuclear power plant when making their decision. With stranded-cost recovery, the shareholders will not have to suffer any consequences if the nuclear power plant proves to be a poor financial decision. The consumer will pay for the plant. However, in competitive market economies, investors make good and bad decisions and are responsible for those decisions. Therefore, allowing "restitution" in a competitive market seems to provide an unfair advantage to utilities, such as PECO. If "restitution" is an equitable remedy in a competitive market place, stranded-cost recovery may be characterized as a subsidy because it allows the local utilities to continue their monopolistic practices in a competitive market place. Therefore, out-of-state utilities, not qualified to take the stranded-cost recovery, will be at a disadvantage.

The burden falls on out-of-state electricity providers indirectly because they are not entitled to stranded-cost recovery in Pennsylvania. Yet, if they wish to do business in Pennsylvania, local utilities will have an advantage over them as they can recover their stranded costs. Due to this economic disadvantage, out-of-state electricity providers will be financially responsible for the breach that the state of Pennsylvania is argued to have committed against the local utilities. Whether stranded-cost recovery is an advantage to in-state providers or a disadvantage to out-of-state providers, it is hardly "equitable" as compared to a level playing field. The scales appear tipped towards the in-state providers.

The stranded-cost provision specifically states that the cost "shall be included on bills to customers."³⁶ Taking the holistic view, as the court appears to have taken, the Competition Act promotes interstate commerce. In promoting interstate commerce, the customers are supposed to be the ultimate beneficiaries because they are able to choose which electricity provider they will use. However, since the stranded costs will be recovered from the customers, the bill charge implies that a customer will have to pay for restitution costs incurred by local utilities regardless of whether that customer chooses a local utility. The costs to customers could be even higher than before, which seems contrary to the

35. *Indianapolis Power & Light Co.*, 711 A.2d at 1074 n.4.

36. 66 PA. CONS. STAT. ANN. § 2808(b) (West 1999).

stated purpose of unbundling service. The unbundling of services was intended to promote interstate commerce in the area of generation³⁷ and, in theory, should bring prices down. The prices will actually go up since the customer will have to pay for the unbundling and, if the customer chooses an out-of-state provider, will also have to pay higher rates as local utilities will have the stranded-cost provisions as a buffer at the expense of the customer and IPL. This type of arrangement appears to be at cross-purposes with the overall purpose of the Competition Act.

The court concluded this section of its analysis by distinguishing IPL's analogy with *West Lynn Creamery*.³⁸ In that case, a Massachusetts pricing order basically required any person in the dairy industry doing business in Massachusetts to pay a premium. The money was then distributed to all Massachusetts dairy producers.³⁹ The court characterized the purpose of the statute as the most important difference between the two cases. In *West Lynn Creamery*, the order was intended to save the local dairy industry.⁴⁰ In the present situation, the overall purpose is to "promote competition and interstate commerce by opening the electric generation market."⁴¹ The court also noted that the pricing order was paid by people in the dairy industry who were located both in-state and out-of-state, whereas in the present situation, stranded-cost provisions are alleged paid only by citizens of Pennsylvania and "have no direct effect on out-of-state entities."⁴² The court further buttressed its argument with the fact that the Massachusetts pricing order had no time duration and was in no way related to any history of state regulation. By contrast, in the present situation, the Competition Act represents a careful scheme limited in amount and time period recoverable.⁴³

In this section of the decision, the court went through three separate analyses to determine that the Competition Act does not violate the Commerce Clause. First, the Competition Act does not violate the Commerce Clause because the practical effect of the Competition Act is to promote interstate commerce. Second, stranded-cost provisions are specific costs with specific amounts recoverable over a specific time period rather than a gratuitous gift from the state legislature. Finally, the Competition Act is distinguishable from IPL's analogy with the Supreme Court's decision in *West Lynn Creamery*.

