6466 Letter

The State of South Carolina
OFFICE OF THE ATTORNEY GENERAL

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ATTORNEY GENERAL

April 17, 1998

The Honorable Harry F. Cato
Member, House of Representatives
407 Blatt Building
Columbia, South Carolina 29211

The Honorable Rebecca D. Meacham
Member, House of Representatives
519B Blatt Building
Columbia, South Carolina 29211

Dear Representative Cato and Representative Meacham:

You have asked for an opinion regarding the use of a requirement of reciprocity in H.3414, also designated as the "South Carolina Competitive Power Act." Specifically, you wish to know whether reciprocity is "legal and can be implemented and enforced." Your particular concern is the effect of the reciprocity provisions "on interstate commerce, intrastate transactions and tax laws."

Law / Analysis

Explanation of H.3414

H.3414 seeks to amend Title 58 of the Code of Laws of South Carolina, 1976 relating to Public Utilities, Services and Carriers by adding Chapter 28 so as to enact the "South Carolina Competitive Power Act." The Bill requires, among other things, that the Public Service Commission adopt a plan for restructuring the electric utility industry; further, electric utilities would be required to file with the Public Service Commission a restructuring plan providing for customer choice; the Bill also enables all retail customers to be permitted to choose their providers of electric generation services by a certain date.

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In addition, the Bill provides, inter alia, that local utilities shall be relieved of the traditional obligation to serve, but shall have an obligation to connect all customers within their service area on nondiscriminatory terms and conditions. An "electric generation supplier" or "electricity supplier" is defined by § 58-28-30(8) to mean

> ... a person or corporation, including municipal corporations which choose to provide service outside the municipal limits except to the extent provided before the effective date of this chapter, brokers and marketers, aggregators, or any other entities, that sell to customers electricity or related services utilizing the jurisdictional transmission or distribution facilities of an electric distribution company or that purchases, brokers, arranges, or markets electricity or related services for sale to end-use customers utilizing the jurisdictional transmission and distribution facilities of an electric distribution company. The term excludes building or facility owners or operators that manage the internal distribution system serving the building or facility that supplies electric power and other related power services to occupants of the building or facility.

Subsection (7) of § 58-28-30 defines an "electric distribution company" as "... the public utility providing facilities for the jurisdictional transmission and distribution of electricity to customers, except building or facility owners or operators that manage the internal distribution serving the building or facility and that supply electric power and other related electric power services to occupants of the building or facility."

The Bill contains several reciprocity provisions. Section 58-28-80 (B)(5) provides:

> [c]ompetition among electricity suppliers and buyers must be fair, nondiscriminatory, and consistent. In order to ensure a level playing field, all competitors shall be subject to the same legal, regulatory, and tax treatments in the future. Subsidies and disparate regulations or legal requirements that favor certain competitors or disadvantage others shall be eliminated by the Commission. While this process immediately does not compel municipal utilities, electric member cooperatives, and state public service to participate in customer choice, they are encouraged to do so. Consequently, no competitor must be

> allowed access to a utility's customers unless comparable and reciprocal access is provided to that competitor's customers.

In addition, § 58-28-90 (C) states that

> [t]he commission shall establish by regulation, and consistent with federal law, standards, and conditions for the exchange of reciprocal rights for transmission and distribution access between corporations located within this State and those located outside the State. Corporations located outside South Carolina may not be an electricity supplier within the State unless the electric distribution company serving that customer has the reciprocal right, whether exercised or not, by statute, regulation, or voluntary tariff of the out-of-state corporation to serve a customer of the out-of-state corporation, if any.

Moreover, § 58-28-100 further provides that

> [u]pon the effective date of this chapter, all intrastate owners and operators of transmission and distribution facilities shall have comparable and reciprocal access to the transmission and distribution customers of other transmission and distribution facility owners and operators, for the purpose of providing generation services to the customers, subject to Section 58-28-150. This section does not impede any transactions involving interstate commerce.

Presumption of Validity

Of course, in considering the constitutionality of an act of the General Assembly, such Act is presumed to be constitutional in all respects. Moreover, the Act will not be considered void unless its constitutionality is clear beyond any reasonable doubt. Thomas v. Macklen, 186 S.C. 290, 195 S.E. 539 (1937); Townsend v. Richland County, 190 S.C. 270, 2 S.E.2d 777 (1939). All doubts of constitutionality are generally resolved in favor of constitutionality. While this Office may comment upon potential constitutional problems, it is solely within the province of the courts of this State to declare the Act unconstitutional. Thus, if the General Assembly were to enact H.3414, all aspects of the Act, **including the foregoing reciprocity provisions**, would be presumed valid and would be enforceable until set aside by a court.

