ORIGINAL

LAW OFFICES
OBERMAYER REBMANN MAXWELL & HIPPEL LLP
204 STATE STREET
HARRISBURG, PA 17101
(717) 234-9730
FAX (717) 234-9734

WALTER W. COHEN

December 1, 1997

James McNulty, Prothonotary
Pennsylvania Public Utility Commission
Room B-20, North Office Building
Harrisburg, PA 17120

Re: Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code
Docket No. R-00973953
Petition of Enron Energy Services Power, Inc. For Approval of An Electric Competition And Choice Plan And For Authority Pursuant To Section 2807(e)(c) Of The Public Utility Code, To Serve As The Provider Of Last Resort In The Service Territory Of PECO Energy Company
Docket No. P-00971265

Dear Prothonotary McNulty:

Enclosed for filing please find an original and two copies and one 3.5" diskette of the Brief of Intervenor Indianapolis Power & Light Company in the above-captioned Proceeding.

Copies of the Brief are being served upon all parties via hand delivery or US Mail, as indicated in the attached Certificate of Service.

Sincerely,

Walter W. Cohen

WWC/dhs
Enclosures

cc: All parties on Certificate of Service

ORIGINAL

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PECO Application For Approval Of Its Restructuring Plan and Joint Petition for Partial Settlement	)))	**Docket No. R-00973953**
Petition of Enron Energy Services Power, Inc. For Approval Of An Electric Competition And Choice Plan And For Authority Pursuant To Section 2807(e)(c) Of The Public Utility Code, To Serve As The Provider Of Last Resort In The Service Territory Of PECO Energy Company	))))))))	**Docket No. P-00971265**

BRIEF OF INTERVENOR
INDIANAPOLIS POWER & LIGHT COMPANY

Michael G. Banta, Esquire
INDIANAPOLIS POWER & LIGHT COMPANY
One Monument Circle
P.O. Box 1595
Indianapolis, Indiana 46206-1595
(317) 261-8449

Walter W. Cohen, Esquire
Andrew J. Giorgione, Esquire
OBERMAYER REBMANN MAXWELL & HIPPEL LLP
204 State Street
Harrisburg, Pennsylvania 17101
(717) 221-7920

Daniel W. McGill, Esquire
BARNES & THORNBURG
11 South Meridian Street
Indianapolis, Indiana 46204
(317) 236-1313

ATTORNEYS FOR INDIANAPOLIS POWER & LIGHT COMPANY

Date: December 2, 1997

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

FEDERAL CASES

Page

STATE CASES

OTHER

I. INTRODUCTION

Intervenor Indianapolis Power & Light Company ("IPL") submits this brief in support of its position that the stranded cost recovery and securitization provisions of the Joint Petition For Partial Settlement Of PECO Energy Company's Proposed Restructuring Plan And Application For A Qualified Rate Order (the "Partial Settlement") filed with the Commission on or about August 27, 1997 must be rejected. Consistent with the Stipulation and Agreement filed with the Commission on September 19, 1997 and accepted into the record without objection at the hearing on October 14, 1997 (as noted by the presiding Administrative Law Judges in Prehearing Order No. 5 dated October 17, 1997), IPL submits that these provisions of the Partial Settlement and the provisions of the Electricity Generation Customer Choice And Competition Act, 66 Pa. C.S. §§ 2801 et seq. (the "Electricity Generation Act") which provide for stranded cost recovery and securitization (collectively "the stranded cost provisions") are invalid and unconstitutional because they conflict with the Commerce Clause of the Constitution of the United States, i.e. U.S. Const., Art. I, § 8, cl. 3. These are the same reasons the Commission's Opinion and Qualified Rate Order dated May 22, 1997 in Docket Nos. R-00973877, R-00973877C001 and R-00973877C002 (the "Initial Securitization Order"), currently on appeal, is invalid and unconstitutional.[1]

II. SUMMARY OF ARGUMENT

The stranded cost provisions of the Electricity Generation Act are invalid, because they conflict with the Commerce Clause of the United States Constitution under controlling precedents of the U.S. Supreme Court. The provisions discriminate against interstate commerce by neutralizing

---

[1]The record of the initial securitization proceeding has been incorporated into the record in this proceeding. *Prehearing Conference Order No.* 1, ¶ 15, p. 7. Record references herein are to the testimony and other matters of record in PECO's initial securitization proceeding.

the advantages of lower cost out-of-state producers in competing for sales of electricity to Pennsylvania consumers. This discrimination is accomplished by requiring all consumers, including those choosing to buy electricity from low cost out-of-state producers, to pay incumbent Pennsylvania utilities for the competitive losses which they otherwise would incur due to their higher costs. These subsidies to high cost Pennsylvania utilities, like PECO, amount to billions of dollars and are not available to their out-of-state competitors.

Because the purpose and the effect of the stranded cost provisions is to discriminate against interstate commerce, the strict scrutiny Commerce Clause test applies. A state law that discriminates against interstate commerce is *per se* invalid unless the state can prove that less discriminatory means are not available to advance a legitimate local interest. Under this test, protecting high cost in-state producers is not a legitimate local interest. Furthermore, assuming *arguendo* that Pennsylvania has some legitimate local interest in paying high cost Pennsylvania utilities for their uneconomic assets, alternative and less discriminatory means are available to serve that interest. Recipients of stranded cost recoveries should be required to divest themselves of their generating assets, withdraw from the competitive market for the generation and sale of electricity, and limit their business to the transmission and distribution of electricity which remain regulated monopoly services. In that way, the stranded cost recoveries would not neutralize the competitive advantages of lower cost out-of-state suppliers.

The Commission was clearly wrong in the Initial Securitization Order in stating that the stranded cost provisions could be implemented because there was no factual basis for a Commerce

Clause challenge. The stranded cost provisions are invalid as a matter of law because they discriminate against interstate commerce on their face. A challenger to such a statute is not required to prove the extent of the effect on interstate commerce. Furthermore, the discriminatory effect here is no less than that deemed obvious in controlling U.S. Supreme Court decisions. Finally, ample record evidence of discrimination exists, all of which was completely ignored by the Commission.

Also wrong is the Commission's suggestion in the Initial Securitization Order that the stranded cost provisions are shielded from Commerce Clause scrutiny because the Act opens the Pennsylvania generation market to competition. Having elected to open the market to competition, the Commonwealth may not employ discriminatory regulations that give in-state firms advantages over their out-of-state rivals. This is clear under the doctrine of unconstitutional conditions and settled U.S. Supreme Court precedent.

Because the stranded cost provisions discriminate against interstate commerce, the balancing test applicable to state statutes which regulate evenhandedly with only incidental effects on interstate commerce does not apply. However, even if the balancing test applied, the challenged provisions would fail because the putative local benefits from stranded cost recovery do not outweigh the burden on interstate commerce. This is particularly true since any local benefits could be accomplished without such burden on interstate commerce, by requiring Pennsylvania utilities choosing stranded cost recovery to divest themselves of their generation business.

These constitutional infirmities are not rectified by the proposal of Enron Energy Services Power, Inc. made in the petition filed with the Commission on October 7, 1997 ("Enron's Proposal").

Under the Electricity Generation Act's severability provision and the legal standards governing severability, the unconstitutional stranded cost provisions are severable from the other provisions of the Act. Therefore, the invalidity of the stranded cost provisions does not preclude the Commission from implementing the remaining provisions of the Act by establishing a competitive market for the sale of electricity in the Commonwealth of Pennsylvania.

III. ARGUMENT

A. The Stranded Cost Provisions Of The Electricity Generation Act Violate The Commerce Clause Of The United States Constitution.

The Electricity Generation Act opens to competition the retail electric generation market in Pennsylvania. Under the stranded cost provisions of the Act, however, all customers must subsidize the generation and sale of electricity by high cost Pennsylvania utilities in the competitive market. Through the "competitive transition charge" and "intangible transition charge," incumbent Pennsylvania utilities receive huge sums of money they are unable to earn in competition with other electric generation suppliers. The Pennsylvania utilities are allowed to retain their electric generating plants, to compete in an unregulated market with those facilities, and to cover their future competitive losses through charges imposed by law on consumers who buy their electricity from out-of-state suppliers. These discriminatory stranded cost charges for the benefit of incumbent Pennsylvania

utilities, which cannot be recovered by or applied to the benefit of non-incumbent, non-Pennsylvania suppliers, violate the Commerce Clause of the United States Constitution.

