Kevin J. McKeon

Index of Representative Cases

(Click on Case to Jump to Opinion)

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Medical Marijuana Access & Patient Safety, Inc., Petitioner	:	
v.	:	No. 58 M.D. 2022
	:	Heard: February 24 and 28, 2022
Keara Klinepeter, Acting Secretary, Pennsylvania Department of Health, John J. Collins, Director of the Pennsylvania Department of Health, Office of Medical Marijuana, and Sunny D. Podolak, Assistant Director and Chief Compliance Officer of the Pennsylvania Department of Health, Office of Medical Marijuana, Respondents	:	

BEFORE: HONORABLE MICHAEL H. WOJCIK, Judge

OPINION NOT REPORTED

MEMORANDUM OPINION
BY JUDGE WOJCIK FILED: June 2, 2022

Before the Court is Medical Marijuana Access & Patient Safety, Inc.'s (Petitioner) application for special relief in the nature of a preliminary injunction (Application), and the answer in opposition thereto of Respondents Keara Klinepeter, Acting Secretary, Pennsylvania Department of Health (DOH), John J. Collins, Director of DOH's Office of Medical Marijuana (OMM), and Sunny D. Podolak, Assistant Director and Chief Compliance Officer of OMM (collectively, Respondents). After a hearing, argument, and written submissions, the Application is ripe for disposition.

I. Background

The pertinent facts are as follows. The Medical Marijuana Act (Act),[1] which took effect on May 17, 2016, establishes a framework for the legalization of medical marijuana in the Commonwealth for certain medical conditions. DOH, and in particular OMM, is the Commonwealth agency responsible for administering and enforcing the Act, including regulating the medical marijuana program in a way "which balances the need of patients to have access to the latest treatments with the need to promote patient safety." Section 102 of the Act, 35 P.S. § 10231.102. The Act also outlines the application process through which medical marijuana grower/processors and dispensaries,[2] also known as medical marijuana organizations (MMOs), can obtain a permit from DOH to grow, process, or dispense medical marijuana. *See* Sections 601-616 of the Act, 35 P.S. §§ 10231.601-10231.616. Of note here, Petitioner is an association consisting of various stakeholders in the medical marijuana industry, including DOH-permitted grower/processors and dispensaries, as well as medical marijuana patients.

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[1] Act of April 17, 2016, P.L. 84, *as amended*, 35 P.S. §§ 10231.101 – 10231.2110.

[2] Section 103 of the Act provides the following definitions:

> "Dispensary." A person, including a natural person, corporation, partnership, association, trust or other entity, or any combination thereof, which holds a permit issued by [DOH] to dispense medical marijuana. . . .
>
> . . . .
>
> "Grower/processor." A person, including a natural person, corporation, partnership, association, trust or other entity, or any combination thereof, which holds a permit from [DOH] under this [A]ct to grow and process medical marijuana. . . .

35 P.S. § 10231.103.

Section 303 of the Act specifically authorizes the dispensing and patient use of certain forms of medical marijuana, including "a form medically appropriate for administration by vaporization . . . ." 35 P.S. § 10231.303(b)(2)(iv). The cannabis in vaporization products contains substances known as terpenes, which are naturally occurring chemical compounds found in cannabis and other plants that give the plant its flavor, aroma, and color. Petition for Review (Petition) ¶ 28. Medical marijuana producers add terpenes extracted from either cannabis itself or other, external sources—such as lemons, hemp, or botanicals—to add flavor to the vapor and to improve the aromatic component of the medicine.[3] Petition ¶ 29. Petitioner asserts that its grower/processor members have added terpenes to their medical marijuana vaporization products since 2018, when medical marijuana first became legally available in Pennsylvania, and that DOH has reviewed and approved each such product before it became available for use by medical marijuana patients. Petition ¶¶ 27, 30, 38-39.

Of particular note to this action, Act 44 of 2021 (Act 44)[4] made numerous changes to the Act, including amending Section 702 (relating to grower/processors) so that it now provides, in pertinent part:

> (a) Authorization.--Subject to subsection (b), a grower/processor may do all of the following in accordance with [DOH] regulations:
>
> . . . .

[3] When added to medical marijuana, terpenes qualify as a type of "excipient," a term which the Act defines as: "Solvents, chemicals or materials reported by a medical marijuana organization and approved by [DOH] for use in the processing of medical marijuana." Section 103 of the Act, 35 P.S. § 10231.103.

[4] Act of June 30, 2021, P.L. 210, No. 44. Act 44 went into effect immediately.

> (5) Add excipients or hemp or hemp-derived additives obtained or cultivated in accordance with paragraph (4). Excipients must be pharmaceutical grade, unless otherwise approved by [DOH]. **In determining whether to approve an added substance, the department shall consider the following:**
>
> > (i) **Whether the added substance is permitted by the United States Food and Drug Administration [(FDA)] for use in food or is Generally Recognized as Safe (GRAS) under Federal guidelines.**
> >
> > (ii) Whether the added substance constitutes a known hazard such as diacetyl, CAS number 431-03-8, and pentanedione, CAS number 600-14-6.

35 P.S. § 10231.702(a)(5) (emphasis added).

On November 16, 2021, after Act 44 went into effect, Respondent Podolak sent an email to a group of MMOs advising them that DOH was "conducting a review of all vaporized medical marijuana products containing additional ingredients (anything that alters the dosage level, color, appearance, smell, taste, effect[,] or weight of the medical marijuana)" and that DOH was "requiring every grower/processor to submit for approval each vaporized product that contains additional ingredients, even if the product had previously been approved." Petition Exhibit 2; *see also* Petition ¶ 41. The November 16, 2021 email included a form for MMOs to use when submitting their products for approval and indicated that the deadline for product submissions was November 30, 2021. Petition Exhibit 2. The email concluded by indicating that failure to comply may result in DOH suspending the sale of an MMO's entire line of vaporized products. *Id.* Petitioner avers that its grower/processor members timely provided all information requested in the November 16, 2021 email. Petition ¶ 43.

On December 2, 2021, OMM emailed all patients in the medical marijuana program advising them that DOH had

> instituted a state-wide review of vaporized products containing added ingredients such as externally sourced flavorings or terpenes. Grower/processors have submitted information regarding these products to [DOH] for review, to include whether these added ingredients are safe for inhalation. [DOH] will review this information as expeditiously as possible. Should [DOH]'s review reveal products containing added ingredients that are not safe for inhalation, those products will be removed from the market. In the interim, you should be aware that products with added ingredients may not be safe for inhalation and you should make your own decision about whether to use these products. If you have any questions or concerns about products, you should consult with your medical professional.

Petition Exhibit 3. Petitioner avers that Luke Schultz, the Medical Marijuana Advisory Board Patient Advocate, emailed Respondent Collins asking whether any adverse events had provoked the December 2, 2021 email. Petition Exhibit 3; *see also* Petition ¶ 45. Schultz's email explained that because DOH did not state a reason for the warning over additives in vaporized products or specify which products were of concern, patients did not feel as though they had enough information to properly make their own decisions about whether to use the products. *Id.* Petitioner avers that DOH never responded to Schultz's email. Petition ¶ 46.

On December 13, 2021, Respondent Podolak sent another email to MMOs requesting further information, as follows:

> In addition to what you may have already provided, and in order to continue our review, please provide any information you have regarding the determined safety of the externally sourced additives for inhalation, including

> artificial terpenes or flavorings, used in your vaporized products.
>
> If you are using additives, including artificial terpenes or flavorings, in other states, please provide the product name and the state in which it is approved.
>
> Please provide this information no later than close of business on Wednesday, December 15, 2021.

Petition Exhibit 5; *see also* Petition ¶¶ 47-48. In response to the December 13, 2021 email, Petitioner's members provided DOH with hundreds of pages of submissions, "including declarations from medical doctors and scientists that affirmed that there are no known safety concerns associated with fruit or botanically-derived terpenes while also confirming that there are benefits to adding these terpenes in medical marijuana vaporized products." Petition ¶ 49; *see also* Petition Exhibit 6 (providing a sample of such member submissions).

The crux of this litigation is a February 4, 2022 email from OMM to grower/processors instituting a mandatory recall of at least 670 individual vaporization products (the Terpene Recall Mandate or Recall). Stipulation ¶¶ 4-5 and Exhibits 1 & 2. That email provides, in pertinent part, as follows:

> [DOH] has reviewed your submission, and your product approval request is **DENIED**.[]
>
> Prior approval for the product(s), if issued, is hereby **RESCINDED**.
>
> [DOH] has reviewed every additive contained in the attached list of products and has determined that additive(s) contained in your product(s) have not been approved for inhalation by the [FDA]. Accordingly, you may no longer produce the product(s). By this notice, [DOH] advises that products on the attached list meet the

conditions for recall under 28 Pa. Code § 1151.42(c)(1).[5] **Accordingly, you MUST follow the mandatory recall procedures outlined in 28 Pa. Code § 1151.42(c)**. Failure to comply will result in [DOH] acting to impose sanctions against you under 28 Pa. Code § 1141.47.

[DOH] provides the following rationale for this determination:

In passing the [Act], the General Assembly specifically declared:

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[5] This section of the regulations (regarding complaints about or recall of medical marijuana products) provides as follows:

(c) The following requirements apply to mandatory recalls:

(1) If a grower/processor discovers that a condition relating to the seeds, immature medical marijuana plants, medical marijuana plants, medical marijuana or medical marijuana products grown or processed at its facility poses a risk to public health and safety, the grower/processor shall:

(i) Immediately notify [DOH] by phone.

(ii) Secure, isolate and prevent the distribution of the seeds, immature medical marijuana plants, medical marijuana plants, medical marijuana or medical marijuana products that may have been affected by the condition and remains in its possession. The grower/processor may not dispose of affected seeds, immature medical marijuana plants, medical marijuana plants, medical marijuana or medical marijuana products prior to notifying [DOH] and coordinating the disposal with [DOH].

(2) If a grower/processor fails to cooperate with [DOH] in a recall, or fails to immediately notify [DOH] of a need for a recall under paragraph (1), [DOH] may seek a cease and desist order under § 1141.47 (relating to general penalties and sanctions) and the grower/processor may be subject to any other penalties or sanctions provided for in the [A]ct or this part.

28 Pa. Code § 1151.42(c).

> (2) *The Commonwealth is committed to **patient safety**. Carefully regulating the program which allows access to medical marijuana will enhance **patient safety** while research into its effectiveness continues.*
> (3) It is the intent of the General Assembly to:
>
> > (i) *Provide a program of access to medical marijuana which balances the need of patients to have access to the latest treatments with the need to promote **patient safety**.*
> > (ii) *Provide a **safe** and effective method of delivery of medical marijuana to patients.*
>
> [Section 102 of the Act,]35 P.S. § 10231.102 [].
>
> Further, the [Act], when recently amended under Act 44 [], explicitly states:
>
> Excipients must be pharmaceutical grade, unless otherwise approved by [DOH]. In determining whether to approve an added substance, [DOH] shall consider the following:
>
> > (i) Whether the added substance is permitted by the [FDA] for use in food or is [GRAS] under Federal guidelines.
> > (ii) Whether the added substance constitutes a known hazard such as diacetyl, CAS number 431-03-8, and pentanedione, CAS number 600-14-6.
>
> [Section 702(a)(5) of the Act,]35 P.S. § 10231.702(a)(5).
>
> You may appeal this action to the Secretary of Health in writing **within 30 days of the date of emailing** of this Notice in accordance with 28 Pa. Code Chapter 1230 (relating to practice and procedure – temporary regulations).

Stipulation Exhibit 1 (emphasis in original). That same day, February 4, 2022, DOH sent a separate email to all patients in the medical marijuana program advising them that "DOH was instructing grower/processors to initiate a mandatory recall of medical marijuana products that contain additives that 'have not been approved for inhalation by the [FDA].'" Stipulation ¶ 19 (quoting Stipulation Exhibit 7).

II. The Petition and Application

On February 10, 2022, Petitioner filed in this Court's original jurisdiction its Petition seeking declaratory and injunctive relief from DOH's Terpene Recall Mandate, on behalf of itself and its members. Petitioner avers that to comply with the Terpene Recall Mandate, its grower/processor and dispensary members immediately halted production and sales of the affected products, and dispensaries started shipping the products subject to the recall back to the originating grower/processors. Petitioner's Brief at 9. The recalled products received by grower/processors were initially being quarantined until DOH could coordinate their disposal pursuant to 28 Pa. Code § 1151.42(c)(1)(ii). Petition ¶ 58; Petitioner's Brief at 9-10. However, Respondents subsequently agreed that the destruction of the recalled products would be suspended pending the outcome of this litigation and the Court issued a consent order to this effect on March 1, 2022.[6]

As for the specific counts asserted in the Petition, Count one requests declaratory judgment for lack of statutory authority. Petitioner claims that Act 44 does not authorize DOH to base approval or disapproval of the addition of an excipient upon whether the FDA has approved it "for inhalation." Petition ¶ 91. Rather, Act 44 authorizes DOH to disapprove a proposed excipient only if the FDA has not approved it "for use in food" or as GRAS. *See* section 702(a)(5) of the Act, 35 P.S. § 10231.702(a)(5).

[6] That Order states: "All recalled products resulting from the Department of Health, Office of Medical Marijuana's February 2022 notice to grower/processors may be held in quarantine and destruction will not occur until the conclusion of this matter." (Pa. Cmwlth., No. 48 M.D. 2022, Order filed Mar. 1, 2022).

Count two seeks declaratory relief on the basis that the Terpene Recall Mandate is an unlawful *de facto* regulation. Petitioner argues that the Recall announces an immediately effective industry-wide rule that purportedly has the force and effect of law. As such, it creates a binding norm which may only be imposed through a properly promulgated regulation.

Count three avers that DOH's regulation set forth in 28 Pa. Code § 1151.42(c) does not grant authority to DOH to initiate a mandatory recall because that section applies when grower/processors discover a condition that poses a risk to public health and safety, which did not occur here.

Count four sounds in declaratory judgment based on vested rights, detrimental reliance, and promissory estoppel. Essentially, Petitioner asserts that its grower/processor and dispensary members have a vested right in producing and dispensing the vaporized medical marijuana products that are subject to the Recall, and which have been approved by DOH since 2018.

Count five asserts that the Terpene Recall Mandate violates the Fifth Amendment of the United State Constitution[7] and article I, section 10 of the Pennsylvania Constitution,[8] in that it effects an unconstitutional taking of private property without compensation. *See Pennsylvania Coal Company v. Mahon*, 260 U.S. 393, 415 (1922) ("while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking"). Petitioner asserts that its members will lose tens of millions of dollars due to the Recall, given that the recalled

[7] U.S. Const. amend. V. The Fifth Amendment provides, in pertinent part: "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

[8] Pa. Const. art. I, § 10. This provision of the Pennsylvania Constitution provides, in pertinent part: "[N]or shall private property be taken or applied to public use, without authority of law and without just compensation being first made or secured."

products will be destroyed or may expire in quarantine, and that the Recall interferes with members' distinct investment-backed expectations. *See Penn Central Transportation Company v. City of New York*, 438 U.S. 104 (1978).

Count six claims that the Terpene Recall Mandate violates the due process rights of Petitioner's members under both the United States and Pennsylvania Constitutions. Pursuant to the Recall, MMOs must immediately cease distributing products containing certain added terpenes and return the products to the grower/processor without a meaningful pre-deprivation hearing. Petitioner maintains that the products will expire if quarantined and, therefore, an administrative appeal absent a supersedeas provision does not provide adequate due process.

Count seven requests declaratory judgment for damage to reputation under article I, section 11 of the Pennsylvania Constitution.[9] Petitioner asserts that by publishing on its website a list of over 670 vaporization products subject to the Terpene Recall Mandate and identifying the grower/processor of each product by name, DOH has communicated to medical marijuana patients that the grower/processor's product is unsafe. Petitioner maintains that its members are not aware of any complaint being made by a caregiver or practitioner concerning an adverse event from using vaporized medical marijuana products, and that DOH has failed to provide any evidence that the identified products are unsafe. Petitioner reiterates that DOH previously approved for production and distribution all of the recalled products containing terpenes. DOH's conflicting messages have caused

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[9] Pa. Const. art. I, § 11. This section guarantees "[a]ll courts shall be open; and every man for an injury done him in his lands, goods, person or reputation shall have remedy by due course of law[.]"

mass confusion with medical marijuana patients and impugned the reputation of Petitioner's members.

Finally, counts eight and nine aver that Petitioner is entitled to a preliminary and permanent injunction, respectively. Petitioner filed the instant Application contemporaneously with its Petition, seeking an order from this Court preliminarily enjoining Respondents' enforcement of the Terpene Recall Mandate.

As directed by the Court, Respondents filed an Answer to the Application on February 17, 2022. Among other things, Respondents deny that DOH initiated a recall in this matter, instead noting that the February 4, 2022 email instructed grower/processors that *they* must follow the mandatory recall procedures outlined in 28 Pa. Code § 1151.42(c). Respondents further deny that Section 702(a)(5) of the Act expressly limits DOH's authority, arguing instead that it gives DOH the authority to revoke or deny approval of medical marijuana products containing additives (here, terpenes) which Petitioner admits alter the smell and taste of the medicine.

With respect to the preliminary injunction standard, Respondents argue that Petitioner cannot demonstrate that releasing products for sale that include additives which have not been deemed safe for inhalation by the FDA will not adversely affect the public interest. Further, Respondents assert that any claim that medical marijuana patients will be inconvenienced and might turn to the "black market" because they no longer have access to their preferred medicine is speculative. Respondents maintain that patients still have access to a substantial number of products even after the purported Recall.

The Court held a hearing on the Application on February 24 and 28, 2022, at which Petitioner presented the testimony of the following witnesses: Trent

Woloveck, Chief Commercial Director, Jushi Holdings, Inc. (Jushi); Shawna Vreeke, PhD (Dr. Vreeke), Head of Research, True Terpenes;[10] Suzanne Sisley, MD (Dr. Sisley), practicing internist, President and Chief Medical Officer, Scottsdale Research Institute and Field to Healed Foundation;[11] and Jon Ahern, CPA, CGMA, Senior Director, Alvarez & Marsal Disputes and Investigations, LLC.[12] The Court finds all four of these witnesses credible.

Of particular importance to the Application, Mr. Woloveck testified[13] that Jushi is the parent company of multiple MMOs, including both grower/processors and dispensaries that are licensed by DOH. (Notes of Testimony, 2/24/22 (N.T.) at 33-36.) He explained that Petitioner "is a group of grower/processors, retailers, patients, a doctor, cannabis operators, as well as experts around terpenes and other practices within the space." (*Id.* at 37.) Mr. Woloveck stated that Jushi is one of the operators within Petitioner and that he himself is specifically authorized to speak on behalf of Petitioner. (*Id.*)

Mr. Woloveck testified that Jushi's subsidiaries have been affected by the Recall in several ways. First, Jushi's dispensaries had to return recalled products to the appropriate grower/processors, and Jushi's grower/processors had to place the

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[10] Dr. Vreeke was offered as an expert in the field of vaporization chemistry and terpene toxicology. The Court admits her as such, over the objection of Respondents.

[11] Dr. Sisley was offered as an expert in the areas of state and federal medical marijuana research, FDA approval processes, and patient impacts. The Court admits her as such, over the objection of Respondents.

[12] Mr. Ahern was offered, and so admitted, as an expert in the areas of analyzing accounting financial and economic issues, including business valuation and calculating damages, with an emphasis on damages to cannabis-related entities and markets.

[13] Respondents objected to the rebuttal testimony of Mr. Woloveck, presented on February 28, 2022, as the substance of his testimony was known to him at the time he was called on direct. The Court sustains the objection. Mr. Woloveck's rebuttal testimony is stricken and was not considered by the Court in its resolution of the Application. As such, the entirety of Mr. Woloveck's testimony can be found at pages 33-117 of the transcript.

recalled products in quarantine. (*Id.* at 43-44, 75-76.) Mr. Woloveck stated that the 670 recalled products, including roughly 330,000 individual units, accounted for several million dollars of inventory. (*Id.* at 41, 76.) In addition, Jushi was no longer able to provide certain medical marijuana patients with their preferred medicine. (*Id.* at 41, 77-78.) He further testified that medical marijuana vaporization products all have an expiration date which is 12 months from when final testing and labeling is done; however, he was unable to give specific expiration dates for any of Jushi's recalled products. (*Id.* at 44, 98-102.)

Mr. Ahern stated[14] that he was retained by Petitioner to evaluate the economic and financial impact and other harms to Petitioner's members due to the Terpene Recall Mandate. (N.T. at 280-81.) In conducting his evaluation, Mr. Ahern relied upon the legal filings in this case as well as financial information provided by five of Petitioner's member MMOs[15] which included sales data, recall data (including the volume of recalled products), product data, margin data, historical advertising spending, and third-party sales. (*Id.* at 283-85, 288-90.) He also had discussions with individuals from the providing MMOs to ensure that he understood the data, and conducted his own independent research. (*Id.* at 285.)

Mr. Ahern testified as to his findings and his expert report was admitted into evidence. His primary conclusion was that Petitioner's members for which he specifically reviewed data have suffered tens of millions of dollars in damages due to the Recall. (N.T. at 281-82.) More pointedly, for the five members of Petitioner he reviewed, he stated: "I've quantified damages between $17 and $18 million. And then if you extrapolate that based on estimates of market share, the number quickly

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[14] Mr. Ahern's testimony can be found at pages 261-349 of the transcript.

[15] Mr. Ahern testified that "all five of the entities for which I reviewed data are both operators of dispensaries and grower/process[o]rs." (N.T. at 288.)

gets up to $30-ish million estimated for all dispensaries and grower/processors in the market." (*Id.* at 292.) Mr. Ahern also testified to reputational harm to Petitioner's MMO members given DOH's direct communication to medical marijuana patients that the recalled products are potentially unsafe and no longer approved. (*Id.* at 298-99.)

Respondents did not call any witnesses at the hearing. Instead, Respondents raised arguments that Petitioner lacks standing to bring this action and, in the alternative, that Petitioner failed to establish the requirements necessary for a preliminary injunction.

At the Court's request, the parties also submitted post-hearing memoranda of law addressing, in particular, the issue of standing. Because "[s]tanding is a justiciability concern, implicating a court's ability to adjudicate a matter[,]" it is a threshold issue that must be resolved before addressing the merits of the case. *Firearm Owners Against Crime v. Papenfuse*, 261 A.3d 467, 481 (Pa. 2021) (citations omitted) (*FOAC*); *also Pennsylvania Social Services Union, Local 668 v. Department of Public Welfare*, 699 A.2d 807, 810 (Pa. Cmwlth. 1997) (*PSSU*).