Dormant Commerce Clause Analysis

The so-called "dormant Commerce Clause" of the United States Constitution [Art. I § 8, Cl. 3] "... directly limits the power of the States to discriminate against interstate commerce." New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 108 S.Ct. 1803, 100 L.Ed.2d 302 (1988). This "'negative' aspect of the Commerce Clause prohibits economic protectionism -- that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors. Id. at 272, citing Bacchus Imports Ltd. v. Dias, 468 U.S. 263, 270-273, 104 S.Ct. 3049, 3054-3056, 82 L.Ed.2d 200 (1984) et al. As the Court stated in Limbach,

> ... state statutes that clearly discriminate against interstate commerce are routinely struck down, see, e.g., Sporhase v. Nebraska ex rel. Douglas, 458 U.S. 941, 102 S.Ct. 3456, 73 L.Ed.2d 1254 (1982); Lewis v. B T Investment Managers, Inc., 447 U.S. 27, 100 S.Ct. 2009, 64 L.Ed.2d 702 (1980); Dean Milk Co. v. Madison, 340 U.S. 349, 71 S.Ct. 295, 95 L.Ed. 329 (1951), unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism, see, e.g., Maine v. Taylor, 477 U.S. 131, 106 S.Ct. 2440, 91 L.Ed.2d 110 (1986).

And, as expressed by the Court recently in General Motors Corporation v. Tracy, ___ U.S. ___, 117 S.Ct. 811, 136 L.Ed.2d 761 (1997),

> [t]he negative or dormant implication of the Commerce Clause prohibits state taxation, see, e.g., Quill Corp. v. North Dakota, 504 U.S. 298, 312-313, 119 L.Ed.2d 91, 112 S.Ct. 1904 (1992), or regulation, see, e.g., Brown-Forman Distillers Corp. v. New York State Liquor Authority, 476 U.S. 573, 578-579, 90 L.Ed.2d 552, 106 S.Ct. 2080 (1986), that discriminates against or unduly burdens interstate commerce and thereby "impedes free private trade in the national marketplace," Reeves, Inc. v. Stake, 447 U.S. 429, 437, 65 L.Ed.2d 244, 100 S.Ct. 2271 (1980).

The Supreme Court has recognized various levels of scrutiny which must be applied to particular State statutes and regulations under the dormant Commerce Clause. For purposes of determining whether there has been an unconstitutional burden placed upon

interstate commerce, the Court has identified two main tests for ascertaining whether a state regulatory scheme which is challenged as placing an impermissible burden upon interstate commerce is constitutional. The line as to where one test ends and the other begins is not altogether clear, however. The following statement by four members of the Court in Camps Newfound/Owatonna v. Town of Harrison, ___ U.S. ___, 117 S.Ct. 1590, 137 L.Ed.2d 852 (1996) sets forth the tests employed by the Court and, in addition, discusses their difficulty in application.

> [o]ur cases have struggled (to put it nicely) to develop a set of rules by which we may preserve a national market without needlessly intruding upon the State's police powers, each exercise of which no doubt has some effect on the commerce of the Nation. See Oklahoma Tax Comm. v. Jefferson Lines, Inc., 514 U.S. 175, 180-183, 131 L.Ed.2d 261, 115 S.Ct. 1331 (1995). The rules that we currently use can be simply stated, if not simply applied: Where a state law facially discriminates against interstate commerce, we observe what has been referred to as a "virtually per se rule of invalidity;" where, on the other hand, a state law is nondiscriminatory, but nonetheless adversely affects interstate commerce, we employ a deferential "balancing test," under which the law will be sustained unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits," Pike v. Bruce Church, Inc., 397 U.S. 137, 142, 25 L.Ed.2d 174, 90 S.Ct. 844 (1970). See Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore. , 511 U.S. 93, 99, 128 L.Ed.2d 13, 114 S.Ct. 1345 (1994).
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> While the "virtually per se rule of invalidity" entails application of the "strictest scrutiny," Hughes v. Oklahoma, 441 U.S. 322, 337, 60 L.Ed.2d 250, 99 S.Ct. 1727 (1979), **it does not necessarily result in the invalidation of facially discriminatory State legislation**, see e.g. Maine v. Taylor, 477 U.S. 131, 91 L.Ed.2d 110, 106 S.Ct. 2440 (1986) (upholding absolute ban on the importation of baitfish into Maine), for "what may appear to be a 'discriminatory' provision in the constitutionally prohibited sense -- that is, a protectionist enactment -- may on closer analysis not be so." New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278, 100

> L.Ed.2d 302, 108 S.Ct. 1803 (1988). **Thus, even a statute that erects an absolute barrier to the movement of goods across state lines will be upheld if "the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism,"** id. at 274, or to put a finer point on it, if the State law "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives," id., at 278.
>
> In addition to laws that employ suspect means as a necessary expedient to the advancement of legitimate State ends, we have also preserved from judicial invalidation laws that confer advantages upon the State's residents but do so without regulating interstate commerce. We have therefore excepted the State from scrutiny when it participates in markets rather than regulates them -- by selling cement, for example, see Reeves, Inc. v. Stake, 447 U.S. 429, 65 L.Ed.2d 244, 100 S.Ct. 2271 (1980), or purchasing auto hulks, see Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 49 L.Ed.2d 220, 96 S.Ct. 2488 (1976), or hiring contractors, see White v. Massachusetts Council of Construction Employers, 460 U.S. 204, 75 L.Ed.2d 1, 103 S.Ct. 1042 (1983). Likewise, we have said that direct subsidies to domestic industry do not run afoul of the Commerce Clause. See New Energy Co, 486 U.S. at 278. In sum, we have declared that "the Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description in connection with the State's regulation of interstate commerce." Ibid ....