1. The Commerce Clause Prohibits Both State Laws That Discriminate Against Interstate Commerce And State Laws That Excessively Burden Interstate Commerce.

The Commerce Clause provides that "Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. Art. I, § 8, cl. 3. Although phrased as a grant of power to Congress, the U.S. Supreme Court has held for more than 150 years that the Commerce Clause also constitutionally limits state economic regulation that impedes "the free flow of commerce across state lines . . . ." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 206 (1994). This is because:

> Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.

Id. at 206-07, quoting *H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 539 (1949). This "negative" or "dormant" aspect of the Commerce Clause "serves to prevent a state from regulating business in such a way as to provide unfair advantage to its own residents at the expense of residents

of another state." *Empire Sanitary Landfill, Inc. v. Commonwealth, Dep't of Environmental Resources*, 546 Pa. 315, 684 A.2d 1047, 1055 (1996).

Analysis of a state or local regulation under the dormant Commerce Clause involves a two-tiered process. The first issue is whether the state law discriminates against interstate commerce. *West Lynn Creamery*, 512 U.S. at 192. *See also, e.g., Empire Sanitary Landfill*, 684 A.2d at 1055. When such discrimination is present, a very strict constitutional standard applies. "Discrimination against interstate commerce in favor of local business or investment is *per se* invalid, save in a narrow class of cases in which the [state or local government] can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest." *C&A Carbone, Inc. v. Clarkstown*, 511 U.S. 383, 392 (1994). *See also, e.g., Delaware County v. Raymond T. Opdenaker & Sons, Inc.*, 652 A.2d 434, 437 (Pa. Commw. Ct. 1994), *appeal dismissed*, 543 Pa. 111, 669 A.2d 929 (1995).

Conversely, in the second tier of the analysis, if the challenged law does not discriminate against, but incidentally burdens, interstate commerce, a balancing test is applied. *Empire Sanitary Landfill*, 684 A.2d at 1056. The balancing test requires a court to determine whether the burden imposed on interstate commerce is outweighed by the local benefits. *Id.* Specifically:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.

Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

As set forth below, the stranded cost provisions of the Electricity Generation Act, and the "intangible transition charges" and "competitive transition charges" called for by the Partial Settlement, violate these constitutional rules.

2. The Stranded Cost Provisions Of The Electricity Generation Act Plainly Discriminate Against Interstate Commerce By Protecting High Cost In-State Producers.

As the U.S. Supreme Court has explained, the "paradigmatic example of a law discriminating against interstate commerce is the protective tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State." *West Lynn Creamery*, 512 U.S. at 193. Such a tariff "violates the principle of the unitary national market by handicapping out-of-state competitors, *thus artificially encouraging in-state production even when the same goods could be produced at lower cost in other States*." *Id.* (emphasis added). The Supreme Court has further made clear that the Commerce Clause also prohibits "state laws that aspire to reap some of the benefits of tariffs by other means." *Id.* State laws and regulations thus may not try "'to neutralize advantages belonging to the place of origin,'" including specifically "the advantage possessed by lower cost out-of-state producers . . . ." *Id.* at 194, quoting *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935). *See also, e.g., Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 406 (1984) (State may not use discriminatory measures "in an attempt to 'induce business operations to be performed in the home State that could more efficiently be performed elsewhere'"), quoting *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 336 (1977).

The strict scrutiny Commerce Clause test applies if the "purpose" of a state law or regulation is to discriminate against interstate commerce, *or* if its "effect" is to do so. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984); *Atlantic Coast Demolition & Recycling, Inc. v. Board of Chosen Freeholders*, 112 F.3d 652, 662 (3d Cir. 1997). Here, the stranded cost provisions of the Electricity Generation Act discriminate against interstate commerce *both* in "purpose" *and* in "effect." Like the regulation in *West Lynn Creamery* (discussed below), both the "purpose" of these provisions and their "effect" are "to enable higher cost [Pennsylvania utilities] to compete with lower cost [electric suppliers] in other States." 512 U.S. at 194.

With respect to "purpose," the stranded cost provisions facially discriminate against interstate commerce. Only Pennsylvania utilities may obtain stranded cost recovery. Out-of-state competitors for electric generation like IPL are ineligible for these massive payments. The statute states on its face that the "competitive transition charge" is to be paid to the "electric distribution company" by each consumer "in whose certificated territory that customer is located." 66 Pa. C.S. § 2808(a).[2]

Likewise under the "intangible transition charge" PECO, but not its out-of-state generation competitors, receives the benefit of that charge imposed on every consumer "located within the

---

[2]The "electric distribution company" is the company providing transmission and distribution services, which continue to be regulated as a natural monopoly. 66 Pa. C.S. §§ 2802(6), 2803 (definition). That company is the incumbent Pennsylvania utility, which is also allowed to compete in the competitive market for electric *generation* while receiving the charge (which represents competitively unrecoverable costs for uneconomic *generating* assets) imposed on the captive transmission and distribution customers. Thus, the Act requires customers of out-of-state suppliers to pay generating costs of high cost Pennsylvania utilities even though those consumers are not using Pennsylvania generation.

certificated territory of [PECO] . . . ." 66 Pa. C.S. § 2812(g) (definition of "Intangible transition charge"). The Electricity Generation Act discriminates on its face in providing for the recovery of stranded costs from consumers through the issuance of transition bonds only by incumbent Pennsylvania electric utilities. 66 Pa. C.S. §§ 2804(13)-(14), 2808(e), 2812. The Act provides that "the commission has the power and duty to approve a competitive transition charge for the recovery of . . . stranded costs it determines to be just and reasonable to recover from ratepayers" and which "provide[s] the investors in *Pennsylvania* electric utilities with a fair opportunity to fully recover the amount of . . . stranded costs that the commission determines to be just and reasonable." 66 Pa. C.S. § 2804(13)-(14) (emphasis added).

Thus, on its face, the Electricity Generation Act permits only incumbent Pennsylvania electric utilities to recover their future competitive losses[3] from Pennsylvania consumers. In so providing, the Act discriminatorily protects local electric generators to the detriment of out-of-state suppliers who may recover only the competitive market price.

Under the Commerce Clause, "'discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93, 99 (1994). *See also, e.g., Harvey & Harvey, Inc. v. County of Chester*, 68 F.3d 788, 797 (3d Cir. 1995), *cert. denied*, 116 S. Ct. 1265 (1996). Furthermore, there is no question that the purpose of the stranded costs provisions

---

[3]As pointed out in Studness, *Never, Never Use The "S" Word! Always Say "Losses,"* 134 Pub. Util. Fortnightly, No. 22, p. 16 (Dec. 1996), the term "stranded costs" has no standing in economics and is really a euphemism for the correct term -- "losses."

is to protect high cost Pennsylvania utilities in competition for generation with lower cost competitors. The Act states on its face that "[r]ates for electricity in this Commonwealth are on average higher than the national average." 66 Pa. C.S. § 2802(4). The very definition of the "stranded costs" of the Pennsylvania utilities is their generating costs "which may not be recoverable in a competitive electric generation market . . . ." 66 Pa. C.S. § 2803 (definition of "Transition or stranded costs"). The declaration of policy section states that incumbent Pennsylvania electric utilities have investments in plants and facilities that may not be recoverable in a competitive market. 66 Pa. C.S. § 2802(15).

As stated above, a state law may also discriminate against interstate commerce in practical "effect." *Bacchus Imports*, 468 U.S. at 270. *See also, e.g., Healy v. Beer Institute*, 491 U.S. 324, 337 n.14 (1989) ("'When a state statute directly regulates or discriminates against interstate commerce, *or when its effect is to favor in-state economic interests over out-of-state interests*, we have generally struck down the statute without further inquiry'") (emphasis added), quoting *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573, 579 (1986); *Philadelphia v. New Jersey*, 437 U.S. 617, 626 (1978) (regardless of statute's "legislative purpose," the "evil of protectionism can reside in legislative means as well as legislative ends").

Here, stranded cost recovery provisions of the Electricity Generation Act discriminate against interstate commerce in "effect" as well as in purpose. Through the "competitive transition charge" and/or "intangible transition charge" that all consumers must pay, Pennsylvania utilities with high cost generating assets are subsidized in competition for electric generation. The effect on the in-state

utility's ability to compete is obvious. The result is to "neutraliz[e] the advantage possessed by lower cost out-of-state producers" and to "enable higher cost [Pennsylvania utilities] to compete with lower cost [generation suppliers] in other States." *West Lynn Creamery*, 512 U.S. at 194.

