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Electricity Restructuring and the Constitutionality of Retail Reciprocity Requirements

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Summary

Retail reciprocity requirements have been included in the electricity restructuring legislation of at least four states. These requirements mandate generally that out-of-state utilities which operate in a state “closed” to retail competition cannot market power to retail consumers in the “open” state. Because state reciprocity requirements enacted without congressional authorization are probably unconstitutional under the Commerce Clause of the U.S. Constitution, Congress would have to include a reciprocity provision in federal electricity restructuring legislation if it wants to support the view that such a provision will increase competition. This report reviews the treatment of state reciprocity requirements by the U.S. Supreme Court and discusses Congress’ power under the Commerce Clause.

Seven of the eight comprehensive electricity restructuring bills introduced during the 106th Congress include reciprocity provisions. The Power Bill, H.R. 667, introduced by Representative Burr, the Electric Utility Restructuring Empowerment and Competitiveness Act of 1999, S. 516, introduced by Senator Thomas, the Electric Energy Empowerment Act of 1999, H.R. 1587, introduced by Representative Stearns, the Comprehensive Electricity Competition Act, H.R. 1828, introduced by Representatives Bliley and Dingell, the Electric Consumers’ Power to Choose Act of 1999, H.R. 2050, introduced by Representative Largent, the Electric Consumer Choice Act, S. 1284, introduced by Senator Nickles, and the Electric Power Market Competition and Reliability Act, S. 2098, introduced by Senator Murkowski, each include reciprocity provisions. The Electricity Competition and Reliability Act, H.R. 2944, introduced by Representative Barton, does not include such a provision.

This report will not be updated.

Since 1996, twenty-one states have restructured their electricity markets. At least four of these states have included reciprocity provisions in their restructuring legislation.¹

¹ The electricity restructuring legislation of Delaware, Illinois, Montana, and Pennsylvania each
(continued...)

These reciprocity provisions mandate generally that out-of-state utilities which operate in a state “closed” to retail competition cannot market power to retail consumers in the “open” state. States have enacted reciprocity requirements as a way of encouraging closed states to open to retail competition.

Although state reciprocity requirements are not per se unlawful, the U.S. Supreme Court has been reluctant to uphold such requirements under the Commerce Clause of the U.S. Constitution.² The Commerce Clause provides that “Congress shall have Power . . . To regulate Commerce . . . among the several States.”³ The Commerce Clause has been interpreted to provide not only an affirmative grant of authority to Congress, but an implied limitation on the power of the states to interfere with or impose burdens on interstate commerce. The doctrine of the “dormant” Commerce Clause, whereby state regulation of interstate commerce may be invalidated because of its burden on interstate commerce, has been well established.⁴

The U.S. Supreme Court has addressed the constitutionality of state reciprocity requirements in several cases. In *Great Atlantic and Pacific Tea Company v. Cottrell*, a Louisiana milk producer challenged a Mississippi regulation that permitted the sale of milk and milk products from another state only if the other state accepted such products from Mississippi on a reciprocal basis.⁵ Contending that the reciprocity requirement was a “free-trade provision,” Mississippi advanced two arguments: first, it argued that the reciprocity requirement served to help eliminate varying inspection standards between the states; second, it maintained that the requirement allowed the state to get around economic barriers erected by Louisiana. The Court rejected both arguments. Requiring states to either sign a reciprocal agreement acceptable to Mississippi or be foreclosed from exporting their products to Mississippi would invite the kind of preferential trade areas the Commerce Clause was meant to prevent.⁶ The Court contended that the reciprocity requirement unduly burdened the free flow of interstate commerce and could not be justified as a permissible exercise of any state power.

In *Sporhase v. Nebraska*, the Court held that a reciprocity requirement would be upheld only where a state can demonstrate a close fit between the requirement and the state’s local purpose.⁷ In *Sporhase*, the owners of contiguous tracts of land in Nebraska and Colorado challenged a Nebraska statute that restricted the ability to use ground water

¹ (...continued)

contain reciprocity requirements. See also Amy Abel & Jon O. Shimabukuro, *State-by-State Comparison of Selected Electricity Restructuring Provisions*, CRS Report RL30405 (2000).