117 S.Ct. 1608-1609 (Justice Scalia, the Chief Justice, Justice Thomas and Justice Ginsburg, dissenting). (emphasis added).

The Court, applying the foregoing analysis, has carefully scrutinized so-called interstate "reciprocity" requirements which are contained in state statutes and regulations. See, New Energy Co., supra; Sporhase v. Nebraska, 458 U.S. 941, 102 S.Ct. 3456, 73 L.Ed.2d 1254 (1982). In the Limbach case, an Ohio statute awarded a tax credit against Ohio motor vehicle fuel tax for each gallon of ethanol by fuel dealers but only if ethanol was produced in Ohio or in a state granting similar tax advantages to ethanol produced

in Ohio. The Court, in declaring the statute to be violative of the Commerce Clause, analyzed the Ohio law as follows:

> [t]he Ohio provision at issue here explicitly deprives certain products of generally available beneficial tax treatment because they are made in certain other States, and thus on its face appears to violate the cardinal requirement of nondiscrimination. Appellees argue, however, that the availability of the tax credit to some out-of-state manufacturers (those in States that give tax advantages to Ohio-produced ethanol) shows that the Ohio provision, far from discriminating against interstate commerce, is likely to promote it, by encouraging other States to enact similar tax advantages that will spur the interstate sale of ethanol. We rejected a similar contention in an earlier "reciprocity" case. Great Atlantic & Pacific Tea Co. v. Cottrell, 424 U.S. 366, 96 S.Ct. 923, 47 L.Ed.2d 55 (1976). The regulation at issue there permitted milk from out of State of origin sold in Mississippi only if the State of origin adopted Mississippi milk on a reciprocal basis. Mississippi put forward, among other arguments, the assertion that "the reciprocity requirement is in effect a free-trade provision, advancing the identical national interest that is served by the Commerce Clause." Id. at 378, 96 S.Ct. at 932. In response, we said that "Mississippi may not use the threat of economic isolation as a weapon to force sister States to enter into even a desirable reciprocity agreement." Id., at 379, 96 S.Ct. at 932. More recently, we characterized a Nebraska reciprocity requirement for the export of ground water from the State as "facially discriminatory legislation" which merited "'strictest scrutiny.'" Sporhase v. Nebraska ex rel. Douglas, supra, 458 U.S. at 958, 102 S.Ct. at 3456, quoting Hughes v. Oklahoma, supra, 441 U.S., at 337, 99 S.Ct., at 1736.
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> It is true that in Cottrell and Sporhase the effect of a state's refusal to accept the offered reciprocity was total elimination of all transport of the subject product into or out of the offering State; whereas in the present case the only effect of refusal is that of the out-of-state product is placed at

a substantial commercial disadvantage through discriminatory tax treatment. That makes no difference for purposes of Commerce Clause analysis. In the leading case of Baldwin v. G. A. F. Seelig, Inc., 294 U.S. 511, 55 S.Ct. 497, 79 L.Ed. 1032 (1935), the New York law excluding out-of-state milk did not impose an absolute ban, but rather allowed importation and sale so long as the initial purchase from the dairy farmer was made at or above the New York State-mandated price. In other words, just as the appellant here, in order to sell its product in Ohio ... only has to cut its profits by reducing its sales price below the market price sufficiently to compensate the Ohio purchaser-retailer for the forgone tax credit, so also the milk wholesaler-distributor in Baldwin, in order to sell its product in New York, only had to increase its purchase price above the market price sufficiently to meet the New York-prescribed minimum. We viewed the New York law as "an economic barrier against competition" that was "equivalent to a rampart of customs duties." Id., at 527, 55 S.Ct. at 502. Similarly, in Hunt v. Washington Apple Advertising Comm'n, 432 U.S. 333, 349-351, 97 S.Ct. 2434, 2444-2445, 53 L.Ed.2d 383 (1977), we found invalid under the Commerce Clause a North Carolina statute that did not exclude apples from other states, but merely imposed additional costs upon Washington sellers and deprived them of the commercial advantage of their distinctive grading system. The present law likewise imposes an economic disadvantage upon out-of-state sellers; and the promise to remove that if reciprocity is accepted no more justifies disparity of treatment than it would justify categorical exclusion. **We have indicated that reciprocity requirements are not per se unlawful**. See Cottrell, supra, 424 U.S., at 378, 96 S.Ct., at 931. But the case we cited for that proposition, Kane v. New Jersey, 242 U.S. 160, 167-168, 37 S.Ct. 30, 31-32, 61 L.Ed. 222 (1916), discussed a context in which, if a State offered the reciprocity did not accept it, the consequence was to be sure, less favored treatment for its citizens, but nonetheless treatment that complied with the minimum requirements of the Commerce Clause. Here, quite to the contrary, the threat used to induce Indiana's acceptance is, in effect, taxing a product made by its manufacturers at a

> rate higher than the same product made by Ohio manufacturers, without ... justification for the disparity.