IV. Analysis

A. Standing

As our Supreme Court has explained:

> The doctrine of standing "stems from the principle that judicial intervention is appropriate only where the underlying controversy is real and concrete, rather than abstract." *City of Phila*[*delphia v. Commonwealth*], 838 A.2d [566,] 577 [(Pa. 2003)]. The touchstone of standing is "protect[ing] against improper p[etitioner]s." *In re Application of Biester*, . . . 409 A.2d 848, 851 ([Pa.]1979). To do so, courts require a p[etitioner] to demonstrate [it]

> has been "aggrieved" by the conduct [it] challenges. *In re Hickson*, . . . 821 A.2d 1238, 1243 ([Pa.]2003). To determine whether the p[etitioner] has been aggrieved, Pennsylvania courts traditionally examine whether the p[etitioner]'s interest in the outcome of the lawsuit is substantial, direct, and immediate. *Robinson T*[*ownship v. Commonwealth*], 83 A.3d [901,] 917 [(Pa. 2013)]. "A party's interest is substantial when it surpasses the interest of all citizens in procuring obedience to the law; it is direct when the asserted violation shares a causal connection with the alleged harm; finally, a party's interest is immediate when the causal connection with the alleged harm is neither remote nor speculative." *Commonwealth, Office of Governor v. Donahue*, . . . 98 A.3d 1223, 1229 ([Pa.]2014).

FOAC, 261 A.3d at 481.

Here, because Petitioner is an association and it is the only named petitioner in this matter, asserting claims on behalf of its members, the Court must examine the concept of associational standing. "It is well settled that an association, as a representative of its members, may have standing to bring a cause of action even in the absence of injury to itself." *PSSU*, 699 A.2d at 810. As this Court has explained,

> [a]n association has standing to bring an action on behalf of its members where at least one of its members is suffering an immediate or threatened injury as a result of the challenged action. . . . To have standing on this basis, the . . . organization must allege sufficient facts to show that at least one of its members has a substantial, direct[,] and immediate interest. General descriptions of an organization's members cannot establish standing if they do not show that a member or members are sufficiently adversely affected to have standing.

Americans for Fair Treatment, Inc. v. Philadelphia Federation of Teachers, Local 3, AFL-CIO, 150 A.3d 528, 533-34 (Pa. Cmwlth. 2016) (internal citations omitted).

Moreover, "[s]tanding may be shown without identification of individual members, but only where the [petition]'s description of the organization's members is sufficient to show that they are aggrieved." *Id.* at 534-35 (citations omitted).

The Court is satisfied that the allegations here are sufficient to establish that Petitioner has standing. Mr. Woloveck testified that he is the Chief Commercial Director of Jushi, the parent corporation of several permitted MMOs, including both grower/processor and dispensary permittees. Given this role, he is familiar with the innerworkings of these permittees, their day-to-day operations, as well as DOH's approval processes for specific medical marijuana products. Mr. Woloveck stated that Jushi's permitted MMOs are directly affected by the Recall because it has forced dispensary members to pull medicine from their shelves and return it to grower/processor members, who in turn have placed the products in quarantine. As Mr. Woloveck explained, all medical marijuana products have expiration dates and while he was not able to provide specific dates on which Jushi's recalled products will expire, it is beyond question that a number of the 670 recalled products, totalling approximately 330,000 units, will expire in quarantine absent a preliminary injunction. Moreover, both Mr. Woloveck and Mr. Ahern testified, in detail, as to the financial and reputational harm MMOs have suffered and will continue to suffer due to the Recall, harm that is unique to these organizations and which surpasses the interest of the general public. This harm includes losses for recalled products that were already on the shelves or somewhere within the production lines, disruption in sales and profits, equipment-related costs, and potential lost sales due to the adverse impact on the reputation of MMOs who sell the recalled products given DOH's statements that the products may be unsafe. Given this uncontested credible testimony, Respondents' argument that Petitioner's asserted harms are speculative lacks merit and the Court finds that Petitioner has standing to bring this action.

B. Preliminary Injunction

The Court now turns to the merits of Petitioner's Application. A preliminary injunction is an extraordinary remedy, the purpose of which "is to preserve the status quo and prevent imminent and irreparable harm that may occur before the merits of the case can be heard and resolved." *Nether Providence Township v. Coletta*, 133 A.3d 86, 91 (Pa. Cmwlth. 2016). It is well established that a court may grant a preliminary injunction only where a petitioner demonstrates each of the following factors:

> (1) the injunction is necessary to prevent immediate and irreparable harm that cannot be compensated adequately by damages; (2) greater injury would result from refusing the injunction than from granting it, and, concomitantly, the issuance of an injunction will not substantially harm other interested parties in the proceedings; (3) the preliminary injunction will properly restore the parties to their status as it existed immediately prior to the alleged wrongful conduct; (4) the party seeking injunctive relief has a clear right to relief and is likely to prevail on the merits; (5) the injunction is reasonably suited to abate the offending activity; and, (6) the preliminary injunction will not adversely affect the public interest.

SEIU Healthcare Pennsylvania v. Commonwealth, 104 A.3d 495, 502 (Pa. 2014) (citing *Warehime v. Warehime*, 860 A.2d 41, 46-47 (Pa. 2004); *Summit Towne Centre, Inc. v. Shoe Show of Rocky Mount, Inc.*, 828 A.2d 995, 1001 (Pa. 2003)). "For a preliminary injunction to issue, every one of the [] prerequisites must be established; if the petitioner fails to establish any one of them, there is no need to address the others." *Summit Towne Centre*, 828 A.2d at 1001 (quoting *County of Allegheny v. Commonwealth*, 544 A.2d 1305, 1307 (Pa. 1988)).

Based on the evidence adduced by the parties during the hearing, as well as the pleadings and written and oral argument on the matter, the Court concludes that Petitioner has met its burden for preliminary injunctive relief.

The Court begins with the fourth criteria necessary for a preliminary injunction—whether Petitioner has a clear right to relief and is likely to prevail on the merits. "For a right to be clear, it must be 'more than merely viable or plausible;' however, this requirement is not the equivalent of stating that no factual disputes exist between the parties." *Wolk v. School District of Lower Merion*, 228 A.3d 595, 611 (Pa. Cmwlth. 2020) (quoting *Ambrogi v. Reber*, 932 A.2d 969, 980 (Pa. Super. 2007)). Our Supreme Court has further explained that "[t]o establish a clear right to relief, the party seeking an injunction need not prove the merits of the underlying claim, but need only demonstrate that substantial legal questions must be resolved to determine the rights of the parties." *SEIU Healthcare*, 104 A.3d at 506 (citing *Fischer v. Department of Public Welfare*, 439 A.2d 1172 (Pa. 1982)). *Accord Marcellus Shale Coalition v. Department of Environmental Protection*, 185 A.3d 985, 995 (Pa. 2018) ("In the context of a motion for a preliminary injunction, only a substantial legal issue need be apparent for the moving party to prevail on the clear-right-to-relief prong.").

Here, Petitioner first argues that it has a clear right to relief because the Recall exceeds and is inconsistent with DOH's statutory authority. As Petitioner points out, Act 44 recently amended Section 702(a)(5) of the Act to expressly permit grower/processors to add excipients to their medical marijuana products. This section now provides that in determining whether to approve an added substance, such as terpenes, DOH shall consider "[w]hether the added substance is permitted by the [FDA] for use in food or is [GRAS] under Federal guidelines." Section 702(a)(5)(i) of the Act, 35 P.S. § 10231.702(a)(5)(i). Notably absent from this newly amended statutory provision is whether the added substance is approved as safe for inhalation by the FDA, the standard DOH used in issuing the Terpene Recall Mandate here. Petitioner observes that in "[a]pplying the rules of statutory construction, the inclusion of a specific matter in a statute implies the exclusion of other matters." *Independent Oil and Gas Association of Pennsylvania v. Board of Assessment Appeals of Fayette County*, 814 A.2d 180, 184 (Pa. 2002). Petitioner has raised a substantial argument that, given the express language of the Act and the specificity of the criteria the General Assembly stated could be considered, DOH may have exceeded its statutory authority by issuing the Recall.

In a related vein, Petitioner further argues that the Recall is an unlawful *de facto* regulation that is void because it was not properly promulgated. Petitioner maintains that the Recall imposes an immediately effective industry-wide rule, namely that terpenes must be approved as safe for inhalation by the FDA in order for DOH to approve them as excipients in medical marijuana vaporization products. According to Petitioner, DOH has created a binding norm through this new mandatory rule and, therefore, DOH was required to engage in the requisite rulemaking processes.

It is well established that while regulations are subject to the formal rulemaking process,[16] "[s]tatements of policy . . . need not be subject to notice and

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[16] This Court has also explained the purpose and advantages of formal rulemaking as follows:

> [t]he process by which regulations are issued provides an important safeguard for potentially affected parties against the unwise or

comment because, presumably, they only provide guidance by which administrative agency personnel carry out their power delegated to them by the General Assembly." *Department of Environmental Resources v. Rushton Mining Co.*, 591 A.2d 1168, 1171 (Pa. Cmwlth. 1991). Moreover, "interpretive rules or regulations[] which 'do not in themselves establish binding standards of conduct . . . need not be promulgated . . . to the extent they merely construe a statute and do not improperly expand upon its terms.'" *Victory Bank v. Commonwealth*, 219 A.3d 1236, 1243 (Pa. Cmwlth. 2019) (quoting *Borough of Pottstown v. Pennsylvania Municipal Retirement Board*, 712 A.2d 741, 743 (Pa. 1998)). However, "[i]f an interpre[]tive rule or statement of policy functions as a regulation, then it will be nullified due to the agency's failure to obey the processes applicable to the promulgation of a regulation." *Transportation Services, Inc. v. Underground Storage Tank Indemnification Board*, 67 A.3d 142, 154 (Pa. Cmwlth. 2013) (citing *Rushton Mining Co.*, 591 A.2d at 1171)).

Here, Petitioner raises a colorable argument that the Terpene Recall Mandate goes beyond a statement of policy and instead creates a binding norm.

> improper exercise of discretionary administrative power. This process, which includes public notice of a proposed rule, making a request for written comments by any interested party, giving due consideration to such comments, and holding hearings as appropriate affords the affected parties a democratic process for participation in the formulation of standards which govern their conduct and increases the likelihood of administrative responsiveness to their needs and concerns. Moreover, it gives the administrative agency facts and information relevant to the proposed rule, as well as opens up the agency to alternatives, detrimental effects, criticism and advice, thereby contributing to the soundness of the proposed regulation.

Department of Environmental Resources v. Rushton Mining Co., 591 A.2d 1168, 1171 (Pa. Cmwlth. 1991).

Respondents' February 4, 2022 emails to both grower/processors and medical marijuana patients specifically state that DOH has determined that certain vaporization products containing terpenes may no longer be produced and are subject to recall because they have not been approved for inhalation by the FDA. The email to grower/processors further rescinds DOH's prior approval of the products and mandates that grower/processors "**MUST follow the mandatory recall procedures outlined in 28 Pa. Code § 1151.42(c).**" Stipulation Exhibit 1 (emphasis in original). There is little air in the language used by DOH. Moreover, Respondents do not dispute that failure to follow the Recall may result in sanctions, or that the majority of the recalled products were previously approved for production and distribution by DOH. As such, Petitioner has raised a substantial legal question as to whether the Recall—specifically, Respondents' use of the standard of "approved for inhalation by the FDA"—establishes a binding norm such that DOH was required go through the formal rulemaking process.

Petitioner also raises several constitutional arguments, including that the Terpene Recall Mandate violates the vested rights of Petitioner's grower/processor and dispensary members; constitutes the taking of private property without compensation; violates due process because it went into effect prior to Petitioner's members being afforded adequate notice and an opportunity to be heard; and impugns the constitutionally protected right to reputation of Petitioner's members. Given all of the above, the Court is satisfied that Petitioner has raised several substantial legal questions which fulfill this prerequisite.

Next, Petitioner must demonstrate that an injunction is necessary to prevent immediate and irreparable harm that cannot be compensated adequately by money damages. *Summit Towne Centre, Inc.*, 828 A.2d at 1001-02. To meet this burden, a petitioner generally must present actual proof of irreparable harm; "speculation and conjecture will not suffice." *Reed v. Harrisburg City Council*, 927 A.2d 698, 706 (Pa. Cmwlth. 2007).

As explained above, Petitioner asserts that its grower/processor and dispensary members will continue to suffer reputational harm given Respondents' statements issued in conjunction with the Terpene Recall Mandate suggesting that the recalled products are unsafe. Moreover, Petitioner argues that its members have suffered and will continue to suffer harm because Respondents' actions violate the Act and are unconstitutional. It is well established that alleged violations of constitutional rights and statutory mandates constitute irreparable harm *per se*. *See, e.g.*, *SEIU Healthcare*, 104 A.3d at 508-09; *Pennsylvania Public Utility Commission v. Israel*, 52 A.2d 317, 321 (Pa. 1947). As such, "[n]o other injury is required for an injunction provided that the other necessary ingredients to relief are present." *Northern Pennsylvania Legal Services, Inc. v. Lackawanna County*, 513 F. Supp. 678, 685 (M.D. Pa. 1981) (citing *Elrod v. Burns*, 427 U.S. 347, 373-74 (1976)).

Even though nothing else is required, Petitioner also argues that its grower/processor and dispensary members will be irreparably harmed absent a preliminary injunction because the Terpene Recall Mandate requires the immediate recall and potential expiration of more than 670 individual medical marijuana vaporization products, totaling approximately 330,000 individual units and representing a collective economic loss of more than $17 million. Petitioner further maintains that it's members invested over $9 million in the development, creation, marketing, and future distribution of the recalled products.

Respondents objected to Mr. Ahern's testimony regarding damages, arguing that such testimony is not appropriate in the context of irreparable harm for purposes of a preliminary injunction. However, as Petitioner correctly notes, money damages are unavailable to its member entities because Respondents may be immune from such damages. Petitioner's action is one seeking a declaratory judgment. While "sovereign immunity does not bar either mandamus or declaratory judgment actions," *Brimmeier v. Pennsylvania Turnpike Commission*, 147 A.3d 954, 961 (Pa. 2016), it does apply when a party seeks to recover money damages. *Finn v. Rendell*, 990 A.2d 100, 105 (Pa. Cmwlth. 2010). Thus, where Respondents would not be liable for lost revenue, even if sufficiently proven, Petitioner's member entities are irreparably harmed because money damages are unavailable to compensate them for their losses.

For these reasons, the Court finds that Petitioner has demonstrated that a preliminary injunction is necessary to prevent immediate and irreparable harm that cannot be compensated adequately by damages.

Petitioner must also show that greater injury would result from refusing the injunction than granting it, and that issuing an injunction would not substantially harm other interested parties. *SEIU Healthcare*, 104 A.3d at 502. Further, Petitioner must demonstrate that a preliminary injunction will not adversely affect the public interest. *Id.* The Court is satisfied that a balancing of the harms weighs in favor of granting the preliminary injunction.

As discussed above, Petitioner has presented credible evidence of the significant harm its grower/processor and dispensary members have suffered and will continue to suffer if the Recall is not enjoined. Petitioner has also raised substantial constitutional and statutory issues with respect to Respondents' issuance of the Recall. The Court is cognizant of DOH's duty, under the Act, to regulate the Commonwealth's medical marijuana program in a way that enhances and promotes patient safety. *See, e.g.*, Section 102 of the Act, 35 P.S. § 10231.102. However, Respondents, have failed to present any evidence to the Court of potential harm to medical marijuana patients due to the recalled products, or more specifically due to the addition of terpenes to these products. Respondents did not call any witnesses during the preliminary injunction hearing or present any evidence regarding patient complaints or adverse events suffered due to the recalled products containing terpenes. To the contrary, Petitioners' witnesses testified to the lack of such evidence. At this juncture, and given the evidence presented to date, the Court concludes that the balancing of harms weighs in favor of granting the preliminary injunction. *See Summit Towne Centre Inc.*, 828 A.2d at 1003 (upholding trial court's conclusion that balancing of harms weighed in favor of granting preliminary injunction where enjoined party failed to present particular evidence of its own harm).

Further, the Court finds that Petitioner's request would maintain the "status quo," which has been defined for purposes of a preliminary injunction as "the last peaceable and lawful uncontested status preceding the underlying controversy." *Hatfield Township v. Lexon Insurance Co.*, 15 A.3d 547, 556 (Pa. Cmwlth. 2011) (quoting *In re Milton Hershey School Trust*, 807 A.2d 324 (Pa. Cmwlth. 2002)). Here, that would be the parties' status prior to DOH's issuance of the Terpene Recall Mandate. Finally, the Court finds that Petitioner's request that Respondents be enjoined from enforcing the Recall is reasonably suited to abate the offending activity.

V. Conclusion

Upon review of the evidence, the Court concludes that Petitioner has met its burden of establishing all of the necessary prerequisites for a preliminary injunction.[17] Accordingly, the Application is granted[18] and Respondents are enjoined from enforcing the Terpene Recall Mandate.

MICHAEL H. WOJCIK, Judge

[17] In its Application, Petitioner requested that the bond required by Pa.R.Civ.P. 1531(b) for the issuance of a preliminary injunction be set at the nominal level of $100. The Court grants this request, being satisfied that no entity will sustain reasonably foreseeable damages in the event it is later determined that the requested preliminary injunction was wrongfully granted.

[18] Petitioner further requested that the Court specify in any order granting a preliminary injunction that no appeal from said order would act as an automatic supersedeas under Pa.R.A.P. 1736(b). The Court declines to grant such relief.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Medical Marijuana Access & Patient Safety, Inc., Petitioner	:	
v.	:	No. 58 M.D. 2022
Keara Klinepeter, Acting Secretary, Pennsylvania Department of Health, John J. Collins, Director of the Pennsylvania Department of Health, Office of Medical Marijuana, and Sunny D. Podolak, Assistant Director and Chief Compliance Officer of the Pennsylvania Department of Health, Office of Medical Marijuana, Respondents	:	

O R D E R

AND NOW, this 2nd day of June, 2022, Petitioner's Application for Special Relief in the Nature of a Preliminary Injunction is GRANTED. Respondents are hereby ENJOINED from enforcing the February 4, 2022 Terpene Recall Mandate.

Pursuant to Pa.R.Civ.P. 1531(b), this Order shall become effective upon Petitioner's filing of a bond or legal tender of the United States with the Court in the amount of one hundred dollars ($100.00).

The Court SUSTAINS Respondents' objection to the rebuttal testimony of Trent Woloveck.

To the extent the Application seeks relief from Pa.R.A.P. 1736(b) pertaining to automatic supersedeas, that request is DENIED.

MICHAEL H. WOJCIK, Judge

[J-65A-2021 and J-65B-2021]
IN THE SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

BAER, C.J., SAYLOR, TODD, DONOHUE, DOUGHERTY, WECHT, MUNDY, JJ.

ENERGY TRANSFER, Appellee v. ERIC FRIEDMAN, Appellant	No. 24 MAP 2021 Appeal from the Order of the Commonwealth Court at No. 982 CD 2019 dated October 21, 2020 Reversing the Order of the Office of Open Records at No. AP 2019-0502 dated June 26, 2019 ARGUED: October 26, 2021
PENNSYLVANIA PUBLIC UTILITY COMMISSION, Appellee v. ERIC FRIEDMAN, Appellant	No. 25 MAP 2021 Appeal from the Order of the Commonwealth Court at No. 980 CD 2019 dated October 21, 2020 Reversing the Order of the Office of Open Records at No. AP 2019-0502 dated June 26, 2019 ARGUED: October 26, 2021

OPINION

JUSTICE DONOHUE **DECIDED: December 22, 2021**

This appeal by permission in a case of first impression considers whether the Office or Open Records ("OOR") has the authority to review the denial of an individual's request for records pursuant to the Right to Know Law, 65 P.S. §§ 67.101–67.3104

("RTKL"),[1] where a public utility has designated records responsive to the request as confidential security information ("CSI") under the Public Utility Confidential Security Information Disclosure Protection Act, 35 P.S. §§ 2141.1–2141.6 ("CSI Act").[2] We hold that the Public Utility Commission ("PUC") has exclusive authority to review such requests and, therefore, the OOR erred in exercising jurisdiction over the CSI-designated records. Accordingly, we affirm the order of the Commonwealth Court reversing the OOR's disclosure order.

Factual Background

Eric Friedman ("Friedman") lives in the area where the Sunoco Pipeline L.P. Mariner East 1 Pipeline ("Pipeline") is located. The Pipeline is a highly volatile liquid ("HVL") pipeline owned and operated by Energy Transfer. On January 31, 2019, Friedman attended a public meeting regarding the Pipeline, at which Paul Metro, the PUC's Manager of Safety Division, Pipeline Safety Section, addressed questions regarding pipeline leaks. In the course of answering questions, Metro mentioned that the PUC possessed hazard assessment reports associated with accidents or releases on HVL pipelines, which included estimates of the blast radius resulting from an accident or release.

The following Monday, Friedman submitted a RTKL request to the PUC for

> all records in the possession of Paul Metro, his superiors or subordinates, that relate to the calculation or estimation of the

[1] Act of 2008, Feb. 14, P.L. 6, No. 3, effective Jan. 1, 2009.

[2] Act of 2006, Nov. 29, P.L. 1435, No. 156, effective May 29, 2007. The CSI Act defines CSI as "[i]nformation contained within a record maintained by an agency in any form, the disclosure of which would compromise security against sabotage or criminal or terrorist acts and the nondisclosure of which is necessary for the protection of life, safety, public property or public utility facilities[.]" 35 P.S. § 2141.2.

> range at which thermal or overpressure events related to accidents on hazardous, highly volatile liquid (HVL) pipelines may be experienced. This request does not seek information provided by Sunoco if that information has been designated as confidential security information. Rather, it seeks records containing or relating to calculations or estimates of blast radius (Sunoco's term) or "buffer zone" (PUC's term) regarding accidents or releases from HVL pipelines in the possession of the PUC, including (but not limited to) information that was produced for PUC by an external source or that was developed internally.

Email Request from Eric Friedman to rchiavetta@pa.gov, 2/4/2019.

The PUC denied Friedman's request, stating that the responsive records had been designated CSI and thus were protected from disclosure by the CSI Act and exempt from disclosure under the RTKL. The PUC informed Friedman that he could challenge the denial of his RTKL request by filing an appeal with the OOR. *See* 65 P.S. § 67.903(5) ("If an agency's response is a denial…, the denial shall be issued in writing and shall include…(5) the procedure to appeal the denial of access under this act."). The PUC did not inform Friedman of its own internal procedures for challenging a public utility's CSI designation.