The court's reasoning in distinguishing the Competition Act from *West Lynn Creamery*⁴⁴ seems sound on its face. Deeper analysis nevertheless reveals some clear similarities between the two cases. The court identified three factors that distinguish the Competition Act from the pricing order in *West Lynn Creamery*: (1) the overall purpose is different; (2) the specific amounts and time periods are present in the Competition Act; and (3) only Pennsylvania citizens pay the stranded costs, whereas both in-state and out-of-state persons in the dairy

37. *Indianapolis Power & Light Co.*, 711A.2d at 1074.

38. *West Lynn Creamery*, 512 U.S. 186.

39. *Id.* at 190-91.

40. *West Lynn Creamery*, 512 U.S. at 192.

41. *Indianapolis Power & Light Co.*, 711 A.2d at 1078.

42. *Id.*

43. *Indianapolis Power & Light Co.*, 711 A.2d at 1079.

44. *West Lynn Creamery*, 512 U.S. 186.

industry paid the premium in *West Lynn Creamery*.

If the court had stopped its reasoning at this point, it would seem that there would be no fault in its reasoning. Intriguingly, later in its own analysis, the court pointed to specific reasons analogizing the pricing order in *West Lynn Creamery* to stranded-cost provisions in the Competition Act. Thus, *West Lynn Creamery* may be more analogous to the present situation than it appears at first glance.

In *West Lynn Creamery*, the Supreme Judicial Court of Massachusetts conceded that the pricing order posed a minimal burden on interstate commerce.⁴⁵ However, the Massachusetts court held that despite the burden on interstate commerce, there was a legitimate local interest, the preservation of the local dairy industry, which outweighed any such burden.⁴⁶ Subsequently, the Supreme Court overturned the decision, finding the pricing order to be unconstitutional.⁴⁷

The Commonwealth Court of Pennsylvania walked the same analytical path in a later part of its opinion.⁴⁸ The court listed many local legitimate interests, all tied to saving the local electric utility. These interests are strikingly similar to the reasons given to justify burdening interstate commerce in *West Lynn Creamery*. Therefore, the Pennsylvania Commonwealth Court's opinion in this section should be scrutinized more closely as its reasoning appears to parallel the analysis and decision of the Supreme Judicial Court of Massachusetts.

The court characterized the need for "viable local electric utilities" as the most important legitimate local interest.⁴⁹ If there are no local utilities, out-of-state suppliers may not be able to provide all of the electricity needed to service Pennsylvania customers. Furthermore, out-of-state providers can pick and choose where they will sell electricity, which may allow them to avoid less profitable segments of the population, while local utilities would still have the responsibility of providing service to everyone within their area.⁵⁰ This line of reasoning is strikingly similar to the one put forth in *West Lynn Creamery*. In *West Lynn Creamery*, the legitimate local interest put forth by the state was the "maintenance of a regular and adequate supply of pure and wholesome milk."⁵¹ This local interest would be in jeopardy if local farmers were not able to earn enough money to survive.⁵² *West Lynn Creamery* seems analogous as the court has suggested there is a possibility of an inadequate supply of electricity to Pennsylvania consumers which would only be assured if Pennsylvania public utilities were given stranded-cost recovery to survive. Though electricity and milk are obviously different products, walking into a supermarket that had no milk would be almost as surprising as walking into a supermarket that had no electricity. Therefore, the maintenance of "viable local electric utilities" can be

45. *West Lynn Creamery v. Healy*, 611 N.E.2d 239, 244 (Mass. 1993).

46. *West Lynn Creamery*, 512 U.S. at 192.

47. *Id.* at 194.

48. *Indianapolis Power & Light Co.*, 711 A.2d at 1085-86.

49. *Id.* at 1085-86.

50. *Indianapolis Power & Light Co.*, 711 A.2d at 1085-86.

51. *West Lynn Creamery*, 512 U.S. at 205.

52. *Id.*

characterized as more of an economic protectionist state interest, rather than a legitimate local interest unrelated to economic protectionism.