486 U.S. at 274-276. (emphasis added).

The Court, however, left open the possibility that a "reciprocity requirement could be constitutionally upheld" in certain narrow circumstances. The Limbach Court outlined this path for constitutional validity in the following way:

> [o]ur cases leave open the possibility that a State may validate a statute that discriminates against interstate commerce by showing that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives. See e.g. Maine v. Taylor, 477 U.S. at 138, 151, 106 S.Ct. at 2447, 2454; Sporhase v. Nebraska ex rel. Douglas, 458 U.S. at 958; Hughes v. Oklahoma, 441 U.S. at 336-337, 99 S.Ct. at 1736; Dean Milk Co. v. Madison, 340 U.S. at 354, 71 S.Ct. at 297. This is perhaps just another way of saying that what may appear to be a "discriminatory" provision in the constitutionally prohibited sense -- that is, a protectionist enactment -- may on closer analysis not be so. However it be put, the standards for such justification are high. Cf. Philadelphia v. New Jersey, 437 U.S. 617, 624, 98 S.Ct. 2531, 2535, 57 L.Ed.2d 475 (1978) ("[w]here simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected"); Hughes v. Oklahoma, supra, 441 U.S. at 337, 99 S.Ct. at 1737 ("[F]acial discrimination by itself may be a "fatal defect" and "[a]t a minimum ... invokes the strictest scrutiny").

468 U.S. at 278-279.

In Sporhase, the Court, although ultimately finding a reciprocity provision to be unconstitutional, also left room for a showing, in a different case, of constitutionality. There, a Nebraska statute provided that an out-of-state person could receive a permit to withdraw ground water from any well located in the State if the withdrawal was deemed reasonable, not contrary to the conservation and use of ground water and not otherwise detrimental to the public welfare if the State in which the water is to be used grants reciprocal rights to withdraw and transport ground water from that State for use in

Nebraska. The Court conceived of circumstances where the Nebraska statute could be upheld, but concluded that the heavy burden had not been met in that instance:

> [t]he reciprocity requirement fails to clear this initial hurdle. For there is no evidence that this restriction is narrowly tailored to the conservation and preservation rationale. Even though the supply of water in a particular well may be abundant, or perhaps even excessive, and even though the most beneficial use of that water might be in another State, such water may not be shipped into a neighboring State that does not permit its water to be used in Nebraska. If it could be shown that the State as a whole suffers a water shortage, that the intrastate transportation of water from areas of abundance to areas of shortage is feasible regardless of distance, and that the importation of water from adjoining States would roughly compensate for any exportation to those States, then the conservation and preservation purpose might be credibly advanced for the reciprocity provision. A demonstrably arid State conceivably might be able to marshal evidence to establish a close means-end relationship between even a total ban on the exportation of water and a purpose to conserve and preserve water. Appellee, however, does not claim that such evidence exists. We therefore are not persuaded that the reciprocity requirement -- when superimposed on the first three restrictions in the statute -- significantly advances the State's legitimate conservation and preservation interest; it surely is not narrowly tailored to serve that purpose. The reciprocity requirement does not survive the "strictest scrutiny" reserved for facially discriminatory legislation. Hughes v. Oklahoma, supra, 441 U.S., at 337, 99 S.Ct., at 1736 ....

458 U.S. at 957-58. See also, Oregon Waste System, Inc. v. Dept. of Env. Quality, supra [surcharge placed on in-state disposal of solid waste generated in other states violates Commerce Clause].

However, in Maine v. Taylor, supra, the Court addressed the validity of a state statute which prohibited altogether the importation of live baitfish into the State of Maine, reaching the conclusion that the statute was valid. The Court recognized that the Maine

law, because of its overt disparate treatment of interstate commerce, must be subjected to "the strictest of scrutiny". 477 U.S. at 144. Further, noted the Court, "... the empirical component of that scrutiny, like any other form of fact finding," is the principal responsibility of the trial court. Id. Even though a strict scrutiny standard was applicable, however, the Court upheld the statute as not placing an impermissible burden upon interstate commerce. The Court reasoned that

> [t]he Commerce Clause significantly limits the ability of States and localities to regulate or otherwise burden the flow of interstate commerce, but it does not elevate free trade above all other values. **As long as a State does not needlessly obstruct interstate trade or attempt to "place itself in a position of economic isolation**," Baldwin v. G. A. F. Seelig, Inc., 294 U.S. 511, 527, 55 S.Ct. 497, 502, 79 L.Ed.2d 1032 (1935), it **retains broad regulatory authority to protect the health and safety of its citizens and the integrity of its natural resources**. The evidence in this case amply supports the District Court's findings that Maine's ban on the importation of live baitfish serves legitimate local purposes that could not adequately be served by available nondiscriminatory alternatives. This is not a case of arbitrary discrimination against interstate commerce; the record suggest that Maine has legitimate reasons, "apart from their origin, to treat [out-of-state baitfish] differently," Philadelphia v. New Jersey, 437 U.S. at 627, 98 S.Ct., at 2537.