Furthermore, under the "intangible transition charge" mechanism used by PECO here, the proceeds from the transition bonds -- repayment of which is secured by the irrevocable intangible transition charge imposed on all consumers -- will be used by PECO, *inter alia*, to pay off outstanding debt. This in effect pays off PECO's high cost generating units, which it then gets to keep and use in the competitive generation market free and clear of these obligations. Also, by repurchasing common equity on the open market or directly from shareholders, PECO can shore up its stock price and enhance its ability to attract new capital which it can use to compete in the generation market.

This stranded cost recovery scheme for Pennsylvania utilities under the Electricity Generation Act is substantively identical to the scheme for Massachusetts dairy farmers that the U.S. Supreme Court invalidated in *West Lynn Creamery*. There, the state required all milk dealers within the state to pay into a "Dairy Stabilization Fund" a "premium payment" on all milk sold to retailers, regardless of where the milk had been produced. However, the proceeds from these "premium payments" were then given to in-state milk producers to enable them to compete with out-of-state producers. 512 U.S. at 190-91, 194. The Supreme Court analogized the "premium payments" to a tax. Although the "tax" was evenhanded, in the sense that it applied to all milk whether produced in-state or out-of-state, the scheme was invalid because payment of the "tax" proceeds to in-state farmers subsidized

their ability to compete with lower cost out-of-state producers -- thus "'neutraliz[ing] the advantages belonging to the state of origin.'" *Id.* at 194-96, quoting *Baldwin*. The Court added that "out-of-staters' ability to remain competitive by lowering their prices would not immunize a discriminatory measure." *Id.* at 195.

Likewise, under the Electricity Generation Act, although the stranded cost recovery charges are imposed on all consumers, regardless of which electric generation supplier they choose and whether that supplier is an in-state or out-of-state producer, the revenues from those charges exclusively benefit the in-state utilities. As in *West Lynn Creamery*, the effect is to subsidize the high cost in-state utility in competition with lower cost out-of-state suppliers. As in *West Lynn Creamery*, this is an invalid discrimination against interstate commerce.

West Lynn Creamery also rejected the contention that there was no economic "protectionism" because the burden of the "tax" fell on only "in-state consumers . . . ." *Id.* at 203. As the Court pointed out, the burden of a tariff -- the "paradigmatic Commerce Clause violation" -- also falls on in-state consumers. The court reiterated the obvious fact that such discriminatory measures *also* benefit in-state producers to the detriment of out-of-state producers, and that, because they "discriminate against out-of-state products, they are unconstitutional." *Id.* at 203-04.

Polar Ice Cream & Creamery Co. v. Andrews, 375 U.S. 361 (1964), also involved a state scheme much like the stranded cost provisions here. The effect of a complex regulatory framework, *see* 375 U.S. at 363-70, was that a Florida milk dealer had to purchase from "Pensacola Milk

Marketing Area" producers the amount of milk they offered (to the extent of the dealer's needs), and therefore as a practical matter the dealer would purchase from other sources only amounts it needed in excess of what the local producers offered. *Id.* at 375-76. This regulation was likewise invalidated under the Commerce Clause as another example of state laws "'designed to neutralize advantages belonging to the place of origin.'" *Id.* at 377. Similar to the regulatory scheme in *Polar Ice Cream*, even though Pennsylvania electricity consumers may choose another generation supplier, they must in effect "buy" some of their generation from the Pennsylvania utility -- in the form of mandatory charges for generation costs the utility cannot charge in a competitive market. Again, the effect is to "neutralize the advantages" of lower cost out-of-state producers.

Another pertinent Commerce Clause decision is *Alliance for Clean Coal v. Miller*, 44 F.3d 591 (7th Cir. 1995). There, amendments to the federal Clean Air Act made it less economic for electric utilities to burn high-sulfur Illinois coal in generating electricity. In response, Illinois enacted a statute which, *inter alia*, encouraged utilities to install scrubbers (allowing high-sulfur coal to be used in meeting air quality standards) and provided that the Illinois Commission would include the costs of the scrubbers in the utilities' rate bases (thus passing the cost on to electric customers). 44 F.3d at 593-94. The statute was held invalid under the Supreme Court's decision in *West Lynn Creamery*. The Seventh Circuit explained:

> Because the Illinois Coal Act, like the milk-pricing order in *West Lynn*, has the same effect as a "tariff or customs duty -- neutralizing the advantage possessed by lower cost out of state producers" [of low-sulfur coal], it too is repugnant to the Commerce Clause and the

> principle of a unitary national economy which that clause was intended to establish.

Id. at 595. *Accord Alliance for Clean Coal v. Bayh*, 72 F.3d 556 (7th Cir. 1995) (invalidating similar Indiana statute). Here, the stranded cost provisions of the Electricity Generation Act advantage the in-state utilities themselves rather than in-state coal producers. But the impermissible effect under the Commerce Clause is the same -- by requiring the utility commission to impose mandatory charges on electric consumers, in-state producers are advantaged in competing with lower cost out-of-state producers.

The comparative "novelty" of the type of state law involved here, where high cost in-state utilities are protected by stranded cost recovery in connection with a shift from territorial public utility monopolies to a competitive market, does not shield the stranded cost provisions from challenge under standard Commerce Clause principles. As the U.S. Supreme Court reiterated in *West Lynn Creamery* when addressing the novel "neutral tax plus in-state subsidy" scheme presented there:

> Our Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce . . . . As the Court declared over 50 years ago: "The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce."

512 U.S. at 201, quoting *Best & Co. v. Maxwell*, 311 U.S. 454, 455-56 (1940). *See also Alliance for Clean Coal v. Miller*, 44 F.3d at 596.

3. The Discriminatory Stranded Cost Provisions Cannot Survive Strict Scrutiny.

As stated above, a state statute or regulation that "[d]iscriminat[es] against interstate commerce in favor of local business or investment is *per se* invalid, save in a narrow class of cases in which the [state] can demonstrate, under rigorous scrutiny, that it has *no other means* to advance a legitimate local interest." *C&A Carbone*, 511 U.S. at 392 (emphasis added). *See also, e.g., Atlantic Coast Demolition & Recycling, Inc. v. Board of Chosen Freeholders*, 48 F.3d 701, 711 (3d Cir. 1995); *Delaware County*, 652 A.2d at 437. As "the party defending the statute" here, PECO and the other settling parties have the burden of proof on this issue, *Atlantic Coast Demolition*, 112 F.3d at 665, and bears the "extremely difficult burden" of showing that the stranded cost provisions of the Electricity Generation Act "'advance[] a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.'" *Camps Newfound/Owatonna v. Town of Harrison*, ____ U.S. ____, 117 S. Ct. 1590, 1601 (1997), quoting *Oregon Waste Systems*, 511 U.S. at 101, quoting *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988). PECO and the other settling parties cannot satisfy this burden.

The first and most crucial point under this strict scrutiny test is that protecting Pennsylvania utilities -- or any variation on that theme (such as creating "fair competition" for high cost producers, or allowing high cost utilities to recover for uneconomic generating plants built under a previous regulatory regime) -- is *not* a *legitimate* local purpose under the Commerce Clause. This is so

because "[p]reservation of local industry by protecting it from the rigors of interstate competition is the *hallmark* of the economic protectionism that the Commerce Clause *prohibits*." *West Lynn Creamery*, 512 U.S. at 205 (emphasis added). "A regulation serving a protectionist purpose is obviously invalid since a discriminatory purpose is *a fortiori* illegitimate." *Harvey*, 68 F.3d at 797.

Thus, the Supreme Court has rejected all manner of such economic justifications for protectionist regulation -- *e.g.*, offsetting lower cost advantages enjoyed by out-of-state producers and enabling high cost local producers to compete, *West Lynn Creamery*, 512 U.S. at 194-95; preventing the total collapse of a declining industry and preserving employment, *id.* at 204-06; lessening the state's reliance on a single source of supply, *Wyoming v. Oklahoma*, 502 U.S. 437, 456 (1992); encouraging development of a fledgling local industry, *Bacchus Imports*, 468 U.S. at 271-72; and "bolstering local ownership, or wealth, or control of business enterprise," *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 43-44 (1980). When keeping "farmers and merchants and workmen . . . [from] the poor relief lists or perish[ing] altogether" cannot justify interstate economic protectionism, high cost utilities certainly are not entitled to special treatment. *See West Lynn Creamery*, 512 U.S. at 206, quoting *Baldwin*, 294 U.S. at 522-23.