Having made a RTKL request, Friedman filed an appeal with the OOR, "disputing the confidential nature of the records and the secure nature of the [P]ipeline infrastructure." OOR Decision, 6/26/2019, at 4. The OOR denied his request for disclosure in part. Interpreting the CSI Act from a procedural perspective, the OOR determined that the PUC had failed to prove that the requested records were CSI. It pointed out that, to designate records as CSI, a public utility must comply with the exacting provisions of the CSI Act, which also reside in the PUC's regulations. Specifically, a public utility must clearly state in a transmittal letter to be shared with the requestor that the records contain CSI and explaining why the information is to be treated as confidential. 52 Pa. Code § 102.3(b)(1). Although the PUC had presented the OOR with two affidavits representing that the responsive records contained CSI, the OOR directed the PUC to provide hard copies of the relevant transmittal letters submitted by Energy Transfer. Because the transmittal letters also contained CSI, the PUC provided the OOR with redacted letters and refused to provide them to Friedman at all. The PUC's refusal to provide Friedman with the letters led the OOR to conclude that there was no evidence in the record proving that the responsive records had been properly designated as CSI. Thus, the OOR ruled that Energy Transfer was not entitled to protection from disclosure under the CSI Act.

Nonetheless, the OOR determined that the PUC had proven, through, inter alia, the affidavits, that certain records were exempt from disclosure under the RTKL. Specifically, the PUC had proven that disclosure of the hazard assessment reports "creates a reasonable likelihood of endangering the safety or the physical security of a…public utility[.]" 65 P.S. § 67.708(b)(3). The OOR further determined that some of the responsive records were exempt from disclosure under a second RTKL exception, i.e., records "of an agency relating to a noncriminal investigation, including (ii) Investigative materials, notes, correspondence and reports[.]" 65 P.S. § 67.708(b)(17)(ii). Finally, the OOR determined that Subsection 335(d) of the Public Utility Code[3] required disclosure of

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[3] Subsection 335(d) of the Public Utility Code provides, in relevant part, as follows:

> In addition to any other requirements imposed by law, including the [RTKL] and the…Sunshine Act, whenever the commission conducts an investigation of an act or practice of a public utility and makes a decision, enters into a settlement

documents relied on by the PUC in its investigation of the Pipeline, excluding the hazard assessment reports that it found were exempt from disclosure under Section 67.708(b)(3) of the RTKL.

Energy Transfer and the PUC appealed to the Commonwealth Court, which reversed the OOR's decision in a unanimous opinion. *PA. Pub. Util. Comm'n v. Friedman*, 244 A.3d 515 (Pa. Commw. 2020). The Commonwealth Court recounted its statement in *Department of Labor and Industry v. Heltzel*, 90 A.3d 823, 832 (Pa. Commw. 2014) (*en banc*), that "[c]onflicts as to public access, as opposed to public nature, are governed by Section 3101.1 of the RTKL[,]" which provides that, where there is a conflict between the RTKL and another state law, the provisions of the RTKL shall not apply. *Friedman*, 244 A.3d at 519; 65 P.S. § 67.3101.1. As a result, pursuant to Section 2141.3(c) of the CSI Act, the OOR does not administer the CSI Act and lacks any authority to determine whether information qualifies as CSI. *Friedman*, 244 A.3d at 519–20 (citing 35 P.S. § 2141.3). Instead, the court opined, challenges to a CSI designation must be brought to the PUC. *Id*. at 520. The Commonwealth Court observed that Friedman did not exhaust the administrative remedies prescribed in the CSI Act and afforded through PUC regulations. The Commonwealth Court "decline[d] to disrupt the authority of the PUC regarding CSI matters." *Id*.

> with a public utility or takes any other official action, as defined in the Sunshine Act, with respect to its investigation, it shall make part of the public record and release publicly any documents relied upon by the commission in reaching its determination, whether prepared by consultants or commission employees, other than documents protected by legal privilege[.]

66 Pa.C.S. § 335(d).

Friedman filed a petition for allowance of appeal, and we granted review of the following issue:

> Does the Office of Open Records have the authority to order the release of a record in Public Utility Commission's possession when the OOR determines that record does not contain Confidential Security Information as defined in the Confidential Security Information Act, 35 P.S. § 2141.3 et seq.?

Energy Transfer v. Friedman, 252 A.3d 1083 (Pa. 2021).

<u>Arguments of the Parties</u>

Friedman contends that the OOR had authority to order the disclosure of the records requested under the RTKL. In support, Friedman raises a distinction between disputes regarding the public nature of documents and those regarding public access to documents. He asserts that the OOR has the authority to adjudicate the public nature of documents, while acknowledging that it has less authority with regard to public access to documents. *See Heltzel*, 90 A.3d 823 (explaining that OOR had authority to interpret federal law regarding the nature of records but not to enforce the procedures in that law for accessing public records).

Friedman also asserts that, even though the RTKL and the CSI Act both address access to records, there is no conflict between the two statutes in this case because the appeal procedure of the CSI Act was not triggered, leaving the OOR with unimpeded authority to adjudicate disclosure of the responsive records. He explains that the RTKL's presumption of public access in 65 P.S. § 67.305 is consistent with the public access provision of the Public Utility Code, which requires any documents relied upon by the PUC in reaching a determination about a public utility to be made part of the record. 66 Pa.C.S. § 335(d). In contrast, the CSI Act exempts some information that might otherwise be subject to disclosure under Subsection 335(d) of the Public Utility Code. However, Friedman insists, the CSI Act affords protection from disclosure only when a public utility follows the procedures set forth in the CSI Act and the corresponding PUC regulations regarding the designation of CSI. *See* 35 P.S. § 2141.3(a) (instructing public utility to "[c]learly state in its transmittal letter, upon submission to an agency, that the record contains [CSI] and explain why the information should be treated as such"); 52 Pa. Code § 102.3(b)(1) (instructing public utility to "[c]learly state in its transmittal letter to the [PUC] that the record contains [CSI] and explain why the information should be treated as confidential").

To Friedman, Energy Transfer's procedural blunder with respect to its transmittal letters was fatal to its designation of the records as CSI and, therefore, to protection under the CSI Act. Because Energy Transfer's transmittal letters did not properly invoke protection under the CSI Act, Friedman reasons, the CSI Act's appeal procedure became irrelevant,[4] and the OOR had authority to adjudicate the public nature of the responsive records. *See* 52 Pa. Code § 102.3(c) (stating that when public utility fails to designate record as containing CSI, "it does not obtain the protections offered in this chapter"). In support, Friedman cites the fact that the CSI Act was enacted two years before the OOR was created and, therefore, does not contemplate the OOR's authority. Friedman also cites *Pennsylvania Public Utility Commission v. Seder/The Times Leader*, 139 A.3d 165, 167 (Pa. 2016), in which, he claims, this Court tacitly approved of the OOR's authority to

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[4] The Pennsylvania Code embodies the procedure set forth in the CSI Act pursuant to which a member of the public may challenge a designation of CSI first to the PUC and then to the Commonwealth Court or request in writing to examine CSI. 52 Pa. Code § 102.4(a)(1), (2)(i–v).

review and grant disclosure of documents under the Public Utility Code, specifically, the non-criminal investigation provision. Pursuant to 66 Pa.C.S. § 335(d), Friedman contends, the OOR's authority in this case is no greater than its authority recognized in *Seder*.

In response, Energy Transfer and the PUC contend that the OOR's role in reviewing the RTKL request ended when the OOR received good faith affidavits from the PUC stating that disclosure of the responsive documents "would compromise security against sabotage or criminal or terroristic acts regarding pipeline facilities." *See* 35 P.S. § 2141.2 (defining "confidential security information"). They argue that the plain language of the CSI Act vests the PUC with jurisdiction over CSI determinations and, therefore, the Commonwealth Court correctly determined the OOR had no authority to reconsider a designation of records as CSI. In support, Energy Transfer and the PUC emphasize that disputes regarding CSI designation — whether the dispute is about the substantive reasons or the procedural basis for the classification — go to the agency that originally received the record, not to the OOR.[5] Accordingly, as the agency that originally received Energy Transfer's records, the PUC claims it wielded sole authority to adjudicate this matter. Energy Transfer and the PUC further assert that, notwithstanding Energy Transfer's mishandling of its transmittal letters, the PUC had authority to consider both the compliance and substantive aspects of Energy Transfer's CSI designation. *See* 52 Pa. Code § 102.3(d) (explaining that authorized PUC person "will make a preliminary

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[5] *See* 35 P.S. § 2141.3(c) (providing that "challenges to a public utility's designation or request to examine records containing [CSI] by a member of the public shall be made in writing to the agency in which the record or portions thereof were originally submitted[,]" and authorizing the agency to develop protocol and procedures to address such challenges).

determination whether the information has been properly designated in accordance with the definition of [CSI]").

Next, Energy Transfer and PUC assert that the RTKL defers to other statutes where a conflict regarding access arises. Specifically, the RTKL states that "if the provisions of this act regarding access to records conflict with any other Federal or State law, the provisions of this act shall not apply." 65 P.S. § 67.3101.1. Energy Transfer and PUC find a conflict between Section 2141.3(c) of CSI Act, which authorizes the PUC to oversee challenges to CSI designations, and the RTKL, which purports to give the OOR general authority over access to information. In light of this conflict, they conclude, the provisions of the RTKL do not apply. In fact, they assert, Section 67.3101.1 of the RTKL is consistent with the CSI Act's provision that "[p]ublic utility records or portions thereof which contain [CSI], in accordance with the provisions of this act, shall not be subject to the provisions of" the RTKL. 35 P.S. § 2141.4.

Additionally, Energy Transfer and the PUC challenge the OOR's reliance on Subsection 335(d) of the Public Utility Code as requiring disclosure of some of the responsive records. They contend that Subsection 335(d), which requires the release of documents following PUC decisions**,** is inapplicable because there was no "decision" or "official action" taken in this case. They refute the notion that the formal complaint and investigation into Energy Transfer pursued by the PUC's Bureau of Investigation and Enforcement constitutes an "official action," as that term is defined in the Sunshine Act.[6] *See* 65 Pa.C.S. § 703 (defining "official action" as recommendations, establishments of

[6] Act of 1998, Oct. 15, P.L. 729, No. 93, § 1, effective December 15, 1998; 65 Pa.C.S. §§ 701–716.

policy, “decisions on agency business made by an agency,” or a “vote taken by any agency on any motion, proposal, resolution, rule, regulation, ordinance, report or order”). They also point out that Subsection 335(d) of the Public Utility Code contains an exception for information which could be used for criminal or terroristic purposes. *See* 66 Pa.C.S. § 335(d) (providing that “if a document required to be released under this section contains … information which, if disclosed to the public, could be used for criminal or terroristic purposes, the identifying information may be expurgated from the copy of the document made part of the public record”). That exception protects the CSI-designated information challenged in the present matter from disclosure.

<u>Analysis</u>

To recap, Friedman submitted a RTKL request to the PUC for non-CSI records related to the blast radius of an HVL pipeline accident or release. In response, the PUC denied the request, claiming that the responsive records were not subject to public disclosure under the CSI Act and thus were exempt from disclosure under the RTKL. The PUC advised Friedman of his right to appeal the denial to the OOR pursuant to the RTKL but not of his right to appeal pursuant to the PUC’s regulations at 52 Pa. Code § 102.3. Friedman filed an appeal with the OOR, challenging the confidential nature of the responsive records.

We must determine whether the OOR had any statutory authority to identify and release to the public records that a public utility has submitted to the PUC with a designation of CSI. As our analysis requires the interpretation of competing statutes, our analysis is governed by the Statutory Construction Act of 1972, 1 Pa.C.S. §§ 1501-1991.

> Pursuant to the Statutory Construction Act, the overriding object of all statutory interpretation “is to ascertain and

> effectuate the intention of the General Assembly" in enacting the statute under review. *Id*. § 1921(a). If statutory language is "clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." *Id.* § 1921(b). Thus, when the words of a statute have a plain and unambiguous meaning, it is this meaning which is the paramount indicator of legislative intent. However, in situations where the words of a statute "are not explicit," the legislature's intent may be determined by considering any of the factors enumerated in Section 1921(c).

McKelvey v. Pennsylvania Dep't of Health, 255 A.3d 385, 397–98 (Pa. 2021). As matters of statutory interpretation involve questions of law, our scope of review is plenary, and our standard of review is de novo. *Philadelphia Gas Works v. Pa. Pub. Util. Comm'n,* 249 A.3d 963, 970 (Pa. 2021).

Neither party argues that the relevant language of the RTKL and the CSI Act is ambiguous, and we find no ambiguity. Thus, our review is based on the plain language of these two statutes,[7] which reveals an overlap in the areas of designating and disclosing a record. Both statutes include procedures for requesting a record in possession of an agency and for challenging the denial of a record request. 65 P.S. §§ 67.702–704, 67.1101; 35 P.S. § 2141.3. They diverge, however, with respect to identifying the nature of, and providing access to, records containing CSI. Before reconciling this divergence as to which forum has statutory authority over CSI, we summarize their unique purposes and provisions.

As "remedial legislation to facilitate government transparency and accountability," the RTKL is "construed to maximize access to public records" in an agency's possession.

[7] Because our review is based on the plain and unambiguous language of the RTKL and the CSI Act, we do not have to consider arguments relating to other statutory factors, e.g., policy arguments. *See* 1 Pa.C.S. § 1921(c) (allowing courts to consider statutory factors to discern legislative intent where language of statute is ambiguous).

McKelvey, 255 A.3d at 399, 400. *Accord Seder*, 139 A.3d at 174 (observing that "the object of the RTKL is to empower the citizens of this Commonwealth with access to information concerning government activities"). To "prohibit secrets, scrutinize the actions of public officials, and make public officials accountable for their actions," the RTKL places the statutory duty of disclosing public records "solely on the government agency." *McKelvey*, 255 A.3d at 400 (quoting *Pa. Educ. Ass'n v. Commonwealth Dep't Cmty. Econ. Dev.*, 148 A.3d 142, 155 (Pa. 2016)); 65 P.S. § 67.706. To that end, the RTKL mandates a Commonwealth or local agency to "provide public records in accordance with [the] act," and without regard to a requester's "intended use of the public record," unless otherwise provided by law. 65 P.S. §§ 67.301, 67.302.

Pursuant to the RTKL, a record in the possession of a Commonwealth or local agency "shall be presumed to be a public record." 65 P.S. § 67.305. The RTKL defines "public record" as a record of a Commonwealth or local agency that:

> (1) is not exempt under section 708 [of this act, 65 P.S. § 67.708(b) (Exceptions for public records)];
>
> (2) is not exempt from being disclosed under any other Federal or State law or regulation or judicial order or decree; or
>
> (3) is not protected by a privilege.

65 P.S. § 67.102.

In furtherance of its transparency goal, the General Assembly created the OOR to enforce the RTKL, giving it specific, enumerated powers. 65 P.S. § 67.1310.[8] In addition

[8] The OOR has statutory authority to provide "information relating to the implementation and enforcement" of the RTKL, issue "advisory opinions to agencies and requester," provide "annual training courses [on the act] to agencies, public officials and public

to administrative and training powers, the OOR has the authority to hear appeals from an agency's denial of a request for access to a record, which appeal "shall state the grounds upon which the requester asserts that the record is a public record … and shall address any grounds stated by the agency for delaying or denying the request." 65 P.S. § 67.1101.[9]

As a creation of the RTKL, the OOR reviews record requests and denials of record requests through the lens of the RTKL. In defining "public record" in the RTKL, however, the General Assembly anticipated the OOR's interpretation of other laws. *Cf. Heltzel*, 90 A.3d at 828 (observing RTKL contemplates interpretation of federal Emergency Planning and Community Right-to-Know Act). The RTKL contains two caveats related to how other laws impact its presumption that a record is public and, therefore, subject to public disclosure. These caveats concern the nature of a record and the accessibility of a record, which are distinct concepts. *Id.* at 831 (observing the two concepts are distinct, "otherwise, one of the RTKL provisions would be superfluous, contrary to presumed legislative intent").[10]

employees," assign "appeals officers to review appeals of decisions by Commonwealth agencies or local agencies," establish "an information mediation program to resolve disputes" under the act and "an internet website with information" relating to the act, conduct "a biannual review of fees charged" under the act, and report annually "on its activities and findings to the Governor and the General Assembly." 65 P.S. § 67.1310(a)(1)-(9).

[9] An OOR appeals officer has the authority to accept documents, hold a hearing, admit evidence that the officer "believes to be reasonably probative and relevant to an issue in dispute," consult with agency counsel, and render "a final determination on behalf of the [OOR] or other agency" with or without a hearing. *Id.* § 67.1102(a)(1)–(4).

[10] The Reporters Committee for Freedom of the Press and 11 News Organizations (collectively, "Reporters Committee") submitted an amicus brief in support of Friedman,

According to the first caveat, nothing in the RTKL "shall supersede or modify the public or nonpublic nature of a record or document established in Federal or State law, regulation or judicial order or decree." 65 P.S. § 67.306. Thus, where a federal or state law establishes a record as public, the record is not subject to a public record analysis under the RTKL. "Given this significant consequence, a statute should be clear when it establishes the public nature of records." *Heltzel*, 90 A.2d at 832. According to the second caveat, if the provisions of the RTKL "regarding access to records conflict with any other Federal or State law, the provisions of [the RTKL] shall not apply." *Id.* § 67.3101.1. Thus, where a federal or state law prescribes certain procedures to access records in a manner that conflicts with the RTKL, the provisions of the other law prevail.

Whereas the RTKL promotes the disclosure of public records in the possession of an agency, the General Assembly enacted the CSI Act "to create mechanisms for the safeguarding of confidential security information of public utilities that is provided to various state agencies, such as the [PUC], from disclosure that may compromise security against sabotage or criminal or terrorist acts." *Designation of Qualified Documents for Elec. Filing*, L-00070187, 2008 WL 5582647, at *2 (Nov. 19, 2008). To that end, the CSI

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claiming there is a critical distinction between disputes about the public nature of documents and those about public access to documents. According to the Reporters Committee, although the CSI Act establishes the nonpublic nature of the responsive records, the RTKL empowers the OOR to determine whether records are confidential under the CSI Act. They argue that if this Court finds that the appeals should be directed through the PUC to the Commonwealth Court, requestors will face substantial additional costs, e.g., attorneys' fees, and be deprived of the more efficient and effective system of review by the OOR. In light of the PUC's expertise with regard to public utilities and its CSI-specific regulations, we do not agree that the OOR's system of review is more efficient and effective when it comes to CSI.

Act contains unique procedures for submitting and challenging records designated as CSI. 35 P.S. § 2141.3. The CSI Act defines CSI as follows:

> **"Confidential security information."** Information contained within a record maintained by an agency in any form, the disclosure of which would compromise security against sabotage or criminal or terrorist acts and the nondisclosure of which is necessary for the protection for life, safety, public property or public utility facilities[.]"

Id. § 2141.2. A public utility is responsible for determining whether a record in its possession or a portion thereof contains CSI and must identify such records as CSI when submitting them to an agency. *Id.* § 2141.3(a), (b). A public utility "must clearly state in its transmittal letter … that the record contains [CSI] and explain why the information should be treated as such." *Id.* § 2141.3(a).

Whereas the OOR enforces the RTKL, the CSI Act identifies as the administrative body authorized to consider and review a public utility's submission of CSI, "the agency in which the record or portions thereof were originally submitted," and having "protocols and procedures to address [filing CSI-designated records and] challenges to the designations or requests to examine records" containing CSI. 35 Pa.C.S. § 2141.3(b), (c)(1)–(4).[11] As with the RTKL, the CSI Act also addresses the impact of other laws.

[11] East Goshen Township submitted an amicus brief in support of Friedman, claiming the CSI Act is not just a PUC statute, as suggested by the Commonwealth Court, because it broadly defines the term "agency." 35 P.S. 2141.2 (defining "agency" as, *inter alia*, any "organization created by or pursuant to a statute which declares in substance that such organization performs or has for its purpose the performance of an essential governmental function"). Without explaining how, East Goshen suggests that the OOR may come into original possession of a public utility's CSI and, if so, may be called upon to administer the CSI Act. It urges the Court to read the PUC's misleading communication with Friedman, directing him to the OOR rather than PUC for his challenge, as constructively exhausting the CSI Act remedies and, therefore, entitling Friedman to review in the Commonwealth Court on the merits. In light of our holding in this case, East Goshen Township's argument fails.

Specifically, public utility "records or portions thereof which contain [CSI], in accordance with the provisions of this act, shall not be subject to the provisions of the [RTKL]." 35 P.S. § 2141.4.

Upon review of the purposes and provisions of the RTKL and the CSI Act, we conclude that reconciling the two statutes weighs in favor of the PUC having exclusive jurisdiction with regard to CSI. Evidence of this primacy is found foremost in the plain language of the competing statutes with respect to three topics: the type of information protected from disclosure, the applicability of other laws, and the specific procedures for submitting CSI-designated records and challenging a CSI designation or request for records containing CSI.

<u>Protected Information</u>

By their own terms, both the RTKL and the CSI Act protect certain records from public disclosure, but only the latter was enacted to protect CSI specifically. *Compare* 65 P.S. § 67.708(b) (setting forth thirty enumerated exceptions from disclosure under RTKL) *with* 35 P.S. § 2141.2 (protecting the confidential information of public utilities, "the disclosure of which would compromise security against sabotage or criminal or terrorist acts"). To ensure an agency's proper oversight in light of the greater risks to public safety associated with a public utility's CSI records, the CSI Act imposes criminal penalties on a public official or public employee who knowingly or recklessly discloses "a public utility record or portion thereof" that contains CSI. *Id.* § 2141.6. Because the disclosure of a public utility's CSI-records could present a significant risk to public safety, we conclude that the General Assembly intended to provide a unique vehicle in the CSI Act for protecting CSI from disclosure. To that end, it removed CSI from the domain of the OOR under the RTKL and placed it squarely in the hands of public utilities and qualified agencies under the CSI Act. In other words, where CSI-designated records are at issue, the General Assembly intended the specific provisions of the CSI Act to prevail over the general provisions of the RTKL.

Relation to Other Laws

The plain language of the two statutes with regard to the impact of other laws also supports the primacy of the PUC over the OOR with regard to the designation of records containing CSI. By its own terms, the RTKL cannot "supersede or modify the public or nonpublic **nature** of a record or document established in Federal or State law, regulation or judicial order or decree." 65 P.S. § 67.306 (emphasis added). And, the RTKL excludes from the definition of "public record" a record that is "exempt from being **disclosed** under any other Federal or State law or regulation or judicial order or decree[.]" 65 P.S. § 67.102 (emphasis added). The CSI Act is a state law that implicitly establishes the nonpublic nature of public utility CSI-designated records by exempting such records from being disclosed. 35 P.S. § 2141.5. As such, a CSI-record is not a public record, as that term is defined in the RTKL, subject to disclosure. Thus, to the extent the RTKL permits greater access to CSI than the CSI Act, a conflict exists between their access provisions. That conflict is resolved by the CSI Act and the RTKL in favor of the CSI Act and its designated agencies. *See* 35 P.S. § 2141.4 ("[p]ublic utility records or portions thereof" that contain CSI are not subject to the provisions of the RTKL); 65 P.S. § 67.3101.1 ("If the provisions of this act regarding access to records conflict with any other Federal or State law, the provisions of this act shall not apply.").