² See *New England Company of Indiana v. Limbach*, 486 U.S. 269, 276 (1988). See also *Great Atlantic and Pacific Tea Company v. Cottrell*, 424 U.S. 366 (1976); *Sporhase v. Nebraska*, 458 U.S. 941 (1982).

³ U.S. Const. Art. I, § 8, cl. 3.

⁴ See THE CONSTITUTION OF THE UNITED STATES OF AMERICA, ANALYSIS AND INTERPRETATION 212 (Johnny H. Killian & George A. Costello eds., 1996).

⁵ 424 U.S. 366 (1976).

⁶ 424 U.S. at 380.

⁷ 458 U.S. 941 (1982).

withdrawn from Nebraska in an adjoining state. The Nebraska statute required anyone withdrawing water with the intention of transporting it for use in an adjoining state to obtain a permit from the Nebraska Department of Water Resources. A permit would be issued only if the state in which the water was to be used granted reciprocal rights to withdraw and transport ground water from that state for use in Nebraska. Under Colorado law, the transport of ground water to any other state was forbidden.

Although Nebraska contended that the reciprocity restriction was necessary to conserve and preserve ground water, it failed to offer any evidence of a water shortage or some other justification for the requirement.⁸ Without this evidence, the Court was unwilling to uphold the requirement. The Court maintained that because such a requirement facially discriminates against interstate commerce, it would be subject to the “strictest scrutiny.”⁹ While the Court acknowledged that conservation and preservation are “legitimate” purposes, it concluded that such a restriction on the withdrawal and transport of Nebraska ground water, absent any evidence of shortage or some other justification, was not narrowly tailored to achieving those purposes.¹⁰

In *New Energy Company of Indiana v. Limbach*, an Indiana manufacturer of ethanol challenged an Ohio statute that awarded a tax credit against the Ohio motor vehicle fuel sales tax for each gallon of ethanol sold by fuel dealers if the ethanol was produced in Ohio or in a state that granted similar tax advantages to ethanol produced in Ohio.¹¹ The manufacturer became ineligible for the Ohio tax credit after Indiana repealed its tax exemption for Ohio-produced ethanol.

In attempting to counter the manufacturer’s Commerce Clause argument, Ohio contended that the availability of the tax credit to some out-of-state manufacturers demonstrated that the statute was likely to promote interstate commerce by encouraging other states to enact similar tax advantages that would spur the interstate sale of ethanol. Citing the “free-trade” argument advanced by Mississippi in *Cottrell*, the Court similarly rejected Ohio’s assertion. The Court maintained that without proper justification Ohio could not use the threat of imposing a higher tax to force other states into a reciprocal arrangement.¹² Although Ohio attempted to argue that its statute was justified by health and commerce concerns, the Court rejected these concerns as “implausible speculation.”¹³

While a state is permitted to exercise its police power over local affairs, this power has generally been limited to legislation that protects the health and welfare of citizens.¹⁴ If the primary purpose of a state electricity reciprocity requirement is to prompt competition in noncompetitive states, it is likely that the analyses provided in *Cottrell* and *Limbach* are applicable. Such a purpose would probably be perceived as impermissible

⁸ 458 U.S. at 958.

⁹ *Id.*

¹⁰ *Id.*

¹¹ 486 U.S. 269 (1988).

¹² 486 U.S. at 276.

¹³ 486 U.S. at 280.

¹⁴ 424 U.S. at 371.

because a noncompetitive state may not be forced into restructuring its electric utility industry simply to sell power to retail consumers in competitive states.

Although a state may not interfere with interstate commerce on its own, Congress may confer upon the states the ability to restrict commerce. Congress' power over interstate commerce has been recognized as "plenary and supreme."¹⁵ The only limitation placed upon Congress' power is in respect to what constitutes commerce.¹⁶ If Congress enacts legislation that permits the states to regulate interstate commerce, any action taken by a state within the scope of that congressional authorization is rendered invulnerable to challenge under the Commerce Clause.¹⁷

In *Western and Southern Life Insurance Company v. State Board of Equalization of California*, the Court upheld a state retaliatory tax that responded to the insurance tax laws of a foreign insurer's home state. Under California's insurance laws, a retaliatory tax is imposed on out-of-state insurers doing business in California when the insurer's state of incorporation imposes higher taxes on California insurers doing business in that state than would be imposed on that state's insurers doing business in California. The California state board contended that the purpose of the tax is to put pressure on other states to maintain low taxes on California insurers.