477 U.S. at 151. (emphasis added).

We turn now to the specific question of the constitutionality of the referenced provisions of the "South Carolina Competitive Power Act." It is well established that the sale and transmission of electricity is an "article of commerce." As the Supreme Court has recognized,

> ... it is difficult to conceive of a more basic element of interstate commerce than electric energy, a product used in virtually every home and every commercial or manufacturing facility. No state relies on its own resources in this respect.

Fed. Reg. Comm. v. Miss., 456 U.S. 532, 72 S.Ct. 2126, 72 L.Ed.2d 532 (1982). See also, Wyoming v. Oklahoma, 502 U.S. 437, 112 S.Ct. 789, 117 L.Ed.2d 1 (1992); New England Power Co. v. New Hampshire , 455 U.S. 331, 102 S.Ct. 1096, 71 L.Ed.2d 188 (1982), Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm., 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983). Thus, it is evident that the above-referenced precedents concerning Commerce Clause analysis of state regulations and requirements of reciprocity would be applicable to any analysis of the constitutionality of §§ 58-28-80 (B) (5) and 58-28-90 (C). It is too late in the day to argue that the regulation of electricity is not subject to Commerce Clause restrictions.

The United States Supreme Court has recognized that whether or not a particular statute survives scrutiny under the Commerce Clause depends in large part upon the factual record in support of the State's purpose in placing a burden upon commerce. As was stated by the Court in Raymond Motor Transportation, Inc. v. Rice, 434 U.S. 429, 98 S.Ct. 787, 54 L.Ed.2d 664 (1978),

> "Commerce Clause adjudication must depend in large part 'upon the thoroughness with which the lawyers perform their task in the conduct of constitutional litigation. Here, as in many other fields, constitutionality is conditioned upon the facts, and to the lawyers the courts are entitled to look for garnering and presenting the facts.'"

434 U.S. at 447, n.25. Of course, this Office is unable to make factual determinations in an opinion. Only a court may do so. Op. Atty. Gen., Dec. 12, 1983.

Analyzing the two reciprocity provisions in question in this context, § 58-28-90 (C) on its face treats corporations "located outside South Carolina" differently from in-state corporations by mandating that such out-of-state entities "... may not be an electricity supplier within the State unless the electric distribution company serving that customer has the reciprocal right, whether exercised or not, by statute, regulation or voluntary tariff of the out-of-state corporation, if any." This Section would appear to provide for "'differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.'" Chambers v. Med. Technologies of S.C., Inc. v. Bryant, 52 F.3d 1252, 1256 (4th Cir. 1994). Thus, this particular provision might well be subjected by a court to the "heightened scrutiny" analysis of City of Phil. v. N.J., supra and Oregon Waste Systems, Inc. v. Dept. of Environmental Quality of Oregon, supra, discussed above. If the "heightened scrutiny" analysis is deemed applicable by a court, the State would be required by a court to demonstrate factually that "'the discrimination

is demonstrably justified by a valid factor unrelated to economic protectionism'" and that no discriminatory alternatives are adequate to preserve the local interests. Chambers, id.

The constitutional problem posed by provisions such as § 58-28-90 (C) is discussed in an article entitled "Leveling the Playing Field - Can Retail Reciprocity Work?", authored in Barbara S. Jost in 11 Nat. Resources and Environment 55 (Spring, 1997). There, Ms. Jost discusses interstate retail reciprocity as part of the effort to "level the playing field" of competition in terms of electric power deregulation. She finds, however, that retail reciprocity

> ... would be subject to legal challenge as constituting a burden on interstate commerce. And, although reciprocity requirements are not unconstitutional per se, courts are likely to find that such requirements violate the Commerce Clause. See Great Atlantic and Pacific Tea Co. v. Cottrell, 424 U.S. 366, 378 - 79 (1976). In Pike v. Bruce Church, 397 U.S. 137 (1970), the Supreme Court established a test to determine whether a statute or regulation is in violation of the Commerce Clause. Under that test, the burden that the statute imposes on interstate commerce is weighed against the local interest that the statute is designed to protect. To date, in those instances when the Supreme Court has applied this test to scenarios involving reciprocity requirements the Court has held that the reciprocity requirements violated the Commerce Clause. See Sporhase v. Nebraska, 458 U.S. 941 (1982); Great Atlantic and Pacific Tea Co., 424 at 366. Moreover, in so doing, the Court has noted that facially discriminatory legislation, like a reciprocity requirement, must survive the "strictest scrutiny." Sporhase, 458 U.S. at 958.

Id. at 57.

However -- as Ms. Jost herself concedes -- the Supreme Court stressed in the Limbach case and others as well that "reciprocity requirements are not per se unlawful." 108 S.Ct. at 1808. Moreover, the Court has upheld a discriminatory provision even though subjected to the rule of virtual per se, invalidity where the State can demonstrate overriding local interests. The Maine v. Taylor baitfish case is an excellent example of an instance where the State has been able to make a convincing case for constitutional validity even though the per se rule is applied.