Procedural Requirements

Lastly, Friedman characterizes the central issue in this case as whether the OOR had the authority to determine if Energy Transfer complied with the CSI Act's procedures for designating records as CSI. In answering this question, we discern no indication in the RTKL that the General Assembly intended for CSI to be disclosed under the RTKL based on a determination by the OOR that a public utility failed to comply with the CSI Act. The General Assembly could have amended the CSI Act to contemplate the OOR's handling of CSI, but it did not.

Because the RTKL's focus is on promoting access to public records, its protocols and procedures relate to submitting and challenging public records in general, not to records affecting public security. 65 P.S. §§ 701–708. In enforcing the RTKL, the OOR is expected to interpret other laws, like the Emergency Planning and Community Right-to-Know Act ("EPCRA") under review in *Heltzel* or the CSI Act in this case, and to make a threshold determination of whether another law applies to a responsive record. Interpreting the CSI Act, the OOR treated Energy Transfer's filing defect as sufficient to render the responsive records "public" in nature and, therefore, subject to disclosure. The OOR's interpretation ignores the lack of any indication in the CSI Act that CSI is public or that its submission provisions were intended to establish the public nature of CSI. *Cf. Heltzel*, 90 A.3d at 832 (explaining that access provision of "EPCRA was not intended to establish the public nature of the records"). It ignores the definition of "public record" in the RTKL as excluding CSI. Most notably, it ignores the plain language of the CSI Act, which sets forth exclusive procedures for submitting CSI and challenging CSI-designations and requests for CSI-records. *See Heltzel*, 90 A.3d at 833 ("Other statutes that provide other avenues, and set other parameters for access to records … operate independently of the RTKL.").

Unlike the RTKL pro-access provisions, the CSI Act's procedures are designed to prevent public access to CSI-designated records, "the disclosure of which would compromise security against sabotage or criminal or terrorist acts[.]" 35 P.S. § 2141.2. To that end, the CSI Act designates agencies that receive records and have protocol and procedures as having authority to enforce its provisions. The PUC is such an agency. As the administrative body that oversees public utilities in Pennsylvania, the PUC receives records from public utilities and has developed protocols and procedures for the filing of a CSI record, the maintenance of CSI records, and challenges to CSI-designations and requests to examine CSI records. 35 P.S. §§ 2141.2 & .3; 52 Pa. Code §§ 102.3 & .4. Such challenges include claims that a public utility failed to comply with the filing requirements of the CSI Act. In such cases, the PUC has express authority, and the expertise, to determine if a public utility record has been properly designated, both substantively and procedurally, and to afford a public utility with the opportunity to resubmit a record that was improperly, defectively, or not designated as CSI. 52 Pa. Code § 102.3(d)–(f). Thus, determining the consequences of failing to comply with the CSI Act or PUC regulations is also an express function of the PUC, not the OOR.

Based on our interpretation of the RTKL and the CSI Act, we conclude the General Assembly intended for the RTKL to yield to the CSI Act in the dual areas of designating and accessing CSI. In short, a CSI-record is not a "public record" under the RTKL and, therefore, is not subject to disclosure through a RTKL request. We considered *Heltzel* instructive on this point. Therein, the OOR ordered the Department of Labor and Industry to release its inventory database of hazardous chemicals at all facilities in the state. The OOR based its order on a determination that the information was "public" as a matter of law under the provisions of the federal EPCRA, 42 U.S.C. §§ 11001–11050, prescribing the conditions by which the public could access an inventory of the chemicals on-site at specified designated locations. Having decided that the EPCRA established the public nature of the information, the OOR did not apply exceptions under the RTKL related to safety and physical security, 65 P.S. § 67.708(b), but simply ordered the entire statewide inventory be disclosed. The Commonwealth Court reversed. Although it acknowledged the OOR's authority to interpret other statutes as to the public nature of documents, the Commonwealth Court observed the EPCRA dictated access to the records, not their nature, and opined that the OOR "was not in a position to enforce EPCRA's conditions on public access under the RTKL" if the RTKL would afford greater access to the entire database where the EPCRA limited access to site-specific inspections. *Heltzel*, 90 A.3d at 832-33.

By analogy to the case at hand, the OOR had authority to interpret the CSI Act as to the public nature of Energy Transfer's CSI, but it was not in a position to enforce the CSI Act's procedures for public access to CSI. Although Friedman specifically requested non-CSI records from the PUC through the RTKL, the PUC determined, as it was authorized to do, that Energy Transfer had designated records responsive to Friedman's request as containing CSI. That designation and determination triggered the protections of the CSI Act, including the procedure for challenging a CSI-designation or the denial of a request for records that contain CSI in the PUC. The OOR had only to consider the definition of "public record" in the RTKL to realize that CSI-designated records fall outside its bailiwick and that it lacked authority to apply the substantive or procedural provisions of the CSI Act or to conclude that records designated by Energy Transfer as CSI and accepted by the PUC as CSI were, in fact, public and accessible.

Although cited by Friedman as authorizing the OOR's review of Energy Transfer's records, the *Seder* case is not instructive. Unlike the case at hand, *Seder* was a straightforward RTKL case. It did not involve a public utility's designation of records as CSI or the interpretation of some other law that established the nature or accessibility of a document. Rather, the record request in *Seder* was made by journalists for documents related to the PUC's informal investigation of an electric utility, including an anonymous employee tip letter alleging violations of the electric utility's "priority-ranking policy when restoring power after [an] October 2011 snowstorm." *Seder*, 139 A.3d at 167. In reviewing the PUC's denial of the record request, the OOR was required to interpret the Public Utility Code's release-of-documents provision, 66 Pa.C.S. § 335(d),[12] under which the PUC sought protection from disclosure of the requested documents. That provision requires the release of "any documents relied upon by the commission in reaching its

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[12] We described the relationship between Subsection 335(d) and the RTKL in *Seder*:

> By providing that the disclosure mandates of Subsection 335(d) supplement the access to records provided by the RTKL, the General Assembly signaled that transparency is of particular importance in the context of the PUC's governing relationship with public utilities. Governmental transparency is of paramount significance when the PUC enters into settlement agreements with public utilities, as such agreements are negotiated behind doors closed to the public. The disclosure requirements of Subsection 335(d) allow the public to view that which informs the PUC's decisions to enter into settlement agreements with public utilities.

Seder, 139 A.3d at 174.

determination" to, inter alia, enter into a settlement agreement with a public utility. 66 Pa.C.S. § 335(d). "The primary dispute [in *Seder* was] what the General Assembly intended when it utilized 'commission' within the context of Subsection 335(d)." *Seder*, 139 A.3d at 171. Concluding that "commission" refers to the entirety of the PUC, not just the PUC's Bureau of Investigation and Enforcement or the PUC commissioners, we held that documents used by the PUC in the course of its investigation and in entering a settlement agreement with the electric utility were to be made part of the public record, subject to the redaction provision in Subsection 335(d) that exempted from disclosure "identifying information contained in the Tip Letter." *Id.* at 174. Given our conclusion in this case that the OOR does not have jurisdiction over CSI-designated records, we need not address its analysis on the issues implicated by our discussion of Subsection 335(d) in *Seder*, i.e., whether the PUC's investigation of Energy Transfer and formal complaint against the utility constituted official action or whether investigation-related records were subject to disclosure, and possibly the security exemption.

The CSI Act expressly provides that challenges to a public utility's designation of CSI or request for CSI records must be presented to the PUC. 35 P.S. § 2141.3(c). Arguably, by informing Friedman only of his right to appeal the denial of his record request to the OOR, and not through its own procedures, the PUC created confusion with regard to the resolution of Friedman's record request. Although less than effective for avoiding the expense of unnecessary litigation, the PUC's direction was not unlawful. The RTKL requires an agency to inform a requestor of his appeal rights, 65 P.S. § 67.903(5). The CSI Act does not require notice of the PUC's appeal procedures.

Based on the foregoing analysis, we hold that the OOR did not have authority to reconsider the nature of Energy Transfer's CSI-designated records or the public accessibility of those records. Upon receipt of CSI-designated records and supporting affidavits, the OOR should have yielded jurisdiction of Friedman's request to the PUC.[13] Accordingly, we affirm the order of the Commonwealth Court reversing the OOR's disclosure order.

Chief Justice Baer and Justices Saylor, Dougherty and Mundy join the opinion.

Justice Wecht files a dissenting opinion in which Justice Todd joins.

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[13] Our holding here does not foreclose Friedman's ability to challenge Energy Transfer's CSI-designation on procedural or substantive grounds pursuant to the CSI Act and corresponding PUC regulations.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Mary Cease, Appellant	:	
v.	:	No. 519 C.D. 2019
	:	ARGUED: February 13, 2020
Housing Authority of Indiana County	:	

BEFORE: HONORABLE PATRICIA A. McCULLOUGH, Judge
HONORABLE MICHAEL H. WOJCIK, Judge
HONORABLE BONNIE BRIGANCE LEADBETTER, Senior Judge

OPINION BY
SENIOR JUDGE LEADBETTER[1] **FILED: February 19, 2021**

Mary Cease appeals from an order of the Court of Common Pleas of Indiana County that affirmed the decision of the Housing Authority of Indiana County (1) denying her application for housing assistance under the United States Department of Housing and Urban Development's (HUD) Housing Choice Voucher Program, commonly referred to as Section 8[2] and (2) concluding that she was a new applicant to the program under Section 13661 of the Quality Housing and Work Responsibility Act (QHWRA), 42 U.S.C. § 13661. The Authority's denial was based upon the statement in her application for admission that she used medical marijuana. We affirm the order to the extent that it determined that Cease was a new applicant to the Section 8 program, vacate it to the extent that it affirmed the Authority's denial of Cease's application, and remand this matter for the Authority to carry out its mandate under Section 13661 of QHWRA: (1) to establish standards

[1] This opinion was reassigned to the author on September 18, 2020.

[2] Section 8(a) of the Housing and Community Development Act of 1974, 42 U.S.C. §1437f(a).

for determining when and on what basis admission is prohibited for an applicant legally using medical marijuana pursuant to a valid Medical Marijuana Identification Card; and (2) to apply those standards when determining Cease's eligibility for Section 8 housing.

Cease is a disabled veteran of the United States Navy, with no prior criminal record. She suffers from post-traumatic stress disorder and chronic back pain for which she has endured multiple surgeries. (Apr. 11, 2019 Trial Court Op. at 1.) Pursuant to Section 501 of the Pennsylvania Medical Marijuana Act,[3] the Pennsylvania Department of Health issued Cease a Medical Marijuana Identification Card. It is undisputed that her card is valid and that Pennsylvania law permits her to obtain and use medical marijuana to treat her conditions.[4] (*Id*. at 2.)

Over the years, Cease has participated in at least two federally funded and subsidized housing programs. The first is HUD's Section 8 program, which the Authority administers in Indiana County. Cease participated in the Section 8 program while living in Nanticoke, Pennsylvania and Wilkes-Barre, Pennsylvania, and applied for admission once again in Indiana County. (*Id*.) The second is the United States Department of Agriculture's (USDA) rural rent supplement program,[5] pursuant to which Cease currently lives at Clymer House Apartments in Clymer, Pennsylvania. Although the USDA's program offers a rental assistance subsidy

[3] Act of April 17, 2016, P.L. 84, 35 P.S. § 10231.501.

[4] Section 303(a) of the Pennsylvania Medical Marijuana Act provides generally that the use or possession of medical marijuana is lawful and that "[n]otwithstanding any provision of law to the contrary, use or possession of medical marijuana as set forth in [the Act] is lawful within this Commonwealth." 35 P.S. § 10231.303(a).

[5] Section 514 of the Housing and Community Development Act of 1974, 42 U.S.C. §1490a, created the USDA's rural rent supplement program.

comparable to what HUD offers qualified residents in metropolitan areas, HUD's regulations do not govern the USDA's program. (*Id*.)

In November 2017, Cease submitted an "Initial Application for Housing Assistance – All Programs" to the Authority for Section 8 housing. (Nov. 30, 2017 Initial Application; Reproduced Record "R.R." at 15a.) In its acknowledgment, the Authority advised Cease that it was placing her on a waiting list with an average waiting time of six months to one year and that "[t]he application process and requirements for eligibility are explained in the policies available for your review at our office." (Nov. 30, 2017 Letter at 1; R.R. at 17a.) In April 2018, the Authority informed Cease that there was an opening in Section 8 housing and requested that she provide a full application to determine her eligibility. (Apr. 10, 2018 Letter at 1; R.R. at 19a.) Cease complied, including a copy of her Medical Marijuana Identification Card with the application.

In denying the application, the Authority stated: "We must deny program participation as marijuana is still considered to be an illegal substance by the Federal government and costs associated with marijuana medical treatments *cannot* be considered in calculation of adjusted income." (June 13, 2018 Letter at 1; R.R. at 37a) (emphasis in original). At Cease's request, informal and formal hearings followed. Ultimately, the Authority upheld its denial based solely on the illegality of marijuana under federal law. (Sept. 26, 2018 Letter at 1; R.R. at 279a.) In so doing, the Authority agreed that Cease's income was well below its "extremely low" threshold and conceded that she met the income standards for Section 8 housing.[6] The Section 8 Coordinator for Indiana County, Holly Hall, testified that

[6] Derived from Social Security benefits, Cease's annual income was $9,240 and below the "extremely low" income level of $13,450. (Sept. 18, 2018 Hearing, Notes of Testimony "N.T." at 20; R.R. at 58a.)

the Authority denied Cease admission based on the federal government's classification of marijuana as an illegal drug and HUD's memos regarding the use of medical marijuana. (Sept. 18, 2018 Hearing, Notes of Testimony "N.T." at 49-50; R.R. at 87a-88a.) In particular, Hall seemed to rely upon Exhibit 9, directed to all public housing agencies and specifically pertaining to the Section 8 program. In the 2011 memo, HUD sought to provide guidance regarding the use of medical marijuana in states that have enacted laws permitting the use of medical marijuana and stated that new admissions of medical marijuana users was prohibited. (*Id*., Ex. 9; R.R. at 4a.) Further, HUD stated that state laws legalizing medical marijuana directly conflict with the admission requirements set forth in QHWRA and are thus subject to federal preemption.[7] (*Id*.)

On appeal, the trial court took additional testimony confirming Cease's status as a former Section 8 program participant in Luzerne County before moving to Indiana County. Following legal argument, it affirmed the Authority's denial of Cease's application for Section 8 housing and determination that she was a new applicant to the program. Cease's appeal to this Court followed.

Cease raises two issues, one with three subparts. In summary and reordered for ease of analysis, the first issue is whether Cease is a new applicant under Section 13661 of QHWRA or an existing participant under Section 13662.[8] If Cease is a new applicant, then she poses the issue of whether Section 13661 requires that the Authority deny her housing based on legal medical marijuana use or whether

[7] The memo lists fourteen states and the District of Columbia as having laws that legalize the use of medical marijuana. In 2011, Pennsylvania was not one of those states. Currently, there are at least thirty-three states and the District of Columbia that have legalized medical marijuana.

[8] Implicit in this issue is the parties' belief that Section 13662 of QHWRA affords a public housing agency discretion to terminate the tenancy or assistance to an existing participant who the agency or owner determines is illegally using a controlled substance.

it may exercise discretion. If the decision to deny housing on that basis is discretionary, then she poses the issue of whether the Authority should afford her accommodation for a disability under the Pennsylvania Human Relations Act (PHRA)[9] and the Pennsylvania Medical Marijuana Act. Cease's second issue is whether the lawful use of medical marijuana constitutes "illegally using a controlled substance" such that the use can form the basis for exclusion from the Section 8 program.

Congress created the Section 8 program in 1974 for "the purpose of aiding low-income families in obtaining a decent place to live and of promoting economically mixed housing" by providing low-income families with assistance payments, or subsidies, to enable them to rent units in the private housing market. Section 8(a) of the Housing and Community Development Act of 1974, 42 U.S.C. § 1437f(a). Pursuant to the program, HUD funds and regulates state or local governmental public housing agencies by distributing federal funds to the agencies, which, in turn, distribute the funds by contracting with property owners to subsidize a portion of a program participant's rent. *See* 42 U.S.C. § 1437f.

In 1998, Congress enacted QHWRA, which, *inter alia*, amended the Housing and Community Development Act of 1974[10] by requiring public housing agencies to establish standards to consider when determining admission to and termination from the Section 8 program. *See* 42 U.S.C. §§ 13661-13664. Section 13661(b)(1)(A) of QHWRA, "Screening of applicants for federal assisted housing," provides:

(b) Ineligibility of illegal drug users and alcohol abusers.

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[9] Act of October 27, 1955, P.L. 744, *as amended*, 43 P.S. §§ 951-963.

[10] 42 U.S.C. §§ 1401-1440.

> (1) Notwithstanding any other provision of law, a public housing agency or an owner of federally assisted housing, as determined by the Secretary, *shall establish standards that prohibit admission to the program* or admission to federally assisted housing for any household with a member--
>
> > (A) who the public housing agency or owner determines is illegally using a controlled substance.

42 U.S.C. §13661(b)(1)(A) (emphasis added). Section 13662(a)(1) of the QHWRA, 42 U.S.C. § 13662(a)(1), "Termination of tenancy and assistance for illegal drug users and alcohol abusers in federally assisted housing," provides:

> (a) In general. Notwithstanding any other provision of law, a public housing agency or an owner of federally assisted housing (as applicable) shall establish standards or lease provisions for continued assistance or occupancy in federally assisted housing that allow the agency or owner (as applicable) to terminate the tenancy or assistance for any household with a member--
>
> > (1) who the public housing agency or owner determines is illegally using a controlled substance[.]

42 U.S.C. §13662(a)(1).

As for which of the aforementioned provisions of QHWRA applies to Cease, we note that she was a participant in the USDA's rural rent supplement program when she applied for Section 8 housing in Indiana County. In other words, she was neither an existing Section 8 participant nor a participant in any federally subsidized housing program administered by the Authority at the time of her Section 8 application. Consequently, we determine that the Authority properly treated Cease as a new applicant to the Section 8 program such that the screening provision in Section 13661 of QHWRA applied. We turn to an analysis of that provision.

As noted above, Section 13661(b)(1)(A) of QHWRA provides that the Authority "shall establish standards that prohibit admission to the program[.]" 42 U.S.C. §13661(b)(1)(A). Notably, there is a difference between "shall establish standards that prohibit admission" and "shall prohibit admission." Otherwise, the term "establish standards" is entirely meaningless. The object of statutory construction is to ascertain and to effectuate legislative intent. Section 1921(a) of the Statutory Construction Act of 1972, 1 Pa.C.S. § 1921(a). "[W]hen the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa.C.S. § 1921(b). Generally, the best indication of legislative intent is the plain language of a statute. *Malt Bevs. Distribs. Ass'n v. Pa. Liquor Control Bd.*, 974 A.2d 1144, 1149 (Pa. 2009). *See also U.S. v. Gonzales*, 520 U.S. 1, 6 (1997) (Where "[g]iven a straightforward statutory command, there is no reason to resort to legislative history.").

By way of contrast, Section 13663(a) of QHWRA, pertaining to sex offenders, provides that "[n]otwithstanding any other provision of law, an owner of federally assisted housing *shall prohibit admission* to such housing for any household that includes any individual who is subject to a lifetime registration requirement under a State sex offender registration program." 42 U.S.C. § 13663(a) (emphasis added). Clearly, there is no discretion in prohibiting admission to such applicants. Accordingly, we construe the mandate in Section 13661(b)(1)(A) of QHWRA as allowing for flexibility to determine when and on what basis admission is prohibited, rather than mandating an outright prohibition. In other words, for purposes of Section 13661(b)(1)(A), the Authority must establish standards for determining when and on what basis admission is prohibited for a Section 8 housing applicant who the Authority determines is illegally using a controlled substance. *See Nation v. Trump*, 818 F. App'x 678, 679-80 (9th Cir. 2020) ("QHWRA requires that owners of federally-assisted housing establish certain occupancy standards pertaining to illegal drug use for residents. *See generally* 42 U.S.C. §§ 13661-62."). Such standards must take into account factors such as the nature of the substance, i.e., whether it is clearly unlawful or in an unclear legal state such as that involved here; the reason for such use; whether it is being used in accordance with legal requirements; other factors concerning the applicant's background, including behavior during any prior residence in federally subsidized housing; and the presence or absence of any prior criminal record.

As for marijuana's legal status, the federal Controlled Substances Act (CSA)[11] classifies marijuana as a Schedule I controlled substance and it is unlawful for any person to knowingly or intentionally possess a controlled substance. Section 841(a)(1) of the federal CSA, 21 U.S.C. § 841(a)(1). Although there have been considerable efforts to reclassify marijuana under federal law, it has remained a Schedule I drug ever since its initial classification. Additionally, there has been resistance to efforts to make exceptions for the use of medical marijuana in federally-funded public housing. *See Nation v. Trump,* 395 F. Supp. 3d 1271 (N.D. Cal. 2019), *aff'd*, 818 F. App'x 678 (9th Cir. 2020) (where former HUD housing fund recipient claimed that HUD's application of the federal CSA against medical marijuana was unconstitutional, court confirmed that QHWRA referred to the CSA to define the term "controlled substance," that the CSA defined that term as a drug or other substance in one of its five schedules, and that marijuana was classified as a Schedule

[11] 21 U.S.C. §§ 801-971.

I drug under the CSA); *Forest City Residential Mgmt. v. Beasley*, 71 F. Supp. 3d 715 (E.D. Mich. 2014) (where Section 8 housing recipient was legally using medical marijuana under state law, court acknowledged that the CSA contained no provision allowing for the medical use of marijuana, held that the CSA preempted the Michigan Medical Marihuana Act,[12] and determined that the Fair Housing Act[13] did not require a federally assisted housing complex to grant the recipient a reasonable accommodation to use medical marijuana in such a complex).

Nonetheless, we are not bound by decisions of lower federal courts in other jurisdictions. Cease possesses a valid Pennsylvania Medical Marijuana Identification Card authorizing her to legally obtain and use medical marijuana under medical supervision, and the Authority does not dispute that she has a valid medical basis for her use and that it is properly prescribed and supervised. Consequently, we find the term "illegally using a controlled substance" to be ambiguous here where her use is prohibited by the federal government but permitted under state law.[14] Criminal law is primarily a matter for the states to determine

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[12] Mich. Comp. Laws §§ 333.26421 - 333.26430.

[13] 42 U.S.C. §§ 3601-3631.