B. Pennsylvania's Police Power

The federal government is a government of enumerated powers. The states retain all power not given up to the federal government, including a state's police power. The court relied on this power to further bolster its decision that the stranded-cost provisions of the Competition Act do not violate the Commerce Clause.

The court first pointed to the history of rate regulation at the local level without Congressional involvement. The court concluded that Pennsylvania's power to regulate electricity rates at the local level validates stranded-cost provisions.⁵³ It drew upon a number of Supreme Court decisions throughout the century, most relating to the natural gas industry, and a few others directed towards the electricity industry.

The court viewed the natural gas and electricity industry as sharing one major characteristic: both are in stages of deregulation. Thus, the court analogized the Supreme Court cases relating to natural gas as well as using cases relating to the electric industry in its decision that Pennsylvania's police power allows it to regulate the electric industry at the local level.

The similarities between the electric and the natural gas industries are minimal. Though both industries are related to energy, the electric industry is "vertically integrated" while the natural gas industry is not. Therefore, the deregulation of the industries would be quite different because the structures of each industry are different.

The court first drew the distinction between wholesale and retail sales. In general, wholesale sales of electricity have a direct impact on interstate commerce. Retail sales are usually the province of the state and, therefore, do not usually impact the Commerce Clause.⁵⁴

Seeking to transfer this reasoning to the context of the electric industry, the court cited *Public Utility Commission of Rhode Island v. Attleboro Steam and Electric Co.*⁵⁵ and *Connecticut Light & Power v. Federal Power Commission.*⁵⁶ In *Connecticut Light & Power*, the Supreme Court discussed the difference between local and wholesale rates, and cited legislative history to bar the Federal Power Commission from regulating certain aspects of the electric industry.⁵⁷

Discussing these cases, the court stated two reasons that stranded-cost provisions are related to Pennsylvania's police power to regulate local rates. First, the charges for stranded-cost recovery are completely intrastate and, therefore,

53. *Indianapolis Power & Light Co.*, 711 A.2d at 1079.

54. See generally *Public Util. Comm'n for Kan. v. Landon*, 249 U.S. 236 (1919); *Pennsylvania Gas Co. v. Public Serv. Comm'r of N.Y.*, 252 U.S. 23 (1920). The Pennsylvania Commonwealth Court cites these cases in its decision to draw the distinction between wholesale and retail sales.

55. *Public Util. Comm'n of R.I. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

56. *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515 (1945).

57. *Id.* at 525-528.

"have no real effect on interstate commerce."⁵⁸ Second, the states still possess police power to control rates at the local level, although Congress has taken away some of this power.⁵⁹ The court then remarked that if the regulatory scheme had remained unchanged, these stranded costs would have been recovered through rate regulation. Thus, the court reasoned there was no justification for failing to allow these charges even though a new market has been created.⁶⁰

The court's analysis in this section of the opinion is troublesome. Two of the cases that the court cited may no longer be strong precedent, having been overturned in whole or in part.⁶¹ The court then cited another Supreme Court opinion, *General Motors Corp. v. Tracy*,⁶² in which the court took a footnote from that case to mean that there is an assumption of state power to regulate local utilities despite Congress assuming some authority over this area.⁶³ In the referenced footnote, the Supreme Court was explaining its holding in *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*.⁶⁴ In *Tracy*, the Supreme Court rejected the wholesale/retail dichotomy. This point is important as the Pennsylvania Commonwealth Court implicated that stranded-cost provisions do not violate the Commerce Clause because Pennsylvania has the right to regulate local utilities, "most notably, the rates charged by local utilities to consumers within the state."⁶⁵ Thus, the first part of the Pennsylvania court's argument is unsupported by Supreme Court precedent. There is no blanket exception for retail sales. Retail sales can be subject to Commerce Clause scrutiny. The *Tracy* Court specifically stated:

Arkansas Electric thereby expanded both the permissible scope of state utility regulation and judicial recognition of the important state interests in such regulation, the reasoning of the case equally implies that state regulation of retail sales is not, as a constitutional matter, immune from our ordinary Commerce Clause jurisprudence, and to the extent that our earlier cases may have implied such immunity they are *no longer good law*.⁶⁶

Thus, the court appears to have misinterpreted Supreme Court precedent. Commerce Clause jurisprudence can be applied to both wholesale and retail sales of electricity. The traditional state power to regulate retail sales is no longer supported by Supreme Court precedent.