Courts have held that the preservation of free competition and the promotion of fair dealing is indeed a legitimate local interest for purposes of the Commerce Clause. See, Opinion of the Justices, 117 N.H. 533, 376 A.2d 118 (1977); Fireside Nissan v. Fanning, 828 F.Supp. 989 (D.R.I. 1993); Groc. Manufacturers of America, Inc. v. Gerace, 755 F.2d 993 (2d Cir. 1985); Gov. of State of Md. v. Exxon Corp., 279 Md. 410, 370 A.2d 1102 (Ct. App. Md. 1977) [promotion of economic welfare is a legitimate interest of a state]. Obviously, what the State is trying to do here, is promote competition by assisting utilities in "gaining access to the customers of utilities over which the State has no ratemaking authority ... ." [in other words, in other States]. President's Comprehensive Electricity Competition Plan. If "neighboring utilities are not subject to a retail competition requirement, a utility in this situation would have greater difficulty in mitigating its losses and the amount of its stranded costs would likely increase." Id. On the other hand, "[i]f neighboring utilities allow retail competition, the utility with surplus power due to the advent of retail competition in its own formerly exclusive service area could mitigate or eliminate stranded costs by selling its surplus to the customers of these utilities." Id. The recovery of utilities' "stranded costs," incurred through prudent past investments under an entirely different system of distributing electricity is, in my judgment, a vital local interest. A reciprocity provision in the specific context of electric power deregulation has, to my knowledge, never been tested in the courts. It could thus be argued that, in this instance, interstate commerce is being promoted, rather than deterred. See, Pelican Chapter, Assoc. Bldrs. and Contractors v. Edwards, 901 F.Supp. 1125 (M.D. La. 1995) [task of Commerce Clause is to create open and efficient interstate market]. While this argument has failed in other contexts, see the discussion above, infra, p. 7 quoting from Limbach, it could certainly be contended here that the electric power industry is unique and that a reciprocity provision is the only effective alternative to promote the local interests of fair competition and recovery of "stranded costs."

Here, if any discrimination is, in reality, not based upon the flow of interstate commerce but, instead, distinguishes between exclusive providers in a "regulated" electric industry and those new providers in a "deregulated" retail-based industry, that distinction may be crucial. Moreover, it is arguable that an increase in "stranded costs" may well drive rates up rather than bring them down as deregulation purports to do. See, General Motors Corp. v. Tracy, supra. ["The size of the captive market, its noncompetitive character, the values served by its traditional regulation all counsel caution before making a choice that could strain the capacity of the States to continue to demand the regulatory benefits that have served the home market of low-volume users since natural gas became readily available."]; Panhandle Eastern Pipe Line Co. v. Mich. Pub. Serv. Comm., 341 U.S. 329, 71 S.Ct. 777, 95 L.Ed. 993 (1951).

In Panhandle, (relied upon heavily in Tracy) Ford Motor Company had entered a contract with an interstate pipeline to supply natural gas at the huge Ford plant in Dearborn, Michigan. The local distribution company was thus bypassed. Pursuant to an order of the Michigan Public Service Commission, the interstate carrier could not provide Ford the natural gas without a certificate of public convenience and necessity. A Commerce Clause challenge was made against the Public Service Commission's actions. The United States Supreme Court disagreed that the Commerce Clause had been violated, noting that

> ... [a]ppellant asserts a right to compete for the cream of the volume business without regard to the local convenience or necessity. Were appellant successful in this venture, it would no doubt be reflected adversely in the over-all costs of service and its rates to customers whose only source of supply is the [local carrier] .... This clearly presents a situation of "essentially local" concern and of vital interest to the State of Michigan.

71 S.Ct. at 780.

Clearly, it could be argued that Tracy and Panhandle support the validity of § 58-28-90 (C). The Court in Panhandle upheld what appeared to be discrimination against an interstate carrier because as the Tracy Court described it, "a change in the customer base could affect the [local carrier's] ability to serve the captive market where there is no such competition." Id. Thus, in both Panhandle and Tracy, no violation of the Commerce Clause was found, because the Court distinguished between "old market" carriers and providers in a "new market" environment. It could be argued that this is precisely the situation present here and that not treating all providers of electricity the same for purposes of the Commerce Clause is a "vital interest" to the State of South Carolina. Panhandle, supra.

Section 58-28-80 (B) (5), may be subjected to a different, less stringent, constitutional test than § 58-28-90 (C). On its face, this provision applies to all electric suppliers and buyers, requiring that the competition among them "must be fair, nondiscriminatory and consistent." This Section states as its explicit purpose" to ensure a level playing field" among "all competitors" by making them "subject to the same legal, regulatory and tax treatments in the future." The Section further requires the Public Service Commission to eliminate "subsidies and disparate regulation or legal requirements that favor certain competitors or disadvantage others", again, in order to insure a level

playing field of competition. Furthermore, municipal utilities, electric member cooperatives and state public service authorities are "encouraged" to "participate in customer choice." Finally, in neutral fashion, the provision, in contrast to § 58-28-90 (C) prescribes that "no competitor must be allowed access to a utility's customers unless comparable and reciprocal access is provided to that competitor's customers." At least facially, this provision may be applied to both intrastate and interstate providers of electricity, although it can probably be argued that the provision disproportionately impacts interstate providers.