[14] Of course, even in the Commonwealth's body of laws, there are statutory conflicts and/or legislative failures to act with respect to accommodations for users of medical marijuana. In *Harrisburg Area Community College v. Pennsylvania Human Relations Commission*, ___ A.3d ___ (Pa. Cmwlth., No. 654 C.D. 2019, filed October 29, 2020) ("*HACC*"), this Court considered the effect of HACC's drug-testing requirement for candidates in its nursing program on a nursing student lawfully using medical marijuana under the Pennsylvania Medical Marijuana Act. We addressed the issue of whether the anti-discrimination provisions of the PHRA and the Pennsylvania Fair Educational Opportunities Act (PFEOA), Act of July 17, 1961, P.L. 776, *as amended*, 24 P.S. §§ 5001-2010, required accommodation of the student's lawful use of medical marijuana. We held that the legalization of medical marijuana in Pennsylvania in the Pennsylvania Medical Marijuana Act did not require an accommodation for its use under either Section 5(i)(1) of the PHRA, 43 P.S. § 955(i)(1), or Section 4(a)(3) of the PFEOA, 24 P.S. § 5004(a)(3), noting that the General Assembly could have amended the language of those acts to require
(Footnote continued on next page…)

within their own jurisdictions. "Federalism, central to the constitutional design, adopts the principle that both the National and State Governments have elements of sovereignty the other is bound to respect." *Arizona v. United States*, 567 U.S. 387, 398 (2012). As the Pennsylvania Supreme Court recently observed:

> [T]he core principle of federalism recogniz[es] dual sovereignty between the tiers of government." *See United States v. Davis*, 906 F.2d 829, 832 (2d Cir. 1990) ("The states and the national government are distinct political communities, drawing their separate sovereign power from different sources, each from the organic law that established it. Each has the power, inherent in any sovereign, independently to determine what shall be an offense against its authority and to punish such offenses."). In enacting the [Pennsylvania Medical Marijuana Act], the Pennsylvania Legislature proceeded pursuant to its independent power to define state criminal law and promote the health and welfare of the citizenry.

Gass v. 52nd Jud. Dist., 232 A.3d 706, 714 (Pa. 2020). Consequently, "while possession and use of marijuana remains illegal under federal law even for medical purposes, . . . the federal [CSA] does not (and could not) require states to enforce it." *Id*. at 714.

In *Gass*, our Supreme Court unanimously declared that the Lebanon County Court of Common Pleas, 52nd Judicial District's "Medical Marijuana

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accommodation but chose not to do so. *Id*. at ___, slip op. at 13 and 15. In her concurring opinion, Judge Covey urged the General Assembly to amend both the PHRA and the PFEOA so the benefits it created in the Pennsylvania Medical Marijuana Act "for the citizens of this Commonwealth are not illusory or applicable only in limited circumstances; thereby, creating an egregious result as is demonstrated in the instant case." *HACC*, ___ A.3d at ___ (Covey, J. concurring), slip op. at 1. Judge Covey opined that "[t]he conflict among these statutes has created an absurd result in requiring Pennsylvania citizens to choose the benefits of medical marijuana or the protections of the PHRA and the PFEOA." *Id*. at ___ (Covey, J. concurring), slip op. at 2-3.

Policy" prohibiting the active use of medical marijuana by individuals under court supervision, such as probationers, was, in both its original and amended forms, contrary to the immunity afforded under the Pennsylvania Medical Marijuana Act and, therefore, could not be enforced. In other words, the Court determined that a local policy could not usurp a state law simply by reference to a federal law such as the federal CSA. *Id*. Accordingly, the *Gass* Court held: "While the circumstances are certainly uneasy -- since possession and use of medical marijuana remains a federal crime -- we find that the [52nd Judicial] District cannot require state-level adherence to the federal prohibition, where the General Assembly has specifically undertaken to legalize the use of medical marijuana for enumerated therapeutic purposes." *Id*. We believe the same is true of the Authority.[15]

Moreover, the pertinent provisions of QHWRA are based on the obsolete and scientifically flawed premise that marijuana "has no currently accepted medical use in treatment in the United States" and that "there is a lack of accepted safety for use of marijuana under medical supervision." Section 812(b)(1)(A-C) of the federal CSA, 21 U.S.C. § 812(b)(1)(A-C). *See also U.S. v. Oakland Cannabis Buyers' Coop.*, 532 U.S. 483 (2001) (recognizing that there is no medical necessity

[15] In *Beasley*, 71 F. Supp. 3d 715, the United States District Court for the Eastern District of Michigan considered how much deference to afford a January 2011 memorandum opinion issued by HUD to the Office of Fair Housing and Equal Opportunity regarding the medical use of marijuana and reasonable accommodation in federal public and assisted housing. Concluding that the HUD memorandum was not a statute, regulation, or formal judicial interpretation, the federal district court rejected the higher level of deference set forth in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Instead, the federal district court concluded that the HUD memorandum was a more informal medium not intended to have the force of law and, therefore, afforded it the lesser level of deference set forth in *Skidmore v. Swift & Company*, 323 U.S. 134, 140 (1944). Accordingly, the federal district court, per *Skidmore*, gave weight to "HUD's conclusion that a medical marijuana accommodation [was] not reasonable under the Fair Housing Act because it would constitute a fundamental alteration in the nature of a [public housing agency] or owner's operations." *Beasley*, 71 F. Supp. 3d at 730.

exception to the federal prohibition against manufacturing and distributing marijuana). In contrast, the General Assembly in Section 102(1) of the Pennsylvania Medical Marijuana Act declared: “Scientific evidence suggests that medical marijuana is one potential therapy that may mitigate suffering in some patients and also enhance quality of life.” 35 P.S. § 10231.102(1). Consequently, given the current circumstances regarding the medically accepted use and ambiguous status of medical marijuana, establishment of fair and reasonable standards regarding the use of that substance under medical supervision is particularly called for here.

Accordingly, we affirm the trial court’s order to the extent that it determined that Cease was a new applicant but vacate the order to the extent that it affirmed the Authority’s denial of Cease’s application. We remand this matter to the trial court with directions to remand to the Authority to do what QHWRA mandates and establish fair and reasonable standards for determining in what circumstances admission to Section 8 housing is prohibited for an applicant who is legally using medical marijuana under state law, and to apply those standards with respect to Cease’s individual circumstances when determining Cease’s eligibility for the Section 8 program.

BONNIE BRIGANCE LEADBETTER,
President Judge Emerita

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Mary Cease, Appellant	:	
v.	:	No. 519 C.D. 2019
Housing Authority of Indiana County	:	

ORDER

AND NOW, this 19th day of February, 2021, we hereby AFFIRM the order of the Court of Common Pleas of Indiana County, in part, VACATE the order, in part, and REMAND this matter to the trial court with directions to remand to the Housing Authority of Indiana County in accordance with the foregoing opinion.

Jurisdiction relinquished.

BONNIE BRIGANCE LEADBETTER,
President Judge Emerita

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Mary Cease,	:	
Appellant	:	
	:	No. 519 C.D. 2019
v.	:	
	:	Argued: February 13, 2020
Housing Authority of Indiana County	:	

BEFORE: HONORABLE PATRICIA A. McCULLOUGH, Judge
HONORABLE MICHAEL H. WOJCIK, Judge
HONORABLE BONNIE BRIGANCE LEADBETTER, Senior Judge

DISSENTING OPINION
BY JUDGE McCULLOUGH FILED: February 19, 2021

I must respectfully dissent. The Majority goes to great lengths to explain why Congress's use of the phrase "shall establish standards that prohibit" in section 13361 of the federal Quality Housing and Work Responsibility Act (QHWRA),[1] means a Public Housing Authority (PHA) has "flexibility" to decide whether to admit an illegal drug user (as defined in the federal Controlled Substance Act[2] (CSA)) into a Section 8 housing program.[3] By avoiding the rules of statutory

[1] 42 U.S.C. §13661.

[2] 21 U.S.C. §§801-971.

[3] Section 8(a) of the Housing and Community Development Act of 1974 (HCDA), 42 U.S.C. §1437f(a).

interpretation, the Majority assigns to the phrase "shall establish standards that prohibit" a meaning that Congress plainly did not intend.

The Majority also disregards some very basic constitutional and jurisprudential concepts to arrive at the desired conclusion that Mary Cease (Cease), a user of medical marijuana, is not "illegally using a controlled substance" under the QHWRA. The fact that Pennsylvania's Medical Marijuana Act[4] (MMA) legalizes the use of medical marijuana in limited situations is immaterial to the disposition of this case. The CSA (which illegalizes medical marijuana as a Schedule I drug) applies here because the QHWRA is a federal statute.

Interpretation of the QHWRA

The Section 8 housing program is a federally funded and supervised rent subsidy program for low-income tenants which is administered by the United States Department of Housing and Urban Development (HUD). The QHWRA is a federal statute. It establishes the parameters for a PHA, such as the Housing Authority of Indiana County (HAIC), to follow when considering admission to, and termination from, the Section 8 housing program. *See* 42 U.S.C. §§13661-13664.

Section 13661 of the QHWRA, titled "Screening of applicants for federally assisted housing," applies to new applicants.[5] By its plain language, section 13661 of the QHWRA ***requires*** owners of federally assisted housing to ***deny admission*** to a new applicant if she, or a household member, is illegally using a

[4]Act of April 17, 2016, P.L. 84, 35 P.S. §§10231.101-10231.2110.

[5] I have no objection to the Majority's conclusion that Cease was a "new applicant" to the Section 8 program.

controlled substance. With regard to "admission to the program," section 13361(b)(1)(A) provides, in this regard, as follows:

> Notwithstanding any other provision of law, a public housing agency or an owner of federally assisted housing, as determined by the Secretary, ***shall establish standards*** ***<u>that prohibit</u>*** ***admission*** to the program or admission to federally assisted housing for any household with a member--
>
> (A)***who the public housing agency or owner determines <u>is illegally using a controlled substance</u>***;
>
> ****

42 U.S.C. §13661(b)(1)(A) (emphasis added).

In contrast to the mandatory grounds for ***prohibiting admission*** to a Section 8 program set forth in section 13661, section 13662 of the QHWRA, titled "Termination of tenancy and assistance for illegal drug users and alcohol abusers in federally assisted housing," grants the PHA ***discretion*** to determine when and on what basis an ***existing participant's*** tenancy may be terminated if she is illegally using a controlled substance or abusing alcohol. Section 13662(a)(1) provides, in this regard, as follows:

> Notwithstanding any other provision of law, a public housing agency or an owner of federally assisted housing (as applicable), ***shall establish standards*** or lease provisions for continued assistance or occupancy in federally assisted housing ***<u>that allow</u>*** the agency or owner (as applicable) ***to terminate the tenancy*** or assistance for any household with a member--

> (1) ***who the public housing agency or owner determines is illegally using a controlled substance***;

****

42 U.S.C. §13662(a)(1) (emphasis added).

In my view, the phrases "***shall establish standards <u>that prohibit</u>***" (section 13661) and "***shall establish standards <u>that allow</u>***" (section 13662) in the sections dealing with illegal drug use make it clear precisely when Congress intended for a PHA to have discretion and when a PHA lacks that discretion.

Congress has a strict drug policy when it comes to the admission of current drug users (as defined by the CSA) into Section 8 housing. As stated by the federal courts, the import of the QHWRA and its accompanying regulations "is to protect public housing from criminal elements, especially drug activity, which could adversely affect the community." *Bennington Housing Authority v. Bush*, 933 A.2d 207, 213 (Vt. 2007*). See also Eastern Carolina Regional Housing Authority v. Lofton*, 789 S.E.2d 449, 452 (N.C. 2016) (observing that, "like everyone else, individuals who live in federally subsidized housing are entitled to be free from 'any criminal activity that threatens the health, safety, or right to peaceful enjoyment of the premises'"). When it comes to deciding whether to ***admit a current drug user*** into a Section 8 housing program, PHAs have no discretion. They must deny admission.[6] *See Campbell v. Minneapolis Public Housing Authority*, 168 F.3d 1069, 1076 (8th Cir. 1999) (holding that the Minneapolis Public Housing Authority was "***obligated to exclude [applicant] from public housing if it 'ha[d] reasonable cause***

[6] Notably, federal regulations permit PHAs to overlook ***drug history*** and ***prior drug convictions*** if the person is no longer engaging in drug abuse or has been rehabilitated. 24 C.F.R. §960.204(a)(1). But here, it is undisputed that Cease is a ***current*** user of medical marijuana.

to believe' that, at the time of his application, he was using illegal drugs or abusing alcohol in a manner that 'may interfere with the health, safety, or right to peaceful enjoyment of the premises by other residents of the project'") (emphasis added).

Contrariwise, when it comes to ***eviction***, *i.e*., the potential ***displacement*** of an ***existing tenant*** and/or her entire household, PHAs are given discretion to "***establish standards <u>that allow</u>***" those tenants or their families to remain in Section 8 housing despite the violation, for example, by issuing warnings, or setting probation periods. This is because of the hardship that arises when tenants lose their housing. *Bennington Housing* (observing that a PHA certainly may evict an entire family for the misdeeds of one member, but it need not do so); *Lofton* (holding that housing authority was required to exercise its discretion before pursuing tenant's eviction from federally subsidized apartment for lease violation arising from third party's drug-related activity).

Despite the clarity with which Congress has indicated when a PHA has discretion, the Majority concludes that section 13661 of the QHWRA allows for "flexibility" to determine when and on what basis admission is prohibited, rather than mandating an outright prohibition to current users of illegal drugs.

The Majority's interpretation is based on its observation that Congress used the phrase "***shall prohibit***" in another section of the QHWRA (prohibiting sex offender's admission to Section 8 housing). Section 13663(a) of the QHWRA states that "notwithstanding any other provision of law, an owner of federally assisted housing ***shall prohibit*** admission to such housing" to registered sex offenders. 42 U.S.C. §13663(a) (emphasis added).

The Majority concludes that, given the different wording, the two phrases, "***shall prohibit***" (in section 13663) and "***shall establish standards that***

prohibit" (in section 13661), must have different meanings. Comparing the language of section 13661 (admission to Section 8 housing) with section 13663 (prohibiting sex offender's admission to Section 8 housing), the Majority concludes that, if Congress intended for Section 8 admission to be denied to current drug users, then it would have stated this as plainly as it did in section 13663 by using the phrase "***shall prohibit***." The Majority reasons that since Congress did not use the words "***shall prohibit***" in section 13661, it must have, therefore, meant for PHAs to have some degree of discretion to admit Cease as a new applicant under section 13661, notwithstanding her current use of medical marijuana. Otherwise, the Majority reasons, the phrase "shall establish standards" is meaningless.

The Majority's interpretive principles are unconvincing. First, the Majority does not explain how section 13661's language is ambiguous in context. Rather, the Majority compares section 13661 (***shall establish standards that prohibit***) with section 13663 (***shall prohibit***) – and based on the differences, arrives at the meaning of "***shall establish standards that prohibit***."

If statutory language is "clear and free from ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa.C.S. §1921(b). Thus, when the words of a statute have a plain and unambiguous meaning, it is this meaning which is the paramount indicator of legislative intent. When interpreting federal statutes, courts must read the statutory language in its proper context and not view it in isolation. *McCarthy v. Bronson,* 500 U.S. 136, 139 (1991). The Majority's approach in only comparing and contrasting language used in a different section of the QHWRA is directly contrary to these principles. *Roethlein v. Portnoff Law Associates, Ltd.*, 81 A.3d 816, 822 (Pa. 2013) (disapproving lower court's focus on two words).

The Majority focuses on the ***presence*** of the phrase "shall establish standards" in section 13661 and its ***absence*** in section 13663, instead of considering the plain and unambiguous language of section 13661, which is the paramount indicator of legislative intent. When the phrase is read in full and in context, it is clear that "***shall establish standards <u>that prohibit</u>***" simply and plainly means that ***whatever*** standards a PHA establishes for admission into a Section 8 housing program, those standards ***must prohibit*** admission if the applicant is determined to be illegally using a controlled substance. There is absolutely nothing ambiguous with that statement. Nevertheless, by isolating the phrase "shall establish standards" from the rest of the sentence, which describes the type of standards the PHA must establish, *i.e.*, "standards ***that prohibit***" – the Majority is able to contrive an ambiguity where none exists. This approach is in clear contravention of well-established rules of statutory interpretation.

Ironically, under the Majority's interpretation, the phrases: "shall establish standards that prohibit" (section 13661) and "shall establish standards that allow" (section 13662) – would mean the exact same thing (*i.e.*, PHAs have flexibility and discretion to admit into program and terminate tenancy) – simply because both sections include the phrase "shall establish standards." If that was the case, then the language "***that allow***" and "***that prohibit***" which follows "shall establish standards" would be rendered entirely meaningless. "The courts must construe every statute, if possible, to give effect to all of its provisions so that none are rendered mere surplusage." *White v. Associates in Counseling & Child Guidance, Inc.*, 767 A.2d 638, 642 (Pa. Cmwlth. 2001) (citing 1 Pa.C.S. §§1921(a) and 1922(a)).

Even if there was an ambiguity, which I submit there is not, I disagree with the Majority's view that the language in section 13661 ("***shall establish standards that prohibit***") is so dissimilar to the language in section 13663 ("***shall prohibit***") – such that we can conclude that Congress intended dissimilar results. There is no reason in law or logic to construe section 13661 in a different manner than section 13663. The phrase "***shall establish standards that prohibit***" in section 13661 is no less definite than the language used in section 13663 ("***shall prohibit***"). Substantively, ***establishing standards that prohibit*** is precisely the same in legal effect as ***prohibiting*** outright. It is a distinction without a difference.

Finally, applying the Majority's own logic, if Congress wanted to give PHAs discretion under section 13661 to ***allow*** drug users ***admission*** to Section 8 housing, it would have used the same language it used in section 13662 to grant that discretion, which states that a PHA "***shall establish standards that allow***" the PHA to terminate an existing tenancy for any household with a member who the PHA determines is illegally using a controlled substance . . . ." 42 U.S.C. §13662(a)(1). However, Congress did not include such language in section 13661. Instead it used "***that prohibit***," which has the exact opposite meaning of "***that allow***."

It is also noteworthy that HUD's regulation, which sets forth standards for PHA tenant selection criteria, 24 C.F.R. §960.204, support the conclusion that the phrase "***establish standards that prohibit***" means that the PHA is ***required to deny*** admission to persons engaging in illegal use of drugs. "Persons engaging in illegal use of a drug" is listed ***under the regulation defining circumstances, which require the denial of admission,*** and states under no uncertain terms that the PHA is required to deny admission to persons ***engaging in illegal use of a drug***. This section of the regulations provides, in pertinent part:

§ 960.204 Denial of admission for criminal activity or drug abuse by household members.

(a) <u>Required denial of admission</u>.

* * *

(2) <u>Persons engaging in illegal use of a drug. The PHA must establish standards that prohibit admission of a household to the PHA's public housing program if:</u>

(i) <u>The PHA determines that any household member is currently engaging in illegal use of a drug</u>[7] (For purposes of this section, a household member is "currently engaged in" the criminal activity if the person has engaged in the behavior recently enough to justify a reasonable belief that the behavior is current) . . . .

24 C.F.R. §960.204(a)(2) (emphasis added.)

Subsection (a)(4) of these same regulations require PHAs to "***establish standards that prohibit admission***" to Section 8 housing ***for registered sex offenders***. If the Majority is correct that the phrase "must establish standards" means that the PHA has "discretion" or "flexibility" to make decisions, then PHAs ***<u>would</u>*** have discretion to admit registered sex offenders, which is directly the opposite of

[7] Under federal law, marijuana is a Schedule I controlled substance with "no currently accepted medical use in treatment in the United States." 21 U.S.C. §812(b)(1)(B). Significantly, Congress also has delineated those controlled substances which it does recognize as having a currently accepted medical use in the United States. These are listed in Schedules II-V. Marijuana is not listed in Schedules II-V. In other words, Congress has determined that not only is marijuana listed as a prohibited Schedule I drug, it also chose not to include it on the list of those substances that it recognizes as having any accepted medical use. *See Harrisburg Area Community College v. Pennsylvania Human Relations Commission*, ___ A.3d ___, ___ (Pa. Cmwlth. No. 654 C.D. 2019, filed Oct. 29, 2020), 2020 WL 6325864, at *4.

what the Majority is arguing based on the language in section 13663 of the QHWRA, which provides that PHAs "***shall prohibit***" admission to registered sex offenders. This pertinent section of the regulations, which relates to sex offenders, provides in part:

> (4) Persons subject to sex offender registration requirement. ***The PHA <u>must establish standards that prohibit</u> admission to the PHA's public housing program if any member of the household is subject to a lifetime registration requirement under a State sex offender registration program***. In the screening of applicants, the PHA must perform necessary criminal history background checks in the State where the housing is located and in other States where household members are known to have resided. (See part 5, subpart J of this title for provisions concerning access to sex offender registration records.)

24 C.F.R. §960.204(a)(4) (emphasis added).

Based on the foregoing, I disagree with the Majority's interpretation of section 13661 of the QHWRA. To me, it is abundantly clear that PHAs have no discretion to admit persons who engage in the illegal use of drugs, as defined in the governing federal law. Rather, PHAs are required to deny admission to Section 8 housing if the PHA determines that the applicant or any household member is currently engaging in illegal use of drugs.

<u>Under Federal Law, Cease is</u>
<u>Illegally Using a Controlled Substance</u>

I also disagree with the Majority's conclusion that Cease is not illegally using a controlled substance for determining her eligibility for Section 8 housing under the QHWRA. Cease's possession and use of medical marijuana violates the CSA.

Even though medical marijuana is legal *in certain situations* under Pennsylvania law pursuant to section 2103(a) of the MMA, 35 P.S. §10231.2103(a), Congress has explicitly classified "marihuana" as an illegal Schedule I controlled substance in the CSA. Section 812(c) of the CSA, SCHEDULE I (c)(10). Along with Morphine, Peyote, LSD, and nearly 100 other Schedule I controlled substances, Congress has declared that marijuana (cannabis): (1) has a high potential for abuse; and (2) ***has no currently accepted medical use in treatment in the United States***. 21 U.S.C. §812(b)(1)(A)-(C). Categorizing marijuana as a Schedule I drug reflects Congress's conclusion that marijuana "lack[s] any accepted medical use, and [that there is an] absence of any accepted safety for use in medically supervised treatment." *Gonzales v. Raich*, 545 U.S. 1, 14 (2005) (citing 21 U.S.C. §812(b)(1)); *see also United States v. Oakland Cannabis Buyers' Cooperative*, 532 U.S. 483 (2001) (recognizing that there is no medical necessity exception to the federal prohibition against manufacturing and distributing marijuana).

Despite efforts to reclassify marijuana, it has remained a Schedule I drug since the enactment of the federal CSA. *Raich*, 545 U.S. at 14-15, n.23 (summarizing "considerable efforts," ultimately unsuccessful, to reschedule marijuana). It follows then that medical marijuana use is considered "illegally using a controlled substance" under federal law for purposes of the QHWRA. Because ***Congress*** has directly and unambiguously spoken in the federal QHWRA regarding the illegality of using medical marijuana, our inquiry should end here. The plain language of the QHWRA is clear and unambiguous regarding Cease's illegal use of a controlled substance. Cease's use and possession of medical marijuana is illegal under federal law. Because Cease is an illegal drug user under the CSA, HAIC was required to deny her application for admission to Section 8 housing under section 13661 of the QHWRA, notwithstanding that Pennsylvania has legalized medical marijuana in the MMA.