58. *Indianapolis Power & Light Co.*, 711 A.2d at 1081.

59. *Id.*

60. *Indianapolis Power & Light Co.*, 711 A.2d at 1081.

61. *Landon*, 249 U.S. 236, was vacated by *Kansas Natural Gas Co. v. Public Util. Comm'n for Kan.*, 249 U.S. 590 (1919), and remanded back to the trial court on all issues. *Pennsylvania Gas Co.*, 252 U.S. 23 was disapproved in *East Ohio Gas Co. v. Tax Comm'n of Ohio*, 51 S. Ct. 499 (1931) (drawing a line where interstate commerce ends and the intrastate burden begins, not necessarily the same for natural gas distribution as for excise taxes).

62. *General Motors*, 519 U.S. 278. See also *Buck*, *supra* note 17.

63. *Indianapolis Power & Light Co.*, 711 A.2d at 1081.

64. *General Motors*, 519 U.S. at 291 n.8.

65. *Indianapolis Power & Light Co.*, 711 A.2d at 1079.

66. *Id.* (emphasis added).

C. *The Commerce Clause Should not Impede the Experiment with Competition*

The trend towards deregulation of all utilities was the third reason promulgated by the Pennsylvania court to uphold the Competition Act. Once again, the court analogized to the natural gas industry to conclude that stranded-cost recovery does not violate the Commerce Clause, but is actually a necessary component of deregulation in the electric industry.

The court noted recent rulemakings by the Federal Energy Regulatory Commission (FERC). In Order 636,⁶⁷ the FERC allowed pipelines to recover costs "stranded" due to unbundling of natural gas pipelines.⁶⁸ The court also cited Order 888,⁶⁹ allowing recovery of certain "stranded" costs by utilities that owned, controlled, or operated transmission facilities in the electric industry. This recovery was allowable due to the FERC's decision to mandate open access to other utilities on the interstate level.⁷⁰ Thus, reasoned the court, even at a wholesale level, stranded-cost recovery has been allowed.

The court then emphasized that an experiment in competition should not be impeded,⁷¹ described the process in which stranded-cost recovery was determined in Pennsylvania,⁷² and stated, "[s]uffice it to say, we believe that this experiment must proceed."⁷³

This section of the decision relates to the court's first argument dealing with the "practical effects" of the Competition Act. In this section, the court further justified its statement that since the overall purpose of the Competition Act is to promote competition, the Commerce Clause should not impede any efforts by the Pennsylvania legislature to do so.

The court cited to little authority except the two FERC rulemakings. Of course, implicit in the FERC rulemakings was federal policy as to which the Commerce Clause is the source of power, not a limitation. Beyond the FERC rulemakings, the court quoted Justice Brandeis' dissenting opinion in *New State Ice Co. v. Liebmann*.⁷⁴ Though Brandeis' opinion has been cited in other cases, its use has been hodgepodge at best.⁷⁵

D. *Stranded-Cost Recovery Serves a Legitimate Local Interest*

The court concluded its analysis by applying the per se test to the Competi-

67. Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation: and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 57 Fed. Reg. 13,267 (1992) [hereinafter Order No. 636].

68. Order No. 636, *supra* note 66, at 13,267.

69. Order No. 888, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities: Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 Fed. Reg. 21,540 (1996) [hereinafter Order No. 888].

70. Order No. 888, *supra* note 68, at 21,540, 21,542.

71. *Indianapolis Power & Light Co.*, 711 A.2d at 1084.