Thus, it is at least arguable that § 58-28-80 (B) (5) is a state law which "'regulates evenhandedly to effectuate a legitimate local interest, and its effects on interstate commerce are only incidental ... .'" Chambers Medical Technologies of S.C. Inc. v. Bryant, 52 F.3d at 1256-57, quoting Pike v. Bruce Church, Inc. If so, "'it will be upheld unless the burden imposed on commerce is clearly excessive in relation to the putative local interests.'" Accordingly, in my judgment, § 58-28-80 (B) (5) has a fairly reasonable chance to be upheld in its present form because it would likely not be subjected to the "heightened scrutiny" standard of Limbach, but instead to the Pike Church "reasonableness" test.

Conclusion

The questions you have raised are novel and far-reaching. The answers to them -- i.e. the constitutionality of reciprocity provisions -- while, at first blush, seemingly clear, are not really so. No case has, as yet, faced this question in the context of deregulation of electric power.

Numerous commentators have written of the enormous impact which electric deregulation would have. See, Note, "The Commerce Clause Implications of Massachusetts' Attempt to Limit the Importation of Dirty Power In the Looming Competitive Retail Market for Electricity Generation," 38 Boston College Law Rev. 811 (July 1997). Such terms as "massive restructuring", turning the electric industry "upside down" and "shaking up" that industry have been employed by analysts in the context of deregulation's effect. Id., particularly citations in n.2. As a result of the severe impact of restructuring this industry, state legislatures have properly responded by employing so-called "reciprocity" provisions in order to mitigate the by-products of deregulation. Id. at 811. For example, some states have proposed reciprocity measures as a necessity to offset the severe economic, health and environmental effects of areas "that are the unwilling recipients of air pollution from neighboring regions." Id.

Sections 58-28-80 (B) (5) and 58-28-90 (C) similarly seek to offset the economic impact of deregulation in South Carolina. The purpose of these provisions is obviously to create a "level playing field" of competition and to require fairness among electric competitors. These provisions seek to insure open markets to all providers of electricity.

A potential constitutional challenge to these provisions is posed by the Commerce Clause of the United States Constitution, however. If the State patently discriminates against interstate providers, the Supreme Court of the United States has declared that a virtual per se rule of invalidity applies. However, the Court has emphasized that reciprocity provisions, such as this one, are not per se invalid even when this standard of "heightened scrutiny" is used.

Based upon this case law, § 58-28-90 (C) would likely encounter serious constitutional difficulties. Nevertheless, several factors militate in favor of this provision. First, § 58-28-90 (C), like any other statute, would, if enacted, be entitled to a presumption of validity and would be enforceable unless and until a court of competent jurisdiction concludes otherwise. Moreover, reciprocity provisions enacted in the context of electric power deregulation have, to my knowledge, not yet been litigated in any court in the country. In essence, the basis of argument for constitutionality is that, unlike other reciprocity provisions which have not been upheld, there exists here **no effective nondiscriminatory alternative to the reciprocity requirement which would promote the State's interest in insuring a "level playing field" among electricity providers and which would not drive the "stranded costs" of current providers so high as to threaten their existence**.

Section 58-28-80 (B) (5) has a fairly good chance of being upheld because it does not patently discriminate against interstate providers, and thus would likely be subjected to a "reasonableness" test, balancing burdens imposed against benefits bestowed.

One other point should be mentioned to illustrate that a reciprocity provision is not per se unconstitutional in the context of electric power deregulation. The Clinton Administration is proposing a "Comprehensive Electricity Competition Plan" to be adopted by Congress. Within that Plan is the proposal to "[p]rovide States that have implemented retail competition with the authority to preclude an out-of-state utility from selling within the State unless that out-of-state utility permits customer choice." In other words, the President's Proposal would "Clarify State Authority to Impose Reciprocity Requirements." The Plan succinctly stresses why such reciprocity requirements are so important to states such as South Carolina, stating that

> [r]etail competition will enable currently captive retail customers to purchase power from alternative suppliers. If neighboring utilities allow retail competition, the utility with surplus power due to the advent of retail competition in its own formerly exclusive service area could mitigate or eliminate stranded costs by selling its surplus to the customers of the utilities. However, if neighboring utilities are not subject to a retail competition requirement, a utility in this situation would have greater difficulty in mitigating its losses and the amount of its stranded costs would likely increase.[1]

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[1] The Public Service Commission's Report on "Proposed Electric Restructuring Implementation Process" makes the same basic points as the President's Proposal does, particularly as to the "unique" nature of electricity and the enormous problem of recovery of "stranded costs.". Such Report states in part that

> ... Reliable and economical electric service is critical to the well-being of all South Carolina citizens and businesses. **It is a service that uniquely affects the public interest.** ...
>
> Customers normally expect two results from deregulation of any industry. First, they expect reliability/availability of service to be equal or better than prior to deregulation. Second, customers expect prices to decline. From a reliability perspective, there is a question of who will be willing to construct new power plants in the future. Peak demand reserve capacity of the Southeastern region of the U.S. is being reduced. Without new capacity additions, how will reliability/availability be the same or better? ... **Assuming recovery of stranded costs, then all customers may not benefit because prices might not decline. Under competition, prices tend to move toward costs.** ...
>
> The present electric generation and distribution system is working well. This Commission is honoring the request that has been made of it by developing this implementation

(continued...)