The recent line of cases invalidating waste flow control as a mechanism to finance solid waste disposal facilities is also analogous to the invalid stranded cost provisions and the authorization of billions of dollars in transition bonds to subsidize PECO's future competitive losses. *E.g., C&A Carbone*, 511 U.S. at 386-94; *Atlantic Coast Demolition*, 112 F.3d at 657-659, 664-67. Until its invalidation under the dormant Commerce Clause, New Jersey's flow control of waste was the vital

economic element in supporting the billions of dollars of capital investment necessary to finance and construct waste-to-energy and landfill disposal facilities. *Atlantic Coast Demolition*, 112 F.3d at 657-59.

In *Atlantic Coast Demolition*, once the Third Circuit determined that New Jersey's flow control statute discriminated against interstate commerce, the State attempted to justify the control of the flow and disposal of waste within its borders as necessary to ensure the economic viability of the facilities it constructed for safe and responsible disposal of its waste. 112 F.3d at 665-67. The solid waste public debt in New Jersey at the time of *Atlantic Coast* was $1.65 billion, which comprised 53 separate public bond issues. *Id.* at 658. The Third Circuit rejected New Jersey's arguments and found that there were less discriminatory alternatives to ensure the viability of this debt within the constraints imposed by the Commerce Clause. The alternatives identified by the Court included restructuring of debt and seeking funding through public revenues. *Id.* at 665-67. The Court held that "'revenue generation is not a local interest that can justify discrimination against interstate commerce,'" *id.* at 666, quoting *C&A Carbone*, 511 U.S. at 666, and that "the State's financial losses alone cannot justify discrimination against interstate commerce," 112 F.3d at 666.

Similarly through the Electricity Generation Act, the Commonwealth and the Commission are attempting to protect investment in Pennsylvania of previously built facilities through a captive "flow" of consumer revenues to support transition bonds. However, Pennsylvania has "other means to advance" any conceivably "legitimate local interest" in providing high cost Pennsylvania utilities with stranded cost recovery. *C&A Carbone*, 511 U.S. at 392; *Atlantic Coast Demolition*, 112 F.3d at 662.

For example, Pennsylvania utilities wanting stranded cost recovery could and should be required to divest themselves of electric generation assets and refrain from the electric generation business.

In fact, this divestiture alternative was identified and adopted by the New Hampshire Commission in its recent Statewide Utility Restructuring Plan, DR96-150 (Feb. 28, 1997). IPL Adm. Notice Ex. 1 (Tr. 781-82) ("New Hampshire Plan"). There, the New Hampshire Commission defined "divestiture to mean that an existing utility may no longer provide competitive and non-competitive services." *Id.* at 19. Utilities desiring to remain in the distribution business would be permitted to recover stranded costs, but must divest their generation assets, *i.e.*, sell or spin off the plants to non-affiliated entities not engaged in the transmission and distribution business. *Id.* at 18. The New Hampshire Commission found that divestiture was required to eliminate the anti-competitive effects of stranded cost charges which otherwise would permit the incumbents to discourage or prevent entry by competitors to the state's generation market "at no cost." *Id.* at 20, 62-63. It explained that "government-mandated stranded cost recovery is inconsistent with effective competition" but "[t]his problem can be avoided by requiring that the assets be sold prior to the introduction of competition so that the incumbent does not end up with both the cash and the paid-off asset." *Id* at 63.[4]

[4]IPL's witness Brehm likewise testified that requiring divestiture as a condition for stranded cost recovery and securitization would "establish a *real* current market price for PECO's assets while simultaneously avoiding the anti-competitive effects of allowing PECO to both receive the massive stranded cost cash flows and simultaneously to compete in the power sale market." Brehm Direct Testimony at 15-16 (emphasis original). Similarly, New England Electric System, a holding company which has electric utilities in Massachusetts, Rhode Island and New Hampshire, agreed to divest its generating facilities in return for stranded cost recovery, and that divestiture is already occurring. *See, e.g., NEES Agrees To Sell Generating Assets In Return For Stranded Cost Recovery*, Electric Utility Week (Oct. 7, 1996) at 1; *USGEN Gets NEES Plants for $1.59 Billion*, 9 Electric Daily, No. 27 (Aug. 7, 1997) at 1; *PG&E Unit To Pay $1.6 Billion For NEES Generating Assets*, The Energy (continued...)

Accordingly, the Commonwealth, PECO and the other settling parties cannot establish a legitimate state purpose for discriminating against out-of-state electric generation suppliers. Furthermore, they cannot establish that no less discriminatory means exist to achieve any legitimate local interest in stranded cost recovery. For these reasons, the stranded cost provisions of the Electricity Generation Act violate the Commerce Clause on their face and in purpose and effect.

4. The Reasons For Rejecting A Commerce Clause Challenge Set Forth In The Initial Securitization Order Are Plainly Wrong.

In its Initial Securitization Order, the Commission summarily addressed and rejected a Commerce Clause challenge, although only as raised by the Environmentalists. *Id.* at 22. The Commission said:

> (1) "There is simply no factual basis upon which to make . . . a determination [that stranded cost recovery violates the Commerce Clause]"; and
>
> (2) "the Electricity Generation Act is expressly designed to bring competition for the electric generation market *into* the Commonwealth."

Id. (emphasis original). Neither of these statements makes the stranded cost provisions constitutional, and the first statement is not even true.

---

[4](...continued)
Daily (Aug. 6, 1997) at 1.

(a) "Factual Basis" For Commerce Clause Challenge.

The first Commission conclusion, that there is "no factual basis" for a determination that stranded cost recovery violates the Commerce Clause, is obviously wrong for several reasons. First, this is primarily a *legal* issue because the statute discriminates against interstate commerce on its face. The stranded cost provisions facially discriminate against out-of-state competitors, allowing only Pennsylvania utilities to recoup such costs. The statute also demonstrates that the purpose is protectionist, stating that Pennsylvania electric rates are higher than average, and defining stranded costs as generating costs the high cost Pennsylvania utilities will be unable to recover in a competitive market. Discrimination against interstate commerce may be found based upon *either* discriminatory purpose *or* effect. When either is present, the burden shifts to the party *defending* the statute to prove that no other means is available to advance a legitimate local interest. *See* Parts 2-3, *supra*.

Second, the U.S. Supreme Court has repeatedly held that a challenger is *not* required to show the "extent" of effect on interstate commerce, or the volume of such commerce which is adversely affected by a discriminatory state law. *Bacchus Imports*, 468 U.S. at 269; *Wyoming v. Oklahoma*, 502 U.S. at 455-56. "It is well settled that '[we] need not know how unequal the Tax is before concluding that it unconstitutionally discriminates.'" *Bacchus Imports*, 468 U.S. at 269, quoting *Maryland v. Louisiana*, 451 U.S. 725, 760 (1981). No such "particularized showing is . . . required," because "there is no 'de minimis' defense to a charge of discriminatory taxation under the Commerce Clause." *Camps Newfound/Owatonna*, 117 S. Ct. at 1601 n.15. *See also West Lynn Creamery*, 512 U.S. at 196 n.12 ("For Commerce Clause purposes, it does not matter whether the challenged

regulation actually increases the market share of local producers or whether it merely mitigates a projected decline").

Third, the discriminatory effect on interstate commerce of the stranded cost subsidy of in-state utilities is at least as obvious as the one held invalid in *West Lynn Creamery*. The disciminatory effect on interstate commerce of giving PECO a *multi-billion dollar* stranded cost subsidy must be held patently and undeniably unconstitutional, as a matter of law. The Supreme Court has held that it makes no difference under the Commerce Clause whether a discriminatory state statute results in "total elimination" of competition or merely places out-of-state producers at a "substantial commercial disadvantage." *New Energy*, 486 U.S. at 275.

Finally, even if further proof of discriminatory effect were required -- and under the U.S. Supreme Court's decisions it is not -- the record here is filled with evidence. For example, IPL's witness Brehm testified that:

> [A]s the electric utility industry transitions to competition, the issues of unfair, subsidized competition are presented. In PECO's case, it is clearly presented by the current request to securitize approximately $3.6 billion of so-called stranded cost.
>
> In this case, PECO's request is based upon an assertion that PECO is due payment, up front, for all past and future "costs" PECO alleges it has or may incur by operating its existing generation in a competitive market, which "costs" may not be received in the future by PECO under hypothetical future market prices for power. Notably the hypothetical future market price postulated by PECO is currently below the long-run marginal cost (LRMC) of producing power to the grid.