72. *Id.* at 1083.

73. *Indianapolis Power & Light Co.*, 711 A.2d at 1084.

74. *Id.*

75. See, e.g., *Chandler v. Miller*, 520 U.S. 305 (1997) (Chief Justice Rehnquist dissenting to striking down drug testing for candidates to state offices); *Arizona v. Evans*, 514 U.S. 1 (1995) (states should be encouraged to find different ways to respect individual rights).

tion Act: (1) whether the Competition Act is discriminatory on its face or in its effects; and (2) whether it serves a legitimate local interest which outweighs the burden on interstate commerce.

The court first discussed whether the Competition Act is discriminatory on its face or in its effects. The court asserted that because the Competition Act is nondiscriminatory in its purpose or its effects as a whole, the first part of the test does not apply. Thus, the Competition Act fulfills the first requirement of the per se test. In proceeding, the court suggested that there is an incidental effect on interstate commerce. The court then compared the burden on interstate commerce with Pennsylvania's interest. Subsequently, the court found that even if the Competition Act places a burden on interstate commerce, the local interest outweighs any burden on interstate commerce.⁷⁶

The court listed the legitimate local interests that embody the stranded-cost provisions of the Competition Act. The most immediate concern, according to the court, is "the need to insure the future viability of Pennsylvania's electric utilities in the period of transition toward competition. . . ."⁷⁷ Another important local interest is the assurance of the existence of the transmission and distribution system in Pennsylvania.⁷⁸ Other legitimate local interests include: (1) the assurance that electricity will be available to Pennsylvania consumers; (2) the provision of adequate funds to decommission nuclear power plants in Pennsylvania; and (3) fairness to electric utilities, their investors, and employees.⁷⁹ Thus, even if the Competition Act does burden interstate commerce, the local interests outweigh any burden on interstate commerce. Therefore, the stranded-cost provision of the Competition Act satisfies the per se test.

In this section, the court appeared to assume, without analysis, that the stranded-cost provision satisfies the first part of the per se test. This approach may be criticized because, although it may not be discriminatory on its face, it is discriminatory in its effects. IPL and PECO are not playing on a level playing field. PECO will be able to charge lower rates outside the state because these rates will not be subject to the distribution charge. PECO will also charge lower rates in-state, as stranded-cost recovery will allow recovery of the high capital costs needed in their nuclear power plants. Thus, any utility with capital costs, not given stranded-cost recovery, such as IPL, will be at an unfair disadvantage in Pennsylvania and possibly other states as well.

The court cited many local interests. However, these interests are similar to the ones used in *West Lynn Creamery*.⁸⁰ As the *West Lynn Creamery* court noted, economic protectionism to save a local industry is not a legitimate local interest.⁸¹ Thus, the court's application of the per se test is problematic.

76. *Indianapolis Power & Light Co.*, 711 A.2d at 1085.

77. *Id.*

78. *Indianapolis Power & Light Co.*, 711 A.2d at 1085.

79. *Id.* at 1086.

80. See discussion *supra*.

81. *West Lynn Creamery*, 512 U.S. at 213-14.

IV. CONCLUSION

In analyzing this lengthy opinion, a strong argument can be made that the Pennsylvania Commonwealth Court was merely allowing state policy to override any Constitutional concerns. To date, the Supreme Court has only raised the issue of Commerce Clause scrutiny in the area of retail electric sales in a footnote in connection with another case.⁸² Thus, the constitutionality of a similar stranded-cost provision may remain suspect pending further scrutiny.

Indianapolis Power & Light Co. is not as forthright in resolving Commerce Clause issues as might have been hoped. Despite its length and some strong reasoning, other portions of the court's analysis are less firmly supported and may not reflect current Commerce Clause law. As noted herein, serious anti-competitive questions may remain, and it is doubtful that this will be the final judicial word on electric restructuring stranded-cost recovery.

Anna Goode

82. *General Motors*, 519 U.S. at 291 n.8.