In finding that the phrase "illegally using a controlled substance" is ambiguous, the Majority reasons that medical marijuana is legal in Pennsylvania and Cease is a Pennsylvania citizen. The Majority draws the distinction in this case on the principle of federalism that the states and the federal government operate in their respective sphere of governance. However, the Majority fails to recognize that, due to the applicability of a federal statute, we are bound to interpret the QHWRA in accordance with federal law, as it is inherently a matter of federal concern. The maxim that "[f]ederalism, central to the constitutional design, adopts the principle that both the National and State Governments have elements of sovereignty the other is bound to respect," *Arizona v. United States,* 567 U.S. 387, 398 (2012), cuts both ways.

The Majority also overstates the breadth of the MMA. Contrary to the Majority's position, the MMA has not made medical marijuana legal in Pennsylvania in every situation. It only legalized it to the extent that the legislature has declared it so. Section 304(a) of the MMA states that "***[e]xcept as provided in section 303, section 704, Chapter 19 or Chapter 20 [of the MMA], the use of medical marijuana is unlawful and shall, in addition to any other penalty provided by law, be deemed a violation of the Act of April 14, 1972 (P.L. 233, No. 64), [as amended, 35 P.S. §§780.101-780.144,] known as the Controlled Substance, Drug, Device and Cosmetic Act."*** (emphasis added.)

The Majority also believes the CSA is based on the "obsolete and scientifically flawed" premise that marijuana has no currently accepted medical use in treatment in the United States and there is a lack of accepted safety or use of marijuana under medical supervision. The Majority oversteps its bounds. Although the Majority feels that the United States Congress and federal administrative bodies "got it wrong" when drafting the federal statutes and regulations – it is not for this Court to hold marijuana should be considered a medically-acceptable drug, as a matter of federal law, or that marijuana should be removed as an illegal substance in the federal CSA. Stripped of its language, the Majority essentially finds that there is no rational basis for the federal CSA and that, therefore, it is unconstitutional. This is tantamount to overruling an act of the United States Congress and well-established precedent from the United States Supreme Court which has held that Congress can regulate the possession of medicinal marijuana through the CSA pursuant to its authority under the Commerce Clause. *See Raich.*

The Majority's position simply cannot be reconciled with the Supremacy Clause of the United States Constitution,[8] which dictates that the federal law prevails over state law. The Supremacy Clause[9] prevents this Court from applying the Pennsylvania MMA to discern the meaning of "illegally using a controlled substance."

Finally, HAIC participates in a federal program under which it receives federal funds. As a condition of receiving such funds, ***it must comply with federal requirements***. By encouraging HAIC to flout the CSA, the Majority is placing HAIC's right to receive federal funding at risk.

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[8] U.S. Const. art. 1, §8, cl. 3.

[9] U.S. Const. art. 6, cl. 2.

Congress has seen fit to exclude medical marijuana users from Section 8 housing based on its belief that medical marijuana has no medical uses. This Court cannot override Congress's clear intent to prohibit ***all*** marijuana users from admission into Section 8 housing for reasons that this Court has no authority to question. While sympathetic to Cease's situation, this Court—no matter how inequitable the factual scenario of a case may be—lacks the constitutional authority to do so.

For these reasons, I dissent.

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PATRICIA A. McCULLOUGH, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Pennsylvania Independent Oil & Gas Association, Petitioner	:	
	:	No. 507 M.D. 2019
v.	:	
	:	Submitted: May 29, 2020
Pennsylvania One Call System, Inc., Respondent	:	

BEFORE: HONORABLE RENÉE COHN JUBELIRER, Judge
HONORABLE PATRICIA A. McCULLOUGH, Judge
HONORABLE BONNIE BRIGANCE LEADBETTER, Senior Judge

OPINION BY
JUDGE McCULLOUGH FILED: January 5, 2021

Before the Court are the preliminary objections of Pennsylvania One Call System, Inc. (POCS), to the petition for review filed by Pennsylvania Independent Oil & Gas Association (PIOGA), which sought a declaratory judgment concerning the propriety of POCS' rate structure under what is known as the Underground Utility Line Protection Law (UULPL).[1] POCS' preliminary objections challenge the subject matter jurisdiction of this Court, assert that PIOGA has failed to state a claim under the UULPL, and contend that PIOGA's action is precluded by the business judgment rule. We sustain POCS' preliminary objection to this Court's jurisdiction, and accordingly offer no opinion concerning its remaining objections.

[1] Act of December 10, 1974, P.L. 852, No. 287, *as amended*, 73 P.S. §§176-86.

Background

POCS is an organization originally formed by Allegheny County public utility companies in 1968, with the goal of providing a means by which excavators and owners of underground utility lines could communicate and avoid damage or disruption to subterranean utility equipment. POCS' operation ultimately expanded beyond Allegheny County and grew to cover all of Pennsylvania. POCS incorporated as a Pennsylvania nonprofit corporation in 1978, and in 1979, it attained tax-exempt Internal Revenue Service 501(c)(6)[2] status. The General Assembly enacted the first version of the UULPL in 1974. Beginning then, and continuing through its various revisions, the UULPL placed certain duties upon both a "One Call System"[3] and the various facility owners that use the system.

The instant dispute concerns the methodology by which POCS sets the fees for using its service. On September 10, 2019, PIOGA filed a petition for review in this Court's original jurisdiction, seeking a declaratory judgment that POCS' fee structure fails to comply with the UULPL. Briefly summarized, PIOGA asserts that

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[2] *See* 26 U.S.C. §501(c)(6) (exempting from taxation "[b]usiness leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual").

[3] The UULPL defines the "One Call System" as follows:

> "One Call System" means the communication system established within this Commonwealth to provide a single nationwide toll-free telephone number or 811 number for excavators or designers or any other person covered by this act to call facility owners and notify them of their intent to perform excavation, demolition or similar work as defined by this act. The One Call System shall be incorporated and operated as a nonprofit corporation pursuant to 15 Pa.C.S. Pt. II Subpt. C (relating to nonprofit corporations).

Section 1 of the UULPL, 73 P.S. §176.

POCS' fee structure is designed to recover a significantly greater proportion of its operating costs from the owners of utility facilities, when compared to the contractors that use POCS' service.[4] PIOGA seeks a determination that the fees for using POCS' service must be divided equally between contractors and facility owners. POCS' first

[4] The parties' dispute primarily centers upon the following fee-related provisions of the UULPL:

> (e) Operation costs for the One Call System shall be shared, in an equitable manner for services received, by facility owner members as determined by the One Call System's board of directors. Political subdivisions with a population of less than two thousand people or municipal authorities having an aggregate population in the area served by the municipal authority of less than five thousand people shall be exempt from the payment of any service fee. The One Call System may be reimbursed for its costs in providing this service from the contractor fees.
>
> (f) All fees shall be set by the board of directors and shall be based on the latest annual audited cost factors of the One Call System. Fees shall be set and adjusted to a rate not more than five percent above the audited cost factor plus the current average published Consumer Price Index for Pennsylvania. Costs of capital improvements may be added, if the improvement receives a majority vote of the board of directors.
>
> (f.1) An excavator, designer or operator who proposes to commence excavation or demolition work and requests information from the One Call System shall pay to the One Call System an annual fee for the service provided by the One Call System under section 3. The fee shall be set by the One Call System board of directors and shall be used to offset a portion of the operation costs of the One Call System and a portion of the operation costs levied on the One Call System's political subdivision and municipal authority members. Failure to pay the fee shall constitute a violation of this act and shall subject the excavator, designer or operator to the enforcement authority of the commission for the nonpayment.

Section 3.1(e)-(f.1) of the UULPL, added by the Act of November 29, 2006, P.L. 1593, 73 P.S. §178.1(e)-(f.1).

and central objection to PIOGA's action is that POCS is a private entity, not the "Commonwealth government," and, thus, that this Court lacks original jurisdiction over the matter. 42 Pa.C.S. §761(a)(1) (providing the Commonwealth Court with jurisdiction over actions "[a]gainst the Commonwealth government, including any officer thereof, acting in his official capacity").[5] Because PIOGA has not asserted any other basis for this Court's jurisdiction, and because no other such basis is apparent on the face of the pleadings, our initial inquiry centers upon whether POCS may be deemed to be a governmental entity notwithstanding its apparent status as a private, nonprofit corporation.

Discussion

A. Standard of Review

Our standard of review over preliminary objections is well-settled:

> In reviewing preliminary objections, all material facts averred in the complaint, and all reasonable inferences that can be drawn from them, are admitted as true. *Vattimo v. Lower Bucks Hospital, Inc.*, 465 A.2d 1231, 1232 (Pa. 1983); *Fletcher v. Pennsylvania Property & Casualty Insurance Guaranty Association*, 914 A.2d 477, 479 n.2 (Pa. Cmwlth. 2007), *aff'd*, 985 A.2d 678 (Pa. 2009). However, a court

[5] For purposes of our original jurisdiction, "Commonwealth government" is defined as:

> The government of the Commonwealth, including the courts and other officers or agencies of the unified judicial system, the General Assembly and its officers and agencies, the Governor, and the departments, boards, commissions, authorities and officers and agencies of the Commonwealth, but the term does not include any political subdivision, municipal or other local authority, or any officer or agency of any such political subdivision or local authority.

42 Pa.C.S. §102.

> need not accept as true conclusions of law, unwarranted inferences, argumentative allegations, or expressions of opinion. *Portalatin v. Department of Corrections*, 979 A.2d 944, 947 (Pa. Cmwlth. 2009). "Preliminary objections should be sustained only in cases that are clear and free from doubt." *Pennsylvania AFL–CIO v. Commonwealth*, 757 A.2d 917, 920 (Pa. 2000).

Seitel Data, Ltd. v. Center Township, 92 A.3d 851, 859 (Pa. Cmwlth. 2014) (citations modified).

A challenge to a court's subject matter jurisdiction may be raised by preliminary objection. *See* Pa.R.C.P. No. 1028(a)(1). In a circumstance such as this, however, the proper disposition of the jurisdictional objection cannot be determined from the pleadings alone, for the determination of whether POCS is a private or a governmental entity turns upon our consideration of evidence relating to POCS' structure and operation. Both our precedent and our Rules of Civil Procedure acknowledge the fact-intensive nature of a preliminary objection of this sort. "There are basically two categories of preliminary objections[:] Those raising questions of fact outside the record and those which may be determined from the facts of record." *Chester Upland School District v. Yesavage*, 653 A.2d 1319, 1325 (Pa. Cmwlth. 1994). A demurrer is of the latter sort, and "may be determined from facts of record so that further evidence is not required." Pa.R.C.P. No. 1028(c)(2), *Note*. POCS' second and third preliminary objections are in the nature of demurrers, and the attempt to introduce evidence in support of either such objection would render it an impermissible "speaking demurrer." *See Minor v. Kraynak*, 155 A.3d 114, 124 (Pa. Cmwlth. 2017).

Here, POCS' jurisdictional challenge under Pa.R.C.P. No. 1028(a)(1), however, is of the sort that "cannot be determined from facts of record." Pa.R.C.P. No. 1028(c)(2), *Note*. "In such a case, the preliminary objections must be endorsed with a notice to plead or no response will be required." *Id.* The respondent bears the burden to demonstrate the absence of jurisdiction, and only upon the presentation of evidence supporting the jurisdictional challenge does the burden shift to the petitioner. *Sawyers v. Davis*, 222 A.3d 1, 5 (Pa. Super. 2019). We have held that a mere allegation that the court lacks jurisdiction is insufficient to shift the burden to the petitioner; rather, the respondent "must first support its challenge to the court's . . . jurisdiction by presenting evidence." *Maleski by Taylor v. DP Realty Trust*, 653 A.2d 54, 61 (Pa. Cmwlth. 1994). "Only after the [respondent] has done so does the burden shift to the [petitioner] to adduce sufficient competent evidence to establish the court's jurisdiction." *Id.* Such evidence is not limited to deposition testimony, and "the burden may be met via affidavits or other competent evidence." *Id.*

POCS endorsed its preliminary objections with a notice to plead, and it supported its position with an affidavit from POCS' President and Chief Executive Officer, William G. Kiger, along with its articles of incorporation as a Pennsylvania nonprofit corporation, its bylaws, and its Internal Revenue Service approval letter recognizing POCS as a tax-exempt organization. (POCS Preliminary Objections at 22; Attachment 1; Exhibits A-C.) Accordingly, we conclude that POCS has properly offered supporting documentation in support of its jurisdictional objection, and that we have sufficient grounds upon which to assess whether POCS may be deemed to be an agency of the Commonwealth, such that jurisdiction over PIOGA's action will lie in this Court under 42 Pa.C.S. §761(a)(1).

B. The Parties' Arguments

Both parties acknowledge that POCS is facially a nonprofit corporation, and that neither the UULPL nor any other statute claims POCS as an agency of this Commonwealth. (Preliminary Objections ¶17; Answer to Preliminary Objections at ¶8). Both parties also acknowledge that the absence of a statutory provision designating POCS as an agency is not necessarily dispositive, and that courts have considered a number of factors in determining whether a putatively private entity may be deemed to be a part of the Commonwealth government for purposes of our original jurisdiction statute. These factors include:

> (1) denomination as a government agency, instrumentality, body politic, etc.,
>
> (2) who appoints a majority of the board of directors or the membership of the governing body,
>
> (3) who receives the assets upon dissolution of the entity,
>
> (4) the source of the operating funds,
>
> (5) the degree of supervision by another [C]ommonwealth entity,
>
> (6) the geographic scope of operations,
>
> (7) entitlement to legal counsel from the Attorney General, and
>
> (8) statutory language distinguishing it from other Commonwealth entities.

Cooper v. Pennsylvania State Athletic Conference, 841 A.2d 638, 641 (Pa. Cmwlth. 2004) (citing G. DARLINGTON, K. MCKEON, D. SCHUCKERS, K. BROWN, & P. CAWLEY, PENNSYLVANIA APPELLATE PRACTICE §40:307 (West 2019-2020 ed.)).

POCS contends that none of the above-listed factors suggest that it may be deemed to be a Commonwealth entity. POCS observes that it is not designated as an agency or a part of the Commonwealth government in the UULPL or any other statute. (Preliminary Objections ¶17(a); POCS' Br. at 20.) With regard to its board of directors, POCS acknowledges that the UULPL requires the presence of the Chairman of the Public Utility Commission (PUC), the Director of the Pennsylvania Emergency Management Agency (PEMA), and the Secretary of the Department of Transportation (PennDOT), and further specifies that 20% of its board must be composed of representatives of municipalities or municipal authorities. 73 P.S. §178.1(d). However, POCS asserts that the majority of its 35-member board consists of private entity stakeholders, who were "chosen by the facility owners" as the UULPL directs. *Id.* Because the Commonwealth does not appoint or control a majority of its board of directors, POCS argues that the second factor supports a conclusion that it is a private entity. (Preliminary Objections ¶17(b) (citing *Pennsylvania State University v. Derry Township School District*, 731 A.2d 1272, 1274-75 (Pa. 1999) (*PSU*) ("When determining whether an institution is an agency or instrumentality of the government, we must consider whether the Commonwealth has majority control of the board.")); POCS' Br. at 20.)

As for the third factor, POCS asserts that under 15 Pa.C.S. §5975(c)[6] (relating to corporations and unincorporated associations) and POCS' bylaws, upon dissolution, POCS' assets will be distributed to POCS' members, not to the Commonwealth. (Preliminary Objections ¶17(c); POCS' Br. at 20.) With regard to the fourth factor, POCS asserts that it never has received any funding from the Commonwealth, and that its operation is funded solely by the fees received from its users. (Preliminary Objections at ¶17(d); POCS' Br. at 20.) As it concerns the fifth factor, POCS argues that it is not controlled or supervised by any other entity of the Commonwealth and, although the UULPL grants authority to the PUC to enforce the

[6] Section 5975(c) states that, except as otherwise provided, upon dissolution of a nonprofit corporation, "any surplus remaining after paying or providing for all liabilities of the corporation shall be distributed to the shareholders, if any, pro rata, or if there be no shareholders, among the members per capita." 15 Pa.C.S. §5975(c).

UULPL and to investigate violations thereof,[7] it does not allow PUC to direct or control POCS or its operations. (Preliminary Objections ¶17(e); POCS' Br. at 27.)

POCS does not address the sixth factor—geographic scope of operations—but it concedes that it operates throughout all of Pennsylvania. (Preliminary Objections ¶7 (stating that "from 1972 until 1978 POCS grew from one-call coverage of [one] county to state-wide coverage")). On the seventh factor, POCS asserts that it is not entitled to legal representation by the Attorney General, that it has never received such representation, and that it has always retained private counsel for its legal needs. (Preliminary Objections ¶17(f); POCS' Br. at 20.) For purposes of the eighth factor, POCS does not point to any statutory language distinguishing it from other Commonwealth entities.

Apart from the considerations that POCS derives from the language of the UULPL, POCS supports the majority of its factual assertions with the declaration of its President and CEO, Mr. Kiger. Beyond the specific factors listed above, Mr. Kiger's declaration offers a litany of other details about POCS' operation that purport to show that POCS is a private, rather than governmental entity: that POCS' employees are not hired or paid by the Commonwealth and do not participate in state pension plans; that POCS procured its own office space and owns the property on which its headquarters are located; that POCS does its own procurements without resort to the Commonwealth Procurement Code;[8] that POCS is not subject to the Right-to-Know Law (RTKL);[9] that

[7] *See, e.g.*, Section 7.10(a) of the UULPL, added by the Act of October 30, 2017, P.L. 806, 73 P.S. §182.10(a) (granting the PUC authority to order compliance with the UULPL, issue warnings, and levy administrative penalties for violations).

[8] 62 Pa.C.S. §§101-2311.

[9] Act of February 14, 2008, P.L. 14, No. 3, 65 P.S. §§67.101-67.3104.

POCS is not subject to the Sunshine Act;[10] and that POCS holds all funds generated by its fees in its own name and has no involvement with public funds. (Preliminary Objections ¶17(g); Attachment 1 ¶¶8-18.)

PIOGA does not dispute the factual assertions about POCS' operations set forth in Mr. Kiger's declaration. PIOGA further concedes that "the relationship between POCS and UULPL does not fit nicely into the existing jurisprudence concerning this [C]ourt's original jurisdiction." (PIOGA's Br. at 17.) In support of its view that POCS should be deemed to be a Commonwealth agency, PIOGA emphasizes the duties that the UULPL places upon POCS, which PIOGA believes to signify the General Assembly's intent to control various aspects of POCS' operations. (Answer to Preliminary Objections ¶11; PIOGA's Br. at 14-15.) In PIOGA's view, these statutorily imposed duties, particularly those related to POCS' fees and finances, have transformed POCS from a private entity into an agency of the Commonwealth.

With regard to the above-listed factors articulated in *Cooper*, PIOGA primarily emphasizes POCS' statewide operation, and points to a statement of our Supreme Court in *James J. Gory Mechanical Contracting, Inc. v. Philadelphia Housing Authority*, 855 A.2d 669, 678 (Pa. 2004) (*Gory*), that "the pivotal factors to be looked at are whether the entity operates on a statewide basis and is predominantly controlled by the state." (Answer to Preliminary Objections ¶5; PIOGA's Br. at 17 n.37.) Because POCS operates across Pennsylvania, and because the UULPL imposes duties upon POCS, PIOGA argues that POCS may be deemed to be an agency of the Commonwealth. Also due to POCS' statewide operation, PIOGA contends that any county in Pennsylvania would be an appropriate venue for the instant litigation; accordingly, if we conclude that jurisdiction will not lie in this Court's original

[10] 65 Pa.C.S. §§701-16.

jurisdiction, PIOGA requests that we transfer the matter to the Court of Common Pleas of Clarion County rather than dismiss its petition. (Answer to Preliminary Objections ¶¶18-19; PIOGA's Br. at 18.)

C. Relevant Case Law

Our analysis is largely informed by a series of decisions of our Supreme Court concerning various entities' status as part of the Commonwealth government. In *Mooney v. Board of Trustees of Temple University of Commonwealth System of Higher Education*, 292 A.2d 395 (Pa. 1972), our Supreme Court considered whether Temple University (Temple) was a "state agency" for purposes of a statute mandating such agencies' disclosure of public records. The question arose from the General Assembly's designation of Temple as a part of the Commonwealth State System of Higher Education, enabling Temple to receive additional funding from the Commonwealth. This Court sustained Temple's preliminary objections to an action brought in our original jurisdiction, concluding that Temple was not a governmental entity, and that we therefore lacked subject matter jurisdiction over the suit.

On review, the Supreme Court noted that Temple was chartered as a nonprofit corporation, and although the legislation that altered its designation referred to Temple as an "instrumentality of the Commonwealth," the Court emphasized that it also provided that Temple "shall continue as a corporation for the same purposes as, and with all rights and privileges heretofore granted to[,] Temple University." *Id.* at 398-99. The Court found this latter language significant, in that it signaled the legislature's intent "to preserve Temple's status as a non[]profit corporation chartered for educational purposes," rather than to transform Temple into a state agency. *Id.* at 399.

The *Mooney* Court noted that, by statute, certain members of Temple's board of trustees were to be appointed by the Governor, the President Pro Tempore of the Senate, and the Speaker of the House. Nonetheless, the "twelve Commonwealth trustees remain only a one[-]third minority of the board's total number of thirty-six trustees," and the "majority of non-public trustees clearly retains the powers to manage and control the University." *Id.* The Court further noted that the applicable statute retained the board of trustees' authority to maintain its facilities, to control the management of its instructional, administrative, and financial affairs, and to adopt bylaws for its own governance, all of which suggested that Temple was not a state agency. *Id.* Even the statutory restrictions upon Temple's use of state-provided funds were not enough to persuade the Court, which stated that the "regulatory scheme provided by the Legislature to safeguard against improper expenditures of public funds in no way intrudes upon or alters Temple's status as a non[]profit corporation chartered for educational purposes." *Id.* at 400. Accordingly, the Court concluded that Temple was not a "state agency," and it affirmed this Court's order sustaining Temple's preliminary objections for lack of subject matter jurisdiction.