> Granting PECO's request would, of course, represent a gigantic subsidy for PECO in a competitive environment, even if PECO's calculation of past and future "cost" and future market prices were correct, which they are not. Other competitors like IPL, based outside of Pennsylvania, would not receive these subsidies. To the extent the Commission subsidizes the capital and operating costs of PECO units, PECO is thereby afforded the opportunity to sell power at prices well below PECO's cost, and substantially below LRMC, thus harming both its out-of-state competitors and competition itself. Such subsidies represent barriers to entry to non-subsidized, out-of-state competitors.
>
> In essence, PECO seeks recovery of all of its generation asset costs up front, *and* the right to keep title to those assets *and* the ability to compete with those assets. Even for efficient companies like IPL, which own generation facilities with relatively low sunk costs and low operating costs, the effects of subsidies like those requested by PECO will be devastating in a competitive environment. The subsidies to PECO and presumably other Pennsylvania companies will drive the value out of non-subsidized generation assets and will produce subsidized, distorted power markets.

Brehm Direct Testimony at 4-5. *See also* Brehm Direct Testimony at 5-6, 7-11, 14; Tr. 1450-52.

Similarly with respect to PECO's securitization request, witnesses Bradford and Silkman testified:

> . . . PECO will enter the competition marketplace for electricity in a financially much healthier condition and thus able to compete more effectively. While other entities may be facing writeoffs of varying amounts to succeed in this new marketplace, PECO will have achieved the same outcome without incurring any financial penalties.

Bradford/Silkman Direct Testimony at 29. PECO's Treasurer J. Barry Mitchell conceded as much when he stated that stranded cost recovery would improve "PECO Energy's general financial health" and "promote the move to competition . . . ." Mitchell Direct Testimony at 27.

PECO's witness Hieronymus did present rebuttal testimony in PECO's initial securitization proceeding that stranded cost recovery would not affect competition -- on the theory that, with or without stranded cost recovery, PECO and other Pennsylvania utilities would charge the market price for electric generation and that "predatory pricing" is "unlikely" in this market. Hieronymus Rebuttal at 2-7. To accept PECO's contention that stranded cost recovery would not affect its competitive position, however, one would have to believe that PECO's competitive position will be identical with billions of dollars in cash than it would be without these subsidies. Such a conclusion is beyond all reason, as well as contrary to the record. Even PECO's Treasurer Mitchell admitted that PECO's proposal was intended to provide competitive advantages which would not otherwise exist:

> To the extent that the Transition Bonds have been issued, the risk associated with the recovery of stranded cost will be reduced considerably. As a result, the Company expects to be viewed more favorably *because of its perceived ability to successfully operate in a competitive market.*

Bradford/Silkman Direct Testimony at 29, quoting Mitchell's response to CEPA-I-22 (emphasis added).

Hieronymus' views are also directly repudiated by the U.S. Supreme Court's conclusion in *West Lynn Creamery* that the subsidy of high cost in-state producers discriminatorily affects interstate commerce and out-of-state competitors -- regardless whether the out-of-state producers "retain their market share by lowering their prices" or, instead, "local goods [are caused] to constitute a larger share . . . of the total sales in the market." 512 U.S. at 195, 196.

The ability of incumbents to use stranded cost recovery as a means to exclude new entrants was recently described in Teichler, *Generation, Deregulation, and Market Power: Will Antitrust Laws Fill The Void?*, 134 Pub. Util. Fortnightly, No. 19, p. 34 (Oct. 15, 1996):

> [T]he mechanisms for stranded-cost recovery may render utilities indifferent to contributions to capital cost and, in fact, provide an incentive to push prices in the competitive market as low as possible. Since utilities will be compensated for the difference between market price and embedded-cost rates, and since such recovery will be putatively guaranteed and may take the form of a lump sum based on a current spot-market price, utilities could achieve a triple whammy by adopting a bare-bones, marginal-cost pricing strategy: 1) eliminate competitors with high variable cost, 2) maximize recovery of fixed cost through stranded-cost recovery, and 3) create a stranded-cost amount sufficiently large to discourage existing customers from leaving the system. This course of action would not only skew the competitive market terribly, but would significantly drive up aggregate stranded costs, thus delaying the projected benefits of competition to most consumers.

Id. at 40-41. IPL's witness Brehm also testified that "granting PECO's request will unreasonably impair commerce, competition and entry by out-of-state suppliers." Brehm Direct Testimony at 14.

As Brehm stated: "The receipt of such a subsidy in one venue when you know those costs have already been covered enable you to price below cost in another venue." Tr. 1452.

Nor is the anti-competitive effect of PECO's stranded cost recovery proposal any less when the recoveries will be used to secure transition bonds and the proceeds of the bond issue used to pay debt and buy stock. PECO's Treasurer Mitchell agreed that "at the end of the day, when the securities are issued, the cash proceeds go to PECO." Tr. at 1085. He said that the securitization would result in "improvements to PECO Energy's general financial health," Mitchell Direct Testimony at 27, and should cause PECO to be viewed more favorably by investors "because of its perceived ability to successfully operate in a competitive market," Bradford/Silkman Direct Testimony at 29 (quoting Mitchell's response to CEPA-I-22). *See also* PECO Witness Hiller Direct Testimony at 8 (securitization will "free up significant amounts of [PECO's] equity capital and . . . access lower-cost sources of debt capital"); Mitchell Direct Testimony at 12 ("announcement of a common stock repurchase program [with transition bond proceeds] would be expected to cause an increase in [PECO's] stock price").

(b) Act "Bring[s] Competition" To Pennsylvania.

Also wrong is the Commission's suggestion in the Initial Securitization Order that, because the Electricity Generation Act opens the Pennsylvania generation market to competition, the Act is therefore shielded from Commerce Clause scrutiny. It is the stranded cost provisions, not the entire

Act, that are challenged as violating the Commerce Clause.[5] Moreover, it may be assumed *arguendo* for present purposes that Pennsylvania is not required to open the generation market to competition, but rather would be free to continue a system of territorial utility monopolies.[6] It does not follow that Pennsylvania may therefore "open" the generation market to competition on any terms and conditions it wishes, including discriminatory preferences for in-state producers. Quite the contrary.

In invalidating on Commerce Clause grounds the ordinance in *C&A Carbone*, for example, the Supreme Court expressly held that "having elected to use the open market to earn revenues for its project, the town may not employ discriminatory regulation to give that project an advantage over rival businesses from out of State." 511 U.S. at 394. *See also Atlantic Coast Demolition*, 112 F.3d at 667. Similarly, although a State has "undisputed power to tax" and grant or refuse tax exemptions, it nevertheless may not do so in ways that discriminate against interstate commerce. *See West Lynn Creamery*, 512 U.S. at 201. These are just particular applications of the doctrine of "unconstitutional conditions." Even where a State has undoubted power to decide whether to take a particular action or grant a particular benefit (and may therefore elect not to do so), it nevertheless may *not* chose to condition the action or benefit in ways that violate constitutional provisions. As the U.S. Supreme Court held long ago:

---

[5]The issue of severability is addressed in Section III(C), *infra*.

[6]That assumption itself is highly questionable, given the General Assembly's findings that due to technological changes and Federal action in the wholesale market, electric generation is no longer a "natural monopoly." *See Atlantic Coast Demolition*, 48 F.3d at 713-15 (indicating that "public utility" justification for monopolies does not survive Commerce Clause scrutiny outside the natural monopoly context); *cf. C&A Carbone*, 511 U.S. at 391, 392 (invalidating under Commerce Clause ordinance giving monopoly to single local business).

> It is not necessary to challenge the proposition that, as a general rule, the state, having power to deny a privilege altogether, may grant it upon such conditions as it sees fit to impose. But the power of the state in that respect is not unlimited; and one of the limitations is that it may not impose conditions which require the relinquishment of constitutional rights. If the state may compel the surrender of one constitutional right as a condition of its favor, it may, in like manner, compel a surrender of all. It is inconceivable that guaranties embedded in the Constitution of the United States may thus be manipulated out of existence.