The Clinton Proposal goes on to say that "[s]tates can assist utilities in gaining access to the customers of utilities over which the state has no ratemaking authority [extrajurisdictional utilities] by imposing a reciprocity requirement. In order to alleviate any Commerce Clause concerns and "[t]o provide States with clear authority, the Federal Power Act should be amended to provide States with the authority to impose a reciprocity requirement on all extra-jurisdictional suppliers of electricity within the United States."

Of course, the State has a strong interest in the provision of electricity to its citizens. See, U.S. v. Pickwick Electric Membership Corp., 158 F.2d 272 (6th Cir. 1946). Energy conservation and consumption as well as the electric rates of consumers are important state interests. Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm., 447 U.S. 557, 100 S.Ct. 2343, 65 L.Ed.2d 341 (1980). As the United States Supreme Court stated in Arkansas Elec. Co-Op. v. Arkansas Pub. Serv. Comm., "... the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States." 103 S.Ct. at 1908. It is a legitimate interest of the State to place utilities on a level playing field with other contractors providing the same services. Utilicorp United, Inc. v. Iowa Utilities Bd., 570 N.W.2d 451 (Iowa 1997).

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[1](...continued)

> process, but in so doing, the Commission remains mindful that there are significant questions that remain about regulation. **It may be helpful to evaluate the results of deregulation in other states before implementing any changes in South Carolina.** ...
>
> Reliable and affordable electric service is critical to the well-being of all South Carolina citizens and businesses. Any attempt to radically alter the present generation, transmission and distribution systems, if in fact, significant changes are necessary, should not be undertaken without a thorough understanding of the implications to existing and future customers, whether they are large businesses or residential customers in South Carolina. ... **The amount of stranded costs to be recovered can have a tremendous impact on the advisability of implementing restructuring.**

Report, pp. 1-3, 35. (emphasis added).

Based upon these important state interests, two points concerning the Clinton proposal are significant. First, the Proposal does not necessarily find that it is a "slam dunk" that State reciprocity provisions are unconstitutional in the context of electric power deregulation. The Clinton proposal speaks of "clarifying" State authority in this area. Secondly, if Congress does enact this legislation, it would put to rest any Commerce Clause concerns. As Justice Rehnquist has stated in Northeast BanCorp, Inc. v. Bd. of Governors of the Federal Reserve System, 472 U.S. 159, 105 S.Ct. 2545, 86 L.Ed.2d 112 (1985), Congress is expressly delegated very broad authority under the Commerce Clause and thus "[w]hen Congress so chooses, state actions which it plainly authorizes are invulnerable to constitutional attack under the Commerce Clause." 105 S.Ct. at 2554. Thus, in addition to the arguments for constitutionality made herein, the General Assembly may wish to await the progress of the federal proposal to see if Congress specifically authorizes the states to enact these reciprocity provisions.

The bottom line here is this: admittedly, a serious constitutional challenge can be mounted to the reciprocity provision contained in § 58-28-90 (C). However, if enacted, the provision **is presumed valid and would be enforceable until a court declares otherwise**. Moreover, for the reasons set forth herein, we cannot say that § 58-28-90 (C), if challenged in court, will necessarily be held unconstitutional. Maine v. Taylor, supra. The United States Supreme Court has "left open the possibility" that a reciprocity requirement could withstand scrutiny under the Commerce Clause in a given case. Limbach, supra. It is at least arguable that existing utilities serving the customers of this State in a "regulated" environment would be deemed by a court to be not "similarly situated" to new providers who might enter the retail market upon "deregulation." See, General Motors Corp. v. Tracy, supra ["Ohio's regulatory response to the needs of the local natural gas market have resulted in a noncompetitive bundled gas product that distinguishes its regulated sellers from independent marketers to the point that the enterprises should not be considered 'similarly situated' for purposes of a claim of facial discrimination under the Commerce Clause."]; Panhandle, supra. It is at least arguable that "different methods of production are used in the generation process ... ." 38 Boston College Law Review, supra, at 842. Thus, it should not be simply assumed that § 58-28-90 (C) is invalid.

Based upon the well-recognized presumption of constitutionality which an Act of the General Assembly must be given, as well as the Tracy and Panhandle cases, the rule that a reciprocity provision is not per se invalid, and the vital local interests present, discussed above, § 58-28-90(C) is "not necessarily" constitutionally invalid, see, Camps, supra at 278, and is thus constitutionally defensible. Section 58-28-80 (B) (5) stands a fairly good chance of being upheld.

With kind regards, I am

Very truly yours,

Robert D. Cook
Assistant Deputy Attorney General

RDC/an