Another question concerning this Court's jurisdiction arose in *T&R Painting Co. v. Philadelphia Housing Authority*, 353 A.2d 800 (Pa. 1976). There, this Court had dismissed an action brought in our original jurisdiction against the Philadelphia Housing Authority (PHA), concluding that the entity was a local agency, not an agency of the Commonwealth. The dispute centered upon statutory language stating that the PHA "shall constitute a public body, corporate and politic, exercising public powers of the Commonwealth as an agency thereof . . . ." *Id.* at 801. Although this language suggested that the PHA was an agency of the Commonwealth, our Supreme Court found the statute ambiguous in light of at least eight other statutory provisions suggesting that it was, instead, "a local agency operating within a limited area." *Id.* Concluding that PHA's statutory powers and duties related only to matters of local concern, and that there was no need for statewide resolution of claims against it, our Supreme Court held that PHA was a local agency, not a Commonwealth agency amenable to suit in this Court's original jurisdiction. *Id.* at 802.

In *Harristown Development Corp. v. Department of General Services*, 614 A.2d 1128 (Pa. 1992), our Supreme Court considered a statute subjecting nonprofit corporations that collected rent from the Commonwealth in excess of $1,500,000.00 to the terms of the Sunshine Act and the RTKL. Relying upon *Mooney*, this Court had concluded that the new statutory language did not transform such nonprofit corporations into agencies of the Commonwealth. The Supreme Court disagreed. Simply, the Court held that the subject entity "is an agency if the General Assembly says it is." *Id.* at 1131. Because the legislation at issue amended the definition of "agency" in the Sunshine Act and the RTKL to include such nonprofit corporations, the Court found it clear that the General Assembly intended to claim them as agencies for purposes of those statutes.

PSU concerned a county and school district's authority to levy real estate taxes upon the Milton S. Hershey Medical Center (HMC), which was owned by Pennsylvania State University (PSU). This Court had concluded that, because PSU was an instrumentality of the Commonwealth, its property was not subject to local real estate taxes. Our Supreme Court disagreed. The Court noted that the determination of whether PSU constituted an agency of the Commonwealth depended upon a variety of factors, and was complicated by "the fact that it is not merely funded by the Commonwealth, but in certain very limited respects it has governmental characteristics, while in other regards it is plainly non-governmental." *Id.* at 1274.

Although courts had reached differing conclusions regarding PSU's status in different contexts, the Supreme Court did not find these disparate characterizations to be problematic "because an entity's status as an agency or instrumentality varies, depending on the issue for which the determination is being made." *Id.*

Public funding alone, the Supreme Court noted, is not dispositive. *Id.* at 1274 ("The mere funding of an institution does not . . . make it an agency or instrumentality of the state.") (citing *Mooney*, 292 A.2d at 398-99). With regard to real estate taxation, our Supreme Court stated that "the pivotal factor" is "whether the institution's real property is so thoroughly under the control of the Commonwealth, that, effectively, the institution's property functions as Commonwealth property." *Id.* The Court found the answer in the composition of PSU's board of trustees. Revisiting *Mooney*, the Court explained that, "[w]hen determining whether an institution is an agency or instrumentality of the government, we must consider whether the Commonwealth has majority control of the board." *Id.* at 1274-75 (citing *Mooney*, 292 A.2d at 399). The Court found that PSU's board was "not governmental in nature." *Id.* at 1275. PSU's board consisted of 32 members, only 10 of whom were public officials. *Id.* "Thus, governmental representation on the board constitutes only a minority interest." *Id.* Given the largely private composition of PSU's board of trustees, the Court found it clear that "the authority to control and dispose of PSU property is not within the purview of the Commonwealth." *Id.* Thus, because the real property owned by PSU was not "so controlled by the Commonwealth as to fall within the latter's immunity from local real estate taxation," PSU could not be deemed an agency of the Commonwealth in this context. *Id.*

The context-sensitivity of the determination of agency status gave rise to the Supreme Court's decision in *Gory*. Although the Supreme Court had deemed PHA to be a local agency in *T&R Painting Co.*, PHA in *Gory* contended that a breach of contract claim brought against it by a construction contractor belonged in this Court's original jurisdiction, rather than that of a court of common pleas. Because the Supreme Court had concluded that the Port Authority of Allegheny County was entitled to sovereign immunity in *Marshall v. Port Authority of Allegheny County*, 568 A.2d 931 (Pa. 1990), and because PHA was a similar entity, PHA contended that *Marshall* had overruled *T&R Painting Co.* and redefined PHA as a Commonwealth agency. *Gory*, 855 A.2d at 676.

Rejecting this position, the Supreme Court again noted that the classification of an entity can vary depending upon the context. *Id.* at 677 (citing *PSU*, 731 A.2d at 1274). *Marshall*, the Court noted, concerned the scope of sovereign immunity, and thus did not control the determination of PHA's status for the "completely different purpose" of this Court's subject matter jurisdiction. *Id.* With regard to this Court's original jurisdiction, the Supreme Court in *Gory* drew a contrast between characteristics of local agencies and those of Commonwealth agencies, and articulated two considerations that are particularly significant to the jurisdictional analysis. The dispute in the instant case largely derives from the parties' differing understandings of this discussion in *Gory*:

> [W]hen determining whether an entity is a Commonwealth agency for jurisdictional purposes so that cases against it must be originally heard in the Commonwealth Court, the pivotal factors to be looked at are whether the entity operates on a statewide basis and is predominantly controlled by the state. As we explained in *T&R Painting Co.*, where the entity acts throughout the state and under the state's control, it is clearly meant to be a Commonwealth agency for jurisdictional purposes so that it may be sued in the Commonwealth Court. In contrast, where the entity operates within a single county or municipality and is governed in large part by that county or municipality, the entity must be

> characterized as a local agency and sued in the trial courts because the trial courts will be more familiar with the issues surrounding the entity's operations and organizational make-up.

Id. at 678.

The *Gory* Court noted that the applicable statutory scheme had changed little since *T&R Painting Co.*, that housing authorities continued to "operate solely in one locality and predominantly under the control of the governing body in that locality," and that they accordingly "must continue to be considered local agencies for purposes of jurisdiction and subject to the original jurisdiction of" the court of common pleas. *Gory*, 855 A.2d at 675-76. Applying these factors to PHA specifically, the *Gory* Court found "clear that PHA is a local agency for jurisdictional purposes" because PHA's "scope of authority is limited to the territorial boundaries of Philadelphia," and because "PHA's five members are all appointed by the Mayor of Philadelphia" rather than a Commonwealth official. *Id.* at 678.

Finally, and by way of contrast to *T&R Painting Co.* and *Gory*, our Supreme Court in *Blount v. Philadelphia Parking Authority*, 965 A.2d 226 (Pa. 2009), concluded that the Philadelphia Parking Authority (PPA) was a Commonwealth agency for purposes of this Court's original jurisdiction. The dispute in *Blount* centered upon the validity of PPA's regulations concerning taxi and limousine services, under which PPA had issued citations to various taxi drivers and companies. This Court had determined that we lacked original jurisdiction over a challenge to PPA's regulations, concluding that PPA was a local agency, not a Commonwealth agency. Our Supreme Court reached the opposite conclusion.

The *Blount* Court emphasized that, by statute, parking authorities were defined as "public bod[ies] corporate and politic, exercising public powers of the

Commonwealth as agenc[ies] of the Commonwealth." *Id.* at 230 (quoting 53 Pa.C.S. §5505(a)(1) (relating to municipalities)) (bracketed material in original). This statutory language was highly similar to that at issue in *T&R Painting Co.*, which similarly designated PHA as an agency of the Commonwealth, yet was not dispositive of PHA's status. *Id.* As in *T&R Painting Co.*, moreover, the applicable statute in *Blount* also contained language suggesting that parking authorities were local entities. *Id.* at 231. Accordingly, the *Blount* Court reasoned, determining the proper classification of PPA required consideration of the General Assembly's intent. The Court conducted this inquiry by analyzing the factors that it had outlined in *Gory*, *i.e.*, "whether the PPA operates statewide and whether it is controlled by the state." *Id.* at 231-32 (citing *Gory*, 855 A.2d at 678).

Beginning with statewide operation, the *Blount* Court observed that PPA exercised regulatory authority not only over taxicabs operating within Philadelphia, but also taxicabs that travel elsewhere in Pennsylvania to or from Philadelphia. *Id.* at 232. Moreover, PPA shared responsibility for regulating taxicab operations with the PUC, and the "two agencies' spheres of operation combine and overlap to create a system of ground transportation that is essential to the welfare of the Commonwealth 'as a whole.'" *Id.* at 233 (quoting 53 Pa.C.S. §5701.1). Where *T&R Painting Co.* and *Gory* had emphasized that PHA's powers and duties were limited to matters occurring within Philadelphia, the comparatively larger geographic scope of PPA's regulatory authority in *Blount* served to distinguish PPA from PHA, and tended to suggest that PPA was not solely a local governmental entity. Further unlike PHA, the *Blount* Court explained, "PPA is controlled by the Commonwealth." *Id.* The PPA's governing board was appointed by the Governor of Pennsylvania, and it managed PPA's property and operations without any local government oversight. *Id.* Moreover, the applicable statutes directed the manner in which PPA was required to utilize its budget, its Taxicab Regulatory Fund was overseen by the General Assembly and not the City of Philadelphia, and the General Assembly reserved the right to examine PPA's accounts and records at any time. *Id.* at 233-34. This significant degree of state-level control over PPA's budget and finances further suggested that PPA was a Commonwealth agency, not a local agency.

The *Blount* Court noted that PPA was "an entity unlike any other in Pennsylvania." *Id.* at 234. Its distinctiveness notwithstanding, the Court found that PPA's status as a local or Commonwealth agency could be ascertained under the *Gory* factors. Because Commonwealth officials controlled "not only its governing structure but also its funding," and because PPA was an "entity whose actions have statewide impact," the Court concluded that PPA is a Commonwealth agency, and an action against it is properly brought in the Commonwealth Court's original jurisdiction. *Id.*

D. Analysis

The above-discussed jurisprudence reveals a variety of considerations that must be weighed in order to determine a given entity's status for purposes of our jurisdiction. These factors include those that we identified in *Cooper*, 841 A.2d at 641; *see supra* at 7, which we find to be useful guideposts for purposes of this analysis. Importantly, however, it is clear that the focus of the inquiry differs depending upon whether we seek to ascertain the identity of an undisputedly governmental body, *i.e.*, its status as an agency of the Commonwealth or rather a local governmental unit, or whether there is a threshold question of the entity's status as a governmental body in the first place. For instance, in *Mooney*, *Harristown*, and *PSU*, our Supreme Court assessed whether ostensibly nongovernmental entities nonetheless could be considered governmental agencies, and considered factors such as statutory identification of the entity as an agency, whether the Commonwealth controlled a majority of the entity's governing board and the extent to which the Commonwealth exercised authority over the entity's governance, whether the entity was funded by the Commonwealth, or any other statutory indication that the General Assembly intended that the entity would operate as a governmental agency. By contrast, in *T&R Painting Co.*, *Gory*, and *Blount*, the question was whether undisputedly governmental entities were agencies of the Commonwealth or, instead, local agencies. In that context, our Supreme Court held, the "pivotal factors" in the determination are whether the entity operates on a statewide basis and whether it is predominantly controlled by the Commonwealth, or instead by a local authority. *Blount*, 965 A.2d at 231-32; *Gory*, 855 A.2d at 678.

In our view, the principal source of the instant dispute is that PIOGA identifies and primarily relies upon the considerations tailored to differentiating between state and local agencies. Its arguments are largely nonresponsive to the threshold question of whether POCS is a governmental agency in the first place. In this regard, we observe that PIOGA does not dispute the facts set forth in Mr. Kiger's declaration, as they concern the factors identified in *Cooper*. Moreover, we disagree with PIOGA's characterization of this litigation as implicating a "unique situation" that "does not fit nicely into the existing jurisprudence concerning this [C]ourt's original jurisdiction." (PIOGA's Br. at 14, 17.) Rather, we conclude that the considerations identified in *Cooper*, coupled with our Supreme Court's holdings on similar questions, provide ample guidance on the determination of POCS' status.

As noted, it is undisputed that POCS is a nonprofit corporation and that no statute defines POCS as a governmental agency. Clearly, then, this is not a situation in which the entity "is an agency if the General Assembly says it is." *Harristown*, 614

A.2d at 1131. Indeed, the General Assembly not only declined to claim POCS as an agency of the Commonwealth, but the definition of a "One Call System" in the UULPL expressly states that such a system "shall be incorporated and operated as a nonprofit corporation." Section 1 of the UULPL, 73 P.S. §176; *see supra* n.3. This is analogous to the *Mooney* Court's observation that, notwithstanding Temple's statutory characterization as an "instrumentality of the Commonwealth," the statute contained language preserving Temple's status "as a corporation for the same purposes as, and with all rights and privileges heretofore granted," which suggested the General Assembly's intent to "preserve Temple's status as a non[]profit corporation chartered for educational pruposes," rather than to claim Temple as an agency of the Commonwealth. *Mooney*, 292 A.2d at 398-99. Not only does the UULPL recognize POCS' status as a nonprofit corporation, but, unlike in *Mooney*, here the General Assembly made no attempt in the UULPL to define POCS as an instrumentality of the Commonwealth.[11] We conclude, thus, that this factor weighs heavily in favor of a conclusion that POCS is not a state agency.

On the second *Cooper* factor, we find that the composition of POCS' board of directors also suggests that it is a private entity. Initially, the UULPL directs that POCS' board of directors is "to be chosen by the facility owners." Section 3.1 of the UULPL, 73 P.S. §178.1(d). That is, the board's composition is largely within the discretion of private party stakeholders; its members are not appointed by Commonwealth officials. This distinguishes POCS' board of directors from bodies such as the governing board of PPA, the members of which were appointed by the

[11] Moreover, although the parties do not place significant emphasis upon the eighth *Cooper* factor—statutory language distinguishing the organization from other Commonwealth entities—we note that UULPL's mandate that a "One Call System" be organized as a nonprofit corporation serves to distinguish such an entity from those that are expressly designated as agencies by statute.

Governor, thereby suggesting the Commonwealth's control over the organization's governance. *See Blount*, 965 A.2d at 233. As POCS acknowledges, however, the UULPL requires that three Commonwealth officials sit on its board—the Chairman of PUC, the Director of PEMA, and the Secretary of PennDOT. Section 3.1 of the UULPL, 73 P.S. §178.1(d)(1)-(2), (4). However, these three officials represent a clear minority of POCS' 35-member board. *See PSU*, 731 A.2d at 1274-75 ("When determining whether an institution is an agency or instrumentality of the government, we must consider whether the Commonwealth has majority control of the board."). The UULPL's mandate that "[n]o less than twenty percent of the seats on the board shall be held by municipalities or municipal authorities," Section 3.1(d) of the UULPL, 73 P.S. §178.1(d), does not alter our analysis. Twenty percent remains far less than majority control, and, in any event, *municipal* officials are clearly not *Commonwealth* officials. Because the Commonwealth does not control a majority of POCS' board of directors or appoint its members, we find that this factor also suggests that POCS is a private entity, not a state agency.

PIOGA does not dispute POCS' observations that the Commonwealth is not entitled to any of POCS' assets should it dissolve, and that POCS' operations are funded by the fees for using its service, not by the public fisc. Moreover, it is clear that POCS is not entitled to legal representation from the Attorney General, as POCS is represented by private counsel in the very case before us. Accordingly, the third, fourth, and seventh *Cooper* factors all suggest that POCS is a not a government agency. We additionally take note of POCS' assertions of various other indicia of its private status: that its employees are not hired or paid by the Commonwealth and do not participate in state pension plans; that it procures its own supplies and owns its own office space; that it is not subject to the RTKL or the Sunshine Act; and that it holds all of its funds in its own name. (Preliminary Objections ¶17(g); Attachment 1 ¶¶8-18.) We agree that these attributes additionally differentiate POCS from entities recognized to be Commonwealth agencies.

All that remains is PIOGA's reliance upon the fifth and sixth *Cooper* factors—the degree of supervision by another Commonwealth entity and the geographic scope of operations. Although PIOGA stresses our Supreme Court's statement that "the pivotal factors to be looked at are whether the entity operates on a statewide basis and is predominantly controlled by the state," *Gory*, 855 A.2d at 678, as noted above, these considerations are most pivotal in distinguishing between state and local agencies, which was the dispositive issue in *T&R Painting Co.*, *Gory*, and *Blount*. Here, the first and most significant inquiry is whether POCS is a government agency of any type.

There is no dispute that the geographic scope of POCS' operations presently includes all of Pennsylvania. However, this factor alone clearly cannot suffice. If statewide operation was all that is required to define an entity as a Commonwealth agency, then countless private entities would be surprised to find themselves reclassified as governmental bodies. As POCS pithily argues, "Starbucks or JiffyLube or State Farm Insurance could be considered to be the 'Commonwealth government' for the court's jurisdictional purposes simply because they have statewide operations." (POCS' Br. at 21.) To be clear, statewide operation is an exceptionally weighty consideration when distinguishing between state and local agencies, for the obvious reason that the extension of a given entity's regulatory authority beyond a particular locale is highly suggestive that it is not strictly a local agency. *See, e.g.*, *Blount*, 965 A.2d at 232-33. However, when deciding whether a facially private entity nonetheless may be deemed to be an agency of the Commonwealth, plainly the analysis requires more than mere statewide operation.

We turn, then, to PIOGA's contentions regarding the degree of control that the Commonwealth exercises over POCS. In support of its contention that POCS is predominantly controlled by the Commonwealth, PIOGA points to certain duties that the UULPL imposes upon POCS, particularly those relating to POCS' operations and the fees that POCS charges for its services. *See* Section 3.1(e)-(f.1) of the UULPL, 73 P.S. §178.1(e)-(f.1); *supra* n.4. These statutory provisions, according to PIOGA, demonstrate the Commonwealth's "pervasive control" over POCS' "governance and finances." (PIOGA's Br. at 17-18.) We already have addressed the UULPL's requirements concerning POCS' board of directors, and contrary to PIOGA's assertions, the composition of POCS' board suggests its status as a private entity, not a Commonwealth agency. To the extent that PIOGA asserts that the UULPL's imposition of duties upon POCS renders it a Commonwealth agency, *see* Section 3 of the UULPL, 73 P.S. §178 (Duties of One Call System), we note that the UULPL also imposes corresponding duties upon facility owners. *See* Section 2 of the UULPL, 73 P.S. §177 (Duties of facility owners). Yet, PIOGA does not suggest that the facility owners which compose its membership are therefore Commonwealth agencies.

We are no more persuaded by the UULPL's fee provisions. The existence of statutory controls on an entity's fees does not transform the entity into an agency of the Commonwealth. As just one example, it is undeniable that private automobile insurance companies are not Commonwealth agencies merely because the Motor Vehicle Financial Responsibility Law[12] contains provisions relating to the manner in which they may charge customers for using their services. Similarly here, the fact that

[12] 75 Pa.C.S. §§1701-1799.7.

the UULPL contains provisions relating to the fees charged by a One Call System does not mean that POCS may be deemed to be part of the Commonwealth government.

In sum, we find that the facts overwhelmingly support POCS' assertion that it is a private entity, and not a Commonwealth agency or otherwise a component part of the Commonwealth government. As such, this Court lacks original jurisdiction over PIOGA's action. 42 Pa.C.S. §761(a)(1).

In the event that we find subject matter jurisdiction lacking, as we have, PIOGA requests that we transfer its petition to the Court of Common Pleas of Clarion County as an alternative to dismissal. (PIOGA's Br. at 18.) POCS opposes such a transfer, although it concedes that, due to its statewide operation, venue would be proper in any county in Pennsylvania under Pa.R.C.P. No. 2179.[13] (POCS' Reply Br. at 11.) Under section 5103(a) of the Judicial Code, 42 Pa.C.S. §5103(a),[14] and

[13] Rule 2179 of the Pennsylvania Rules of Civil Procedure provides that an action against a corporation or similar entity may be brought in "a county where it regularly does business." Pa.R.C.P. No. 2179(a)(2).

[14] Section 5103(a) provides:

> If an appeal or other matter is taken to or brought in a court or magisterial district of this Commonwealth which does not have jurisdiction of the appeal or other matter, the court or magisterial district judge shall not quash such appeal or dismiss the matter, but shall transfer the record thereof to the proper tribunal of this Commonwealth, where the appeal or other matter shall be treated as if originally filed in the transferee tribunal on the date when the appeal or other matter was first filed in a court or magisterial district of this Commonwealth. A matter which is within the exclusive jurisdiction of a court or magisterial district judge of this Commonwealth but which is commenced in any other tribunal of this Commonwealth shall be transferred by the other tribunal to the proper court or magisterial district of this Commonwealth where it shall be treated as if originally filed in the transferee court or magisterial district of this Commonwealth on the date when first filed in the other tribunal.

(Footnote continued on next page…)

Pa.R.C.P. No. 213(f),[15] we will transfer the matter to the Court of Common Pleas of Clarion County. *See Seitel*, 92 A.3d at 863-64. The Prothonotary of this Court shall transmit the record of the above proceedings to the Prothonotary of the Court of Common Pleas of Clarion County. PIOGA shall bear the costs of the transfer. Pa.R.C.P. No. 213(f); *Leonard v. Thornburgh*, 463 A.2d 77, 79 (Pa. Cmwlth. 1983).

POCS' preliminary objection is sustained.

PATRICIA A. McCULLOUGH, Judge

Judge Crompton did not participate in this decision.

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42 Pa.C.S. §5103(a).

[15] Rule 213(f) provides:

> When an action is commenced in a court which has no jurisdiction over the subject matter of the action it shall not be dismissed if there is another court of appropriate jurisdiction within the Commonwealth in which the action could originally have been brought but the court shall transfer the action at the cost of the plaintiff to the court of appropriate jurisdiction. It shall be the duty of the prothonotary or clerk of the court in which the action is commenced to transfer the record together with a certified copy of the docket entries to the prothonotary or clerk of the court to which the action is transferred.

Pa.R.C.P. No. 213(f).

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Pennsylvania Independent Oil & Gas Association, Petitioner	:	
v.	:	No. 507 M.D. 2019
Pennsylvania One Call System, Inc., Respondent	:	

ORDER

AND NOW, this 5th day of January, 2021, the preliminary objection of Pennsylvania One Call System, Inc., is SUSTAINED. Because this Court lacks subject matter jurisdiction over the claims asserted in Pennsylvania Independent Oil & Gas Association's petition for review, we transfer the above-captioned matter to the Court of Common Pleas of Clarion County. The Prothonotary of this Court shall transmit the record and a certified copy of the docket entries of the above proceedings to the Prothonotary of the Court of Common Pleas of Clarion County. Pennsylvania Independent Oil & Gas Association shall bear the costs of the transfer.

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PATRICIA A. McCULLOUGH, Judge

NOT FOR PUBLICATION WITHOUT THE
APPROVAL OF THE APPELLATE DIVISION

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-2204-18T4
A-2219-18T4
A-2276-18T4
A-2278-18T4
A-2283-18T4
A-2288-18T4
A-2292-18T4
A-2305-18T4

IN THE MATTER OF THE APPLICATION FOR MEDICINAL MARIJUANA ALTERNATIVE TREATMENT CENTER FOR PANGAEA HEALTH AND WELLNESS, LLC.