Frost & Frost Trucking Co. v. Railroad Comm'n of California, 271 U.S. 583, 593-94 (1926).[7] Accordingly, whether or not Pennsylvania has unfettered discretion whether to open the electric generation market to competition, it is not free to do so in a way that discriminates against out-of-state competitors and violates standard Commerce Clause principles.

5. The Stranded Cost Provisions Also Violate The Commerce Clause By Imposing A Burden On Interstate Commerce That Is Clearly Excessive In Relation To Putative Local Benefits.

In the second tier of the Commerce Clause analysis, if the challenged statute regulates evenhandedly with only "incidental" effects on interstate commerce, a balancing test is applied, rather than strict scrutiny. *Empire Sanitary Landfill*, 684 A.2d at 1055. Even if the Electricity Generation

---

[7]The prohibition on "unconstitutional conditions" has been applied in a wide variety of constitutional contexts. *See, e.g., Board of County Comm'rs v. Umbehr*, ___ U.S. ___, 116 S. Ct. 2342, 2347 (1996) (First Amendment rights); *Dolan v. City of Tigard*, 512 U.S. 374, 385 (1994) (Fifth Amendment property rights); *Gomillion v. Lightfoot*, 364 U.S. 339, 347 (1960) (voting rights); *Western Union Tel. Co. v. Kansas ex rel. Coleman*, 216 U.S. 1, 34-37 (1910) (Commerce Clause rights); *see also Dennis v. Higgins*, 498 U.S. 439, 447-50 (1991) (Commerce Clause confers constitutional rights); *United States v. Chicago, M., S. P. & P. R.R.*, 282 U.S. 311, 327-29 (1931) ("the exercise of a privilege granted by the state cannot be made to depend upon the grantee's submission to a condition prescribed by the state which is hostile to the provisions of the federal Constitution" -- same rule applies to Congress' exercise of power under the Commerce Clause).

Act did not on its face or in its purpose or effect discriminate against interstate commerce, the stranded cost provisions would still violate the Commerce Clause because they impose an excessive burden on interstate commerce in relation to the local benefits.

The balancing test applied by the Pennsylvania Supreme Court in *Empire Sanitary Landfill* was first enunciated in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970). The *Pike* balancing test requires a determination whether the burden imposed on interstate commerce is "clearly excessive in relation to the putative local benefits." 397 U.S. at 142. In making this assessment, a court must consider "the nature of the local interest" and "whether [that local interest] could be promoted as well with a lesser impact on interstate activities." *Id.*

In *Empire Sanitary Landfill*, the Pennsylvania Supreme Court held that, as applied, a Pennsylvania county's flow control ordinance, which was based on statutory authority and agency policy, burdened interstate commerce by precluding the transportation of county-generated waste to out-of-state facilities. 684 A.2d at 1056. The Court determined that the burdens from the application of the relevant statute and administrative policies fell "more heavily on out-of-county facilities," and did not place out-of-state waste facilities on an "equal footing" with in-county facilities in competing for this commerce. *Id.* at 1057. Balancing these burdens against the local benefits of ensuring available landfill space, the Court held the County's flow control ordinance invalid. *Id.*

In the instant matter, the burden on interstate commerce is also excessive, and for similar reasons. As previously stated, the Electricity Generation Act permits the financing of stranded costs

of incumbent Pennsylvania utilities like PECO, and the recovery of those stranded costs from all Pennsylvania consumers. 66 Pa. C.S. §§ 2808, 2812. Out-of-state electricity suppliers are not placed on an "equal footing," but rather must compete with incumbent Pennsylvania utilities that have a portion of their fixed costs for plant, equipment and debt service paid by Pennsylvania consumers. The incumbent utilities can offer reduced prices since they will not have to include these fixed costs as an increment in the price offered to potential generation customers. Likewise, funds from the transition bonds can be used to offset current fixed costs and debt service costs, which will permit incumbent in-state utilities to offer lower prices.

Stranded cost recovery and securitization will provide PECO with advantages over out-of-state competitors. By carving out its uncompetitive generation costs and insulating them from competition, PECO would have a unique competitive position: It can earn a market return on its competitive generation assets and a guaranteed return of (and on) its uncompetitive assets. To be profitable, any business must recover its fixed costs. A utility that recovers its fixed costs through the intangible transition charge not subject to competition can sell electricity in the competitive market at prices that exclude recovery of fixed costs covered by the charge. In contrast, new entrants into the competitive market must recover all of their costs in that market.[8]

[8]The effects of securitization on interstate commerce are exacerbated by the non-price advantages PECO already has as the incumbent electricity supplier. Tr. 930-32. Furthermore, in competing to provide power, PECO also has the advantage of being the exclusive provider of transmission and distribution services to all customers. No other competitor has these advantages.

Any putative local benefit of providing stranded cost recovery "fails to outweigh [these] burdens on interstate commerce," which do not place out-of-state competitors "on an equal footing with [incumbent Pennsylvania utilities] in competition for" electric generation customers. *Empire Sanitary Landfill*, 684 A.2d at 1057. Local interests in providing stranded cost recovery especially do not outweigh the burdens on interstate commerce where, as here, any such local interests "could be promoted as well with a lesser impact on interstate activities." *Pike*, 397 U.S. at 142. As previously discussed, any such local benefits could be accomplished perfectly well, and with a lesser impact on interstate commerce, by requiring Pennsylvania utilities who want stranded cost recovery to divest their electric generation business.

The Electricity Generation Act, however, does not require divestiture. On the contrary, the Act provides that "[t]he commission may permit, but shall not require, an electric utility to divest itself of facilities or to reorganize its corporate structure." 66 Pa. C.S. § 2804(5). If the legislature's goal is to reimburse companies for generation assets which are worth less in a competitive market than what they cost, its goal could easily be accomplished by requiring those companies electing to receive stranded cost recoveries to withdraw from the generation business so that the recoveries cannot be used to subsidize their ability to compete with out-of-state generators like IPL. Since the Commonwealth's interests could be accomplished "with a lesser impact on interstate activities," the burdens imposed on interstate commerce are excessive. The stranded cost provisions of the Act are invalid for this reason as well.

6. The Supreme Court's Decision In *General Motors Corp. v. Tracy* Does Not Sanction The Discrimination Against Interstate Commerce Presented Here.

PECO argued in the initial securitization proceeding that the stranded cost provisions do not violate the Commerce Clause under *General Motors Corp. v. Tracy*, ___ U.S. ___, 117 S. Ct. 811 (1997). Such argument is wrong.

At issue in *Tracy* was Ohio's sales and use taxes, which generally applied to sales of all goods to Ohio residents. However, sales of natural gas by local distribution companies ("LDCs") were exempt from the tax. 117 S. Ct. at 816. The LDCs were regulated public utilities and provided monopoly service to most retail gas customers. However, Ohio permitted industrial customers to purchase "unbundled" gas from natural gas producers or independent marketers. *Id.* at 817.[9] Because LDCs were in-state companies, and because the sales by non-LDC sellers to industrial customers did not receive the tax exemption, the exemption was claimed to discriminate against out-of-state non-LDC sellers and therefore violate the Commerce Clause. *Id.* at 818-19.

In rejecting the Commerce Clause challenge, the Supreme Court reasoned that the LDCs and non-LDCs were not in competition for most of the retail market -- specifically, the LDCs provided regulated monopoly service to most customers. *Id.* at 824-26. Furthermore, while there apparently was some competition between LDCs and non-LDCs for unbundled gas sales to industrial customers, Commerce Clause precedent did not dictate a clear answer to this "dual market" situation. Because public utility regulation in the natural monopoly context had traditionally been upheld under the

[9]In other words, industrial customers could purchase the gas itself from these other sellers and buy only the transportation service from the LDC. 117 S. Ct. at 817.

Commerce Clause, and because Commerce Clause rules applicable to competitive markets might "imperil the delivery by regulated LDCs of bundled gas to the noncompetitive captive market,"[10] no Commerce Clause violation was found. *Id.* at 826-29.

The result in *Tracy* has no application here, for several reasons. First, no such "dual market" is involved. Under the Electricity Generation Act, *all* electric generation is to be "unbundled" and *all* retail customers are to be supplied by a competitive market. 66 Pa. C.S. §§ 2802(13)-(14), 2804(2), 2806(a)-(b). In a later case invalidating a discriminatory state tax exemption under the Commerce Clause, the Supreme Court reiterated that *Tracy* involved "'sellers of 'bundled' and 'unbundled' natural gas [who] were principally competing in different markets.'" *Camps Newfound/Owatonna*, 117 S. Ct. at 1602 n.16.