With the enactment of the McCarran-Ferguson Act, Congress removed all Commerce Clause limitations on the ability of the states to regulate and tax the business of insurance.¹⁸ The limitations associated with the dormant Commerce Clause were no longer present because Congress exercised its authority through legislation. Because Congress explicitly intended the McCarran-Ferguson Act to permit state regulatory and taxing powers over the insurance business, even state taxation that discriminated against out-of-state insurers could be permissible.

In *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, the Court upheld two state statutes on similar grounds.¹⁹ The Douglas Amendment to the Bank Holding Company Act prohibits the Federal Reserve Board from approving an application of a bank holding company or bank located in one state to acquire a bank located in another state unless the acquisition is authorized by the laws of the state in which the bank is located.²⁰ Pursuant to the Douglas Amendment, Massachusetts and Connecticut enacted statutes which permit an out-of-state holding company with its

¹⁵ See *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946).

¹⁶ *Id.*; cf. *United States v. Lopez*, 514 U.S. 549 (1995) (In *Lopez*, the Court held that the commerce power was inadequate to sustain the Gun-Free School Zone Act. The Act, which prohibited the knowing possession of firearms in a school zone, was found to have nothing to do with commerce or any kind of economic enterprise. *Lopez* is the only case since the New Deal to invalidate a federal law on the grounds that Congress exceeded its authority under the Commerce Clause).

¹⁷ See *Western and Southern Life Insurance Company v. State Board of Equalization of California*, 451 U.S. 648 (1981).

¹⁸ See 15 U.S.C. § 1011 *et seq.*

¹⁹ 472 U.S. 159 (1985).

²⁰ See 12 U.S.C. § 1842(d).

principal place of business in another New England state to acquire a Massachusetts or Connecticut bank or holding company so long as the other state allows reciprocal privileges to Massachusetts and Connecticut banking organizations.

The Massachusetts and Connecticut statutes were challenged on the grounds that they were not authorized by the Douglas Amendment, and discriminated improperly against non-New England bank holding companies. After reviewing the legislative history of the Douglas Amendment, the Court concluded that the Massachusetts and Connecticut statutes were consistent with the purpose of the Douglass Amendment; that is, to promote differing approaches to interstate banking and to retain local, community-based control over banking.²¹ The interest in pursuing regional banking within New England was consistent with that purpose.

If Congress enacts electricity restructuring legislation that permits states to impose reciprocity requirements, such requirements are likely to be permissible under the Commerce Clause. Like the retaliatory tax in *Western and Southern Life Insurance Company* and the regional acquisition statutes in *Northeast Bancorp*, a state reciprocity requirement should be permissible under the Commerce Clause because it would be enacted pursuant to congressional authorization.

Those who support a federal reciprocity provision contend that such a provision would force closed states to consider retail competition. They argue that the inclusion of a reciprocity provision in federal restructuring legislation will likely enable consumers to choose from a wider variety of domestic and out-of-state suppliers. As consumers and utilities in closed states observe the benefits and potential offered by open access, it is believed that they will encourage their state legislatures to adopt competition. Opponents of reciprocity, including utilities operating in closed states and consumers in states with low electric power rates, maintain that the federal government should not interfere with a state's decision to reject competition.

Seven of the eight comprehensive restructuring bills introduced during the 106th Congress include reciprocity provisions.²² Although the provisions vary slightly in language, they generally provide a state with the authority to prohibit the supply of electricity generated in a noncompetitive state.

²¹ 472 U.S. at 172.

²² H.R. 667, S. 516, H.R. 1587, H.R. 1828, H.R. 2050, S. 1284, and S. 2098 include reciprocity provisions. Although H.R. 2944 included a reciprocity provision when it was introduced, that provision was removed during its mark-up.