Second, even as to the limited competition in *Tracy* for industrial customers, the LDCs supplied gas pursuant to regulated tariffs and there was no *price* competition. The Supreme Court expressly stated that no Commerce Clause issue was decided where LDC sales were not "price-regulated . . . ." 117 S. Ct. at 823 n.11. Under the Electricity Generation Act, by contrast, there is no price regulation of the competitive generation market, and in-state and out-of-state suppliers must compete on price.

---

[10]As the Supreme Court had previously held in rejecting a Commerce Clause challenge to state retail gas regulation in the natural monopoly context, allowing competition for industrial customers would skim "'the cream of the volume business'" and "adversely [affect] . . . the LDCs' over-all cost of service and its rates to customers whose only source of supply is the LDC." 117 S. Ct. at 827, quoting *Panhandle Eastern Pipe Line Co. v. Michigan PSC*, 341 U.S. 329, 334 (1951).

Third, the basic rationale in *Tracy* was Ohio's interest in protecting "captive" gas customers for whom the monopoly LDC, regulated as a public utility, was the only source of supply. By contrast, the Pennsylvania legislature has determined that consumer interests in electric generation are best served by competition, not monopoly regulation. Under the Electricity Generation Act, therefore, there are to be no "captive" customers for generation; rather, "all customers of electric distribution companies in this Commonwealth shall have the opportunity to purchase electricity from their choice of electric generation suppliers." 66 Pa. C.S. § 2806(a).

Finally, the Supreme Court has made clear in a variety of contexts that state regulation of electric power is subject to Commerce Clause limitations, and that there is no general exemption from those principles even in the traditional public utility "natural monopoly" situation. *Wyoming v. Oklahoma*, 502 U.S. at 454-57 (invalidating state law requiring electric utilities to use at least 10% in-state coal); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 338-39 (1982) (invalidating state commission order reserving to in-state electric utility customers benefit of lower-cost hydroelectric power); *see also Arkansas Elec. Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 389-95 (1983) (holding that modern Commerce Clause standards apply to state regulation of electric utility companies).

B. Enron's Proposal.

The stranded cost recovery and securitization provisions of Enron's Proposal are invalid for the same reasons described above. Under Enron's Proposal, PECO would still retain its generation assets for use in the competitive generation market. In addition PECO would be given a $5.5 billion

cash subsidy which it can use in competition with out-of-state suppliers. Regardless of whether Enron itself has found a way to profit from anticipated excess recovery of the stranded costs, the stranded cost recovery and securitization aspects of Enron's Proposal are just as invalid as the corresponding provisions in the Partial Settlement.

C. The Unconstitutional Stranded Cost Provisions May Be Severed From The Remainder Of The Act.

The unconstitutionality of the stranded cost provisions under the Commerce Clause does not require that Pennsylvania consumers be deprived of the benefits of a competitive market for electric generation. The invalid stranded cost provisions are severable and the remainder of the Act may be upheld.

As an initial matter, "[t]he public policy of this Commonwealth favors severability." *Commonwealth, Dep't of Education v. First School*, 471 Pa. 471, 370 A.2d 702, 705 (1977). Moreover, the issue of severability is a matter of statutory construction and legislative intent. *Id.* at 706 n.16; *Grube v. Troncelliti*, 326 Pa. Super. 339, 473 A.2d 1379, 1381 (1984). Here, the Electricity Generation Act expressly provides that:

> The provisions of this act are severable. If any provision of this Act or its application to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of this act which can be given effect without the invalid provision or application.

Act 1996, Dec. 3, P.L. 802, No. 138, § 5; *see* 66 Pa. C.S.A. § 2801, Historical and Statutory Notes. Thus, "'the legislature has expressed its intention [by including a severability clause] . . . . While such an expression of legislative intent is not always conclusive, ordinarily it is but little short of a mandate.'" *Commonwealth, Dep't of Education*, 370 A.2d at 706 (citation omitted); *Grube*, 473 A.2d at 1382. *See also Snider v. Thornburgh*, 496 Pa. 159, 436 A.2d 593, 602 (1981) (legislative intent expressed in severability clause "must be given great weight").

The severability question thus becomes whether, in the words of the statute, the "other provisions . . . of the Act . . . can be given effect without the invalid [stranded cost] . . . provision[s] . . . ." The answer is "yes." The basic purpose of the Electricity Generation Act is to bring the benefits of electric generation competition to Pennsylvania consumers. The purpose to remove monopolistic barriers to competition in the electric industry and permit consumers to choose the provider of their electric power is accomplished regardless whether incumbent Pennsylvania electric utilities recover and securitize their stranded costs. The Act primarily focuses on protecting the interests of Pennsylvania consumers, whereas the stranded cost provisions focus solely on protecting the interests of incumbent private entities.[11]

Furthermore, the basic statutory scheme of the Act remains intact without the provisions for recovery and securitization of stranded costs. The other provisions of the Act can operate

---

[11]Indeed, as previously stated, the stranded cost provisions thwart effective competition and a consumer's right to choose. Rather than promoting competition, these provisions give an unfair advantage to incumbent Pennsylvania electric utilities and will curtail the benefits of competition in Pennsylvania.

independently of the unconstitutional stranded cost provisions. Removing monopolistic barriers to competition and permitting consumers to choose the provider of their electric service can occur without imposition of stranded cost charges. The provisions of the Act which provide for competition do not depend upon operation of the stranded cost provisions.

Thus, the situation is like that in *Equitable Life Ass. Society v. Murphy*, 153 Pa. Commw. 338, 621 A.2d 1078 (1993), where the Court found that the invalid exemption could "be severed without destroying Philadelphia's general legislative scheme regarding taxation of real estate transfers." 621 A.2d at 1089. Likewise here, the invalid stranded cost provisions can be severed "without destroying" -- indeed, without affecting at all -- the "general legislative scheme" for competition in the electric generation industry.

Finally, if the valid and invalid provisions of a statute "'are distinct and not so interwoven as to be inseparable . . . courts should sustain the valid portions.'" *Commonwealth, Dep't of Education*, 370 A.2d at 705 (citation omitted). Here, the invalid stranded cost provisions are "distinct" from the other provisions of the Act. The operative stranded cost provisions are contained in entirely separate sections of the Act. *See* 66 Pa. C.S. §§ 2808, 2812. Other, "definitional" and "standards," provisions relating to stranded costs are contained in distinct subsections. *See* 66 Pa. C.S. §§ 2802(15), 2803

(definitions of "Competitive transition charge" and "Transition or stranded costs"), 2804(13)-(14).[12]

Thus, as in *Commonwealth, Dep't of Education* and *Equitable Life Ass. Society*, severing the invalid stranded cost provisions does not require the Commission or a court to "engage in 'judicial legislation' by drafting words" to add to the Act, 370 A.2d at 707 n.23, or to "insert[] any clause" into the Act, 621 A.2d at 1090. Rather, and as *Equitable Life*, the invalid stranded cost provisions need only be "delete[d]" so "that the [Act can] pass constitutional muster." 621 A.2d at 1090.

In sum, although the stranded cost provisions are unconstitutional, those invalid portions may be severed from the remainder of the Act consistent with the intent of the General Assembly of Pennsylvania as expressed in the Act's severability provision.

IV. CONCLUSION

For the foregoing reasons, the stranded cost recovery and securitization provisions of the Partial Settlement and Enron's Proposal should be rejected as violative of the Commerce Clause of the U.S. Constitution. This determination should not prevent the Commission from moving forward with implementation of the remaining provisions of the Electricity Generation Act.

---

[12]In a few instances, references are made to stranded cost recovery in subsections addressing other matters. *See, e.g.*, 66 § 2806(e) ("proposed competitive transition charge"). However, as held in *Commonwealth v. Liquor Seized in Route 15, Adams County*, 46 Pa. Commw. 490, 407 A.2d 83 (1979), "the fact that an unconstitutional provision is found within an otherwise valid paragraph does not prevent its being severed." 407 A.2d at 85 n.4. *Accord, Equitable Life Ass. Society*, 621 A.2d at 1090 (unconstitutional "portion of [a] provision" may be severed).

Respectfully submitted,

Michael G. Banta, Esquire
INDIANAPOLIS POWER & LIGHT COMPANY
One Monument Circle
P.O. Box 1595
Indianapolis, Indiana 46206-1595
Telephone: (317) 261-8449

Walter W. Cohen
Penn. Attorney No. 12097
Andrew J. Giorgione, Esquire
Penn. Attorney No. 66276
OBERMAYER REBMANN MAXWELL
& HIPPEL LLP
204 State Street
Harrisburg, Pennsylvania 17101
Telephone: (717) 221-7920

Daniel W. McGill, Esquire
BARNES & THORNBURG
11 South Meridian Street
Indianapolis, Indiana 46204
Telephone: (317) 236-1313

Attorneys for Petitioner Indianapolis
Power & Light Company

INDS01 DWM 232035

CERTIFICATE OF SERVICE

I hereby certify that I have this 1st day of December, 1997, served copies of the foregoing document upon the persons addressed below, in the manner indicated:

Via Hand Delivery (2 copies and one diskette)

John M. Quain, Chairman
Pennsylvania Public Utility Commision
North Office Building, Room 104
Harrisburg, PA 17120

Robert K. Bloom, Vice Chairman
Pennsylvania Public Utility Commission
North Office Building, Room 112
Harrisburg, PA 17120

John Hanger, Commissioner
Pennsylvania Public Utility Commission
North Office Building, Room 116
Harrisburg, PA 17120

David W. Rolka, Commissioner
Pennsylvania Public Utility Commission
North Office Building, Room 110
Harrisburg, PA 17120

Nora Mead Brownell, Commissioner
Pennsylvania Public Utility Commission
North Office Building, Room 107
Harrisburg, PA 17120

Kenneth L. Mickens, Esquire
Charles D. Shields, Esquire
Pennsylvania Public Utility Commission
Office of Trial Staff
901 North 7th Street, 3rd Floor Rear
Harrisburg, PA 17120

Cheryl Davis, Director
Office of Special Assistants
Pennsylvania Public Utility Commission
North Office Building, Room 210
Harrisburg, PA 17120

Via Hand Delivery

Tanya McCloskey, Esquire
Steven K. Steinmetz, Esquire
Assistant Consumer Advocate
Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120

Linda C. Smith, Esquire
Dilworth, Paxson, Kalish & Kauffman
305 N. Front Street, Suite 403
Harrisburg, PA 17101-1236
(Counsel for AARP)

Karen Oill Moury, Esquire
Bernard A. Ryan, Esquire
Assistant Small Business Advocate
Commerce Building, Suite 1102
300 N. 2nd Street
Harrisburg, PA 17101

Christopher B. Craig, Esquire
Democratic Committee on Appropriations
Room 545, Main Capitol Building
Harrisburg, PA 17120
(Counsel for The Honorable Vincent J. Fumo)

Daniel Clearfield, Esquire
Alan Kohler, Esquire
Wolf, Block, Schorr and Solis-Cohen
305 N. Front Street, Suite 401
Harrisburg, PA 17101
(Counsel for Enron)

Robert A. Mills, Esquire
Pennsylvania Retailers' Association
McNees, Wallace & Nurick
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166

Terence Fitzpatrick, Esquire
David DeSalle, Esquire
Ryan, Russell, Ogden & Seltzer
800 North Third Street, Suite 101
Harrisburg, PA 17102
(Counsel for GPU Energy)

John Gallagher, Esquire
Michael Klein, Esquire
Zsuzsanna E. Benedek, Esquire
LeBoeuf, Lamb, Greene and MacRae, LLP
200 North Third Street
Suite 300
Harrisburg, PA 17108-2105
(Counsel for Enron)

David Kleppinger, Esquire
Derrick P. Williamson, Esquire
McNees, Wallace & Nurick
100 Pine Street
Harrisburg, PA 17108-1166
(Counsel for PAIEUG)

Joseph J. Malatesta, Jr., Esquire
Lillian Smith Harris, Esquire
Municipal Intervenors Group
Malatesta Hawke & McKeon LLP
P.O. Box 1778
Harrisburg, PA 17105

Craig A. Doll, Esquire
214 State Street
Harrisburg, PA 17101
(Counsel for Delmarva Power & Light)

William T. Hawke, Esquire
Janet Miller, Esquire
Malatesta Hawke & McKeon LLP
100 N. Tenth Street
Harrisburg, PA 17105
(Counsel for Mid-Atlantic Power Supply Association)

Via U.S.Mail

Honorable Marlane R. Chestnut
Administrative Law Judge
1302 Philadelphia State Office Building
1400 West Spring Garden Street
Philadelphia, PA 19130

Honorable Charles E. Rainey, Jr.
Administrative Law Judge
1302 Philadelphia State Office Building
1400 West Spring Garden Street
Philadelphia, PA 19130

John Klauberg, Esquire
Bruce Miller, Esquire
LeBoeuf, Lamb, Greene and MacRae, LLP
125 West 55th Street
New York, NY 10019-5389
(Counsel for Enron)

Paul R. Bonney
Noel H. Trask, Esquire
Ward L. Smith
Assistant General Counsel
PECO Energy Company
2301 Market Street, S23-1
Philadelphia, PA 19103

Paul Russell, Esquire
Pennsylvania Power & Light Company
Two North Ninth Street
Allentown, PA 18101
(Counsel for PP&L)

Steven P. Hershey, Esquire
Community Legal Services, Inc.
1424 Chestnut Street
Philadelphia, PA 19102
(Counsel for CEPA, TAG, Action Alliance of Sr. Citizens & John Long, Jr.)

Randall V. Griffin, Esquire
Delmarva Power & Light Company
800 King Street
Wilmington, DE 19899
(Counsel for Delmarva Power & Light)

David Boonin
President, Mid-Atlantic
New Energy Ventures
1845 Walnut Street, Suite 2525
Philadelphia, PA 19103

John L. Munsch, Esquire
Allegheny Power
800 Cabin Hill Drive
Greensburg, PA 15601

Gerald Gornish, Esquire
Wolf, Block, Schorr and Solis-Cohen
12th Floor, Packard Building
Southeast Corner
15th and Chestnut Streets
Philadelphia, PA 19102

H. Allan Knopp
Director, Regulatory Affairs
DuPont Power Marketing Inc.
P.O. Box 2197, CH-1038
Houston, TX 77252

Donald A. Kaplan, Esquire
Lisa M. Helpert, Esquire
Pennsylvania Power & Light
1735 New York Avenue, NW
Suite 500
Washington, DC 20006-4759
(Counsel for PP&L)

Roger Clark, Esquire
Environmentalists
905 Denston Drive
Ambler, PA 19002-3901

Joel D. Newton, Esquire
Paul E. Nordstrom
Verner, Liipfert, Bernhard, McPherson & Hand
901 15th Street, NW
Washington, DC 20005-2301

Alan J. Barak, Esquire
Attorney for Environmentalists
Widener University Law School
3700 Vartan Way
Harrisburg, PA 17110

Joseph A. Dworetzky, Esquire
John P. Lavelle, Jr. Esquire
Hangley Aronchick Segal & Pudlin
One Logan Square
12th Floor
Philadelphia, PA 19103
(Counsel for New Energy Ventures)

Audrey Van Dyke, Esquire
Naval Facilities Engineering Command
Washington Navy Yard
Building 218, Room 200
901 M Street, S.E.
Washington, DC 20374-5018

Gary A. Jeffries, Esquire
CNG Energy Services Corporation
One Park Ridge Center
P.O. Box 15746
Pittsburgh, PA 15244-0746

Usher Fogel, Esquire
Pennsylvania Petroleum Association
Roland, Fogel, Koblenz & Carr, LLP
1 Columbia Place
Albany, NY 12207

Paul L. Ziegler, Esquire
Delaware Valley Schools Energy/Utility Consortium
Ziegler & Zimmerman, PC
355 North 21st Street, Suite 304
P.O. Box 1080
Camp Hill, PA 17011-3707

Lance Haver
6048 Ogontz Avenue
Philadelphia, PA 19141

Gordon Smith, Esquire
Duke Energy Trading & Marketing LLC
John & Hengerer
1200 17th Street, N.W. Suite 600
Washington, DC 20036-3006

Vickiren S. Aeschleman, Esquire
QST Energy, Inc.
Duane, Morris & Heckscher, LLP
1667 K Street N.W., Suite 700
Washington, DC 20006-1608

OBERMAYER REBMANN MAXWELL & HIPPEL LLP

Walter W. Cohen, Esquire