IN THE MATTER OF THE APPLICATION FOR MEDICINAL MARIJUANA ALTERNATIVE TREATMENT CENTER FOR GGB NEW JERSEY, LLC.

APPROVED FOR PUBLICATION
November 25, 2020
APPELLATE DIVISION

IN THE MATTER OF THE APPLICATION FOR MEDICINAL MARIJUANA ALTERNATIVE TREATMENT CENTER FOR LIBERTY PLANT SCIENCES, LLC.

IN THE MATTER OF THE APPLICATION FOR MEDICINAL MARIJUANA ALTERNATIVE TREATMENT CENTER FOR ALTUS NEW JERSEY, LLC.

IN THE MATTER OF THE APPLICATION FOR MEDICINAL MARIJUANA

ALTERNATIVE TREATMENT CENTERS
COMPASSIONATE CARE FOUNDATION,
INC.

IN THE MATTER OF THE APPLICATION
FOR MEDICINAL MARIJUANA
ALTERNATIVE TREATMENT CENTER
FOR ALTUS NEW JERSEY, LLC.

IN THE MATTER OF THE APPLICATION
FOR MEDICINAL MARIJUANA
ALTERNATIVE TREATMENT CENTER
FOR HARVEST OF NEW JERSEY, LLC.

IN THE MATTER OF THE APPLICATION
FOR MEDICINAL MARIJUANA
ALTERNATIVE TREATMENT CENTER
FOR BLOOM MEDICINALS OF PA, LLC.

Argued October 20, 2020 – Decided November 25, 2020

Before Judges Fisher, Moynihan and Gummer.

On appeal from a final agency decision of the New Jersey Department of Health, dated December 17, 2018.

John W. Bartlett argued the cause for appellant Pangaea Health and Wellness LLC (Murphy Orlando LLC, attorneys; John W. Bartlett, Jason F. Orlando and Christopher D. Zingaro, on the briefs in A-2204-18).

Joshua S. Bauchner argued the cause for appellant GGB New Jersey, LLC (Ansell Grimm & Aaron, P.C., attorneys; Joshua S. Bauchner, of counsel and on the briefs; Rahool Patel, on the briefs in A-2219-18).

Seth R. Tipton argued the cause for appellant Liberty Plant Sciences LLC (Florio Perrucci Steinhardt & Cappelli LLC, attorneys; Seth R. Tipton, of counsel and on the briefs in A-2276-18).

Kevin J. McKeon of the Pennsylvania bar, argued the cause for appellant Altus New Jersey (Hawke McKeon & Sniscak LLP, attorneys; Kevin J. McKeon, Judith D. Cassel and Melissa A. Chapaska, of counsel and on the briefs in A-2278-18 and A-2288-18; Rachel S. Cotrino, of counsel and on the briefs in A-2288-18).

Sean Mack argued the cause for appellant Compassionate Care Foundation, Inc. (Pashman Stein Walder Hayden, PC, attorneys; Sean Mack and Matthew Frisch, on the briefs in A-2283-18).

Maeve E. Cannon argued the cause for appellant Harvest of New Jersey LLC (Stevens & Lee, PC, attorneys; Maeve E. Cannon and Patrick D. Kennedy, of counsel and on the briefs; Wade D. Koenecke, on the briefs in A-2292-18).

Stuart M. Lederman argued the cause for appellant Bloom Medicinals of PA, LLC (Riker Danzig Sherer Hyland & Perretti LLP, attorneys; Stuart M. Lederman, of counsel and on the briefs; Diane N. Hickey, on the briefs in A-2305-18).

Jacqueline R. D'Alessandro, Deputy Attorney General, argued the cause for respondent New Jersey Department of Health (Gurbir S. Grewal, Attorney General, attorney; Melissa H. Raksa, Assistant Attorney General, of counsel; Jacqueline R. D'Alessandro, on the briefs in all appeals).

Christopher R. Gibson argued the cause for respondent Columbia Care New Jersey, LLC (Archer & Greiner, PC, attorneys; Christopher R. Gibson and Patrick M. Flynn, of counsel and on the briefs in all appeals).

George R. Hirsch argued the cause for respondent MPX New Jersey, LLC (Sills Cummis & Gross, PC, attorneys; George R. Hirsch and Kenneth F. Oettle, of counsel and on the briefs in all appeals).

Eric I. Abraham argued the cause for respondent GTI New Jersey, LLC (Hill Wallack LLP, attorneys; Eric I. Abraham and Henry T. Chou, of counsel and on the briefs in all appeals).

Benjamin Clarke argued the cause for respondent Verano NJ, LLC (DeCotiis, Fitzpatrick, Cole & Giblin, LLP, attorneys; Benjamin Clarke, of counsel and on the briefs in all appeals; Michael DiFazio, on the briefs in all appeals; and join in the brief of respondent New Jersey Department of Health in A-2276-18, A-2283-18, A-2288-18 and A-2292-18).

Robert A. Magnanini argued the cause for respondent JG New Jersey, LLC (Stone & Magnanini, LLP and Frank Newel, (Loevy & Loevy) of the Illinois bar, admitted pro hac vice, attorneys; Robert A. Magnanini and Michael Clore, and Frank Newel, of counsel and on the briefs in A-2278-18, A-2288-18 and A-2292-18; and join in the brief of respondent New Jersey Department of Health in A-2204-18, A-2219-18, A-2276-18, A-2283-18, and A-2305-18).

A. Matthew Boxer argued the cause for respondent NETA NJ, LLC (Lowenstein Sandler, attorneys; A. Matthew Boxer and Steven Llanes, on the briefs in A-2219-18 and A-2305-18; and join in the brief of respondent New Jersey Department of Health in A-

2204-18, A- 2276-18, A-2278-18, A-2283-18, A-2288-18 and A-2292-18).

The opinion of the court was delivered by

FISHER, P.J.A.D.

In these eight appeals, which have been calendared together, appellants contend the Department of Health made numerous errors in its selection of entities to operate Alternative Treatment Centers to grow, process, and dispense marijuana as part of the State's Medicinal Marijuana Program. Appellants Pangaea Health and Wellness LLC, Harvest of New Jersey, LLC, Liberty Plant Sciences LLC, Bloom Medicinals of PA, LLC, GGB New Jersey, LLC, Altus New Jersey, LLC, and Compassionate Care Foundation, Inc. complain about, among other things, the Department's selection process, including the criteria used, the manner in which their applications were scored, and the overall sufficiency and explanation of the final agency decisions. Because we agree with appellants that the scoring system produced arbitrary results that have gone unexplained, we intervene and vacate the final agency decisions in question, and we remand for further proceedings.

I

The Applicable Legislation. The Compassionate Use of Medical Marijuana Act, N.J.S.A. 24:6I-1 to -30, which was enacted on January 18, 2010, protects qualifying patients and their caregivers from arrest, prosecution, and other penalties in New Jersey for possessing marijuana for medical purposes. N.J.S.A. 24:6I-2(e).[1] To qualify, a patient must suffer from one of the enumerated conditions or from any condition the Department establishes as debilitating. N.J.S.A. 24:6I-3.

The Compassionate Use Act also protects those authorized to produce, process, and dispense marijuana pursuant to the statute's terms, N.J.S.A. 24:6I-7, and charges the Department with implementing the State's Medicinal Marijuana Program (the Program), N.J.S.A. 24:6I-3. See Natural Med., Inc. v. N.J. Dep't of Health and Senior Servs., 428 N.J. Super. 259, 262 (App. Div. 2012). This includes establishing a registry of qualified patients and issuing permits for the operation of Alternative Treatment Centers (ATCs). N.J.S.A. 24:6I-4; N.J.S.A. 24:6I-7.1; Natural Med., 428 N.J. Super. at 262.

N.J.S.A. 24:6I-7(a)(3) tasks the Department with "ensur[ing] the availability of a sufficient number of [ATCs] throughout the State, pursuant to need" and requires that the Department issue permits for "at least two [ATCs]

[1] The Act has undergone significant revisions. See L. 2019, c. 153. Those amendments, however, did not go into effect until July 2, 2019, and have no bearing on our disposition of these appeals about the final agency decisions rendered in December 2018.

each in the northern, central, and southern regions of the State." Beyond the mandated six ATCs, the Department "has discretion to determine how many ATCs are needed to meet the demand for medicinal marijuana and whether the issuance of a permit to a particular applicant would be consistent with the purposes of the Act." Natural Med., 428 N.J. Super. at 263. In ensuring the availability of a sufficient number of ATCs, the Department promulgated regulations, N.J.A.C. 8:64-1.1 to -13.11, which provide the framework through which it issues requests for applications for the operation of ATCs.

In 2011, to fulfill its obligation under N.J.S.A. 24:6I-7(a), the Department issued a request for applications to select entities to operate the State's first six ATCs. In re Inst. for Health Rsch. and Abunda Life Ctr., No. A-0069-11 (App. Div. Aug. 22, 2013) (slip op. at 1-2). A five-member reviewing committee consisting of three Department members, one member from the Department of Agriculture, and one from the Department of Community Affairs, evaluated thirty-five applications and awarded scores for each criterion. Id. at 2-3. At that time the Department decided that no applicant could hold more than one ATC permit and that two ATCs could not be opened in the same municipality, concluding this standard would promote accessibility to more patients and the availability of more diverse products. Id. at 3-4. The reviewing committee chose two different high-scoring applicants for each of the three regions. Ibid.

After the Department rendered decisions announcing the entities it had chosen to proceed with the ATC permitting process, several disappointed applicants appealed. Id. at 1. We concluded that the Department's proceedings were not arbitrary, capricious, or unreasonable. Id. at 7-9.

In January 2018, the Governor issued Executive Order 6, which directed the Department to review the Program's status with a mind toward expanding access to medical marijuana. A few months later, the Department added new conditions to the list of those qualifying for the Program, including certain types of chronic pain, Tourette's syndrome, migraines, and anxiety. These additions caused a rapid increase in qualified and registered patients between March and July 2018.

The Request for Applications. In July 2018, to ensure that the growing population of qualified patients would be adequately served, the Department issued a second request for applications for the selection of six more entities, two in each region, to receive ATC permits.

The request for applications had two sections. Part A required information about:

- the applicant's corporate form;
- proposed locations for grow sites and dispensaries and whether these locations complied with all local codes and ordinances;
- names of all managers, staff, contractors, vendors, landlords, and suppliers;
- whether the applicant held any medical marijuana-related licenses in other states; and
- disclosures of any regulatory violations, litigation, and criminal histories.

Part A was evaluated on a pass/fail basis; the application would be rejected if the applicant failed to respond sufficiently to each question.

Part B consisted of sixty scored criteria requiring applicants to provide narrative responses and to attach responsive documents. The criteria covered several topics, asking applicants about their experience, expertise, and plans to operate an ATC in New Jersey if selected, including but not limited to:

- cultivation policies and procedures and knowledge of botany and chemistry related to the growing and processing of marijuana products;
- mobilization plans and time estimates for producing first crops;

- past business experience with medical marijuana, if any;
- quality assurance and quality control plans;
- plans for insect and disease control and sanitation;
- plans to assist scientific research;
- security plans;
- proposed facility floor plans;
- financial records, records of past taxes paid, and proposed budgets; and
- workplace and ownership diversity and collective bargaining agreements.

The request for applications informed prospective applicants that responses to Part B would be evaluated by a review committee on a 1000-point scale; the request listed the maximum points that could be earned for each criterion. The total scores awarded to an applicant by the review committee would then be averaged, creating the applicant's final composite score. The request for applications also clarified that winning applicants would not be issued permits immediately; they would instead be "chosen to proceed in the permitting process."

On August 9, 2018, the Department held a mandatory pre-submission conference for applicants to explain the scoring process. It also responded in writing to questions from prospective applicants in an official "Q&A" document made publicly available less than a week later.

By the application closing date of August 31, 2018, the Department received 146 applications from 103 entities, with several entities applying in more than one region. For example, Altus applied in the central and southern regions, Bloom in all three, and Liberty in the northern and southern regions. Three appellants applied in only a single region: GGB in the northern region; Harvest in the southern region; and Pangaea in the central region.

The review committee. The Department chose a six-member committee to review and score all applications; this review committee was comprised of four representatives from the Department, one from the Department of Agriculture, and one from the Department of Treasury. On September 5, 2018, before the scoring process began, the review committee members attended a workshop, which included a discussion about the Program, guidance on scoring applications, and training on diversity and bias. Each review committee member completed disclosure forms and signed certifications stating that neither they nor any members of their immediate family had any financial or personal ties to any applicant.

The Department provided the review committee members additional printed scoring instructions for the sixty criteria. For each criterion, the instructions directed members to award points on a scale from zero to a maximum number of points allowable, which varied. The instructions also stated that scores of zero should be reserved for "non-responsive" answers.

Review committee members were initially given sixty days from the application due date to complete their evaluations, but, when committee members expressed concerns about this allotted time, the Department extended the review period for six weeks. At times, members emailed questions to the Department about how to score some of the criteria, to which the Department responded.

On December 12, 2018, the review committee recommended six applications per region for "further consideration." Five days later, the Department issued final agency decisions to all applicants, expressing its acceptance or rejection of their applications. Included with these collective decisions was the Department's explanation that, as with the previous round of ATC permitting, it would not award more than one permit to any single applicant, even if that applicant was one of the two highest scorers in more than one region. The Department believed that choosing six different entities would benefit patients because it would lead to a greater variety of products and would ensure that if one entity suffered a setback like a crop failure, only one ATC would be affected.

After identifying the region with the greatest need for medical marijuana, the Department chose two applicants for that region first. The Department explained, in its final agency decisions, that it had ordered the regions by greatest supply and demand by considering the

> total population of the region divided by total statewide population . . . and, utilizing the Department's Medical Marijuana Patient Registry, the current medical marijuana patient population in the region divided by total statewide medical marijuana patient population. The two calculations were averaged to determine the demand factor. The Department calculated a medical marijuana supply factor using data extracted from the inventory management systems of the current ATCs. The supply factor was the total current medical marijuana supply of the region in ounces divided by total statewide supply in ounces.

The Department then divided the two factors to determine the ratio of supply to demand for each region, with lower numbers expressing the need for greater supply to meet the care requirements of Program patients. In this way, the

Department ranked the regions according to need in this order: northern, southern, and central.

Once the applications were scored, the Department ascertained the region-by-region top scorers. For the northern region, the Department chose the two highest scoring applicants: NETA NJ, LLC, with 932.1667 points, and GTI New Jersey, LLC, with 927.3333 points.[2] For the southern region, MPX and NETA scored highest, with 958.1667 and 932.1667 points, respectively, but because NETA had already been selected for the northern region, the Department chose MPX and Columbia Care New Jersey, LLC, which came in third with 929 points. In the central region, MPX, NETA, Columbia, and GTI scored highest, but all were bypassed because their applications were top finishers in other regions. As a result, the next two highest-scoring applicants were chosen: Verano, with 920.8883 points, and JG New Jersey, LLC, with 913.3333 points.

The final agency decisions. Accepting those scores without further apparent scrutiny, and without allowing disappointed applicants any means to question or challenge their scores or the scores of those that were approved, the

[2] Appended to this opinion is a list of the top two scorers and others that finished close behind in each region.

Department rendered final agency decisions. In its brief four-page decisions, the Department:

- recounted how the Department called for and received applications;

- described the review committee's formation but in no greater detail than we have explained here;

- stated that it first reviewed applications for completeness;

- identified the top six finishers in each region along with their composite scores;

- explained why it chose the top two finishers in first the northern and then the central and southern regions and provided a brief explanation for why there was an increased demand in that order;

- declared its bottom-line ruling on the application;

- informed applicants of the time within which an appeal could be filed; and

- mentioned that the fees provided by unsuccessful applicants would be returned.

The final agency decisions did not explain whether or to what extent the Department may have reviewed or verified the scores rendered by the review committee.

The filing of appeals and attempts to expand the record. Following the final agency decisions, several unsuccessful applicants – including some of these appellants – submitted requests to the Department under the Open Public Records Act (OPRA), N.J.S.A. 47:1A-1.1 to -13, for copies of the winning applications, score sheets, and other related documents. The Department responded by creating an online library of materials, including redacted versions of successful applications. None of the appellants challenged the Department's response.

Pangaea, Harvest, Liberty, Bloom, GGB, Altus,[3] and Compassionate Care appeal the Department's final agency decisions. Motions for stays pending appeal were denied at the Department level, as well as in this court and the Supreme Court.

Pangaea, Liberty, and Bloom also unsuccessfully moved in this court for leave to supplement the record with expert reports in the field of statistical

[3] Altus has filed two appeals, separately challenging the unfavorable final agency decisions rendered on its central and southern region applications.

mathematics. The Supreme Court denied Pangaea's motion for leave to appeal the denial of its motion to supplement. In re Application for Med. Marijuana Alt. Treatment Ctr., 240 N.J. 385 (2020).

II

Because appellants' many arguments are either similar or overlap, we heard the appeals together. We now decide these eight appeals by way of this single opinion.

Our response to many of the issues posed by appellants is informed by our view of the legitimate questions posed by appellants as to the scores assigned by the Department. In short, all roads lead to the same point: numerous, indisputable anomalies in the scoring of the appellants' applications prevent us from having sufficient confidence in the process adopted by the Department or its results for the approval of ATCs in this important industry that provides "beneficial use[s] for . . . treating or alleviating the pain or other symptoms associated with" certain medical conditions. N.J.S.A. 24:6I-2(a). It is for this chief reason that we remand to the Department to undertake further steps to ameliorate these concerns.

To explain our disposition of these appeals, we consider and first discuss appellants' arguments about scoring because our view of those issues impacts most of the remaining issues. Accordingly, we analyze in the following order: (a) appellants' arguments about scoring; (b) the standard of appellate review; (c) the sufficiency of the record on appeal; (d) the lack of an intermediate step between the results achieved by the review committee and the issuance of final agency decisions; (e) the sufficiency of the Department's findings; (f) a handful of discrete issues; and (g) the remedy that we believe is necessary to instill public confidence in the Department's procedures and the results it achieved.

A

We first consider appellants' specific arguments about the scoring and their contention that, because the Department tolerated too great a degree of "relative error" in its scoring, its decisions were arbitrary, capricious and unreasonable. This argument, with which we agree, is demonstrated by numerous examples that simply cannot be rationally explained on the record before us.

As mentioned, the review committee consisted of six members who were required to provide a score on a given range – a range that started at zero and finished at various numbers depending on the particular criterion. The scores of each six members were then averaged to produce the applicant's final score on each criterion. The Department argues that by averaging the scores of six diverse members, a fair and reasonable assessment of an applicant's score on each criterion would be obtained. But appellants argue, and we agree, that any averaging only slightly ameliorates anomalies and tends to produce inaccurate scores. They argue that there is such a large degree of "relative error" in some of the criteria that no one – not this court, not the applicants, and not the public – can have confidence in the final results.

In considering this relative-error concept, we emphasize that we are not suggesting that either the Administrative Procedure Act or the legislation in question somehow incorporates the world of statistics, cf. Lochner v. New York, 198 U.S. 45, 75 (1905) (Holmes, J., dissenting and observing that "[t]he Fourteenth Amendment does not enact Mr. Herbert Spencer's Social Statics"), but we do suggest they require the application of common sense and strive to suggest a more accurate process than that which seems to have been adopted here.

Moreover, in expressing concern for the relative error of some of the examples provided by appellants, we do not mean to suggest that an agency engaging in a similar process may not tolerate an occasional error or mistake without running the risk of being labelled arbitrary or capricious. To the contrary, we expect that an administrative process may lead to imperfect conclusions because the participants and the public expect speed and efficiency at that level. <u>See, e.g.</u>, <u>Texter v. Dep't of Hum. Servs.</u>, 88 N.J. 376, 385 (1982) (recognizing that administrative agencies necessarily "possess the ability to be flexible and responsive to changing conditions"). Nevertheless, the concept of relative error – in the face of the Department's failure to offer appellants a platform for arguing that the review committee made mistakes that ought to be examined and corrected – is an appropriate means for examining why, if left unexamined, uncorrected, or unexplained, the results of the Department's process must be viewed as arbitrary, capricious, and unreasonable.

Relative error is a concept that simply measures the extent to which a computation may be mistaken. It can range from a relative error of zero percent (everyone agrees) to 100% (one judge gives the lowest possible score and another gives the highest possible score). The higher the relative error, the greater the doubt about the accuracy of the score derived from averaging the scores. Stated another way, when six individuals consider the same criterion – assuming the examiners use the same observational tools and share the same understanding about how to score what they see – one would expect that these individuals would produce the same or quite similar scores, meaning the relative error would be close to zero. So, any system that produces an extensive variety of scores calls into question the accuracy or legitimacy of its results. For example, if four baseball umpires watch the same play – a fly out to centerfield – anarchy would soon follow if only one umpire said he saw a fly out to centerfield, while the other three claimed to have seen: the batter swing and miss; a groundout to shortstop; and a pop-out to the catcher. The two competing teams – and spectators that tuned in to watch – would rightfully find the judging system deeply flawed even if the "average" of those four calls amounted to an out. That approach would soon lead to chaos and cast grave doubt on the accuracy of the game's final score. The many scoring examples provided by appellants similarly lead us to question whether the Department has enacted a system that's producing non-arbitrary results that the Legislature intended in its enactment of the Compassionate Use Act and that the participants and the public have a right to expect.

Pangaea asserts that in eight of the sixty Part B scoring categories – thirteen percent of the overall test – it received in the same category perfect scores as well as zeroes. That is, in thirteen percent of the overall test, the review committee's assessment was based on a 100% relative error factor; with the committee giving scores that consisted of an average of both perfect scores and perfectly bad scores.

Three categories sought the applicant's floor plans or interior renderings for the proposed ATC's cultivation, manufacturing, and dispensary sites, and noted that "[n]o explanation is necessary"; these categories were scored on a range of zero to fifteen, with zero being assessed only as to applicants who had failed to provide the requested plan or rendering. Pangaea provided floor plans, yet one reviewer gave scores of zero, five, and zero on these three categories. Because Pangaea provided plans, one might expect perfect scores across the board, but with the unexplained low scores, and their inclusion in the calculus that produced the average for each of these categories, Pangaea's score was brought down considerably from what one would expect in light of the fact that the remainder of the group viewed Pangaea's response as near perfect.[4] Even if the Department's response was correct that Pangaea's floor plans were provided elsewhere in its application, and thus it was reasonable for a low score to be assigned, one can only wonder about the reasonableness of the other perfect scores.

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[4] Pangaea makes the further point that these scores are all the more surprising because some applicants – who secured higher scores – did not actually have a site for these facilities, but merely promised a particular type of facility in a specific location. Pangaea had actually leased property in Ewing and provided 108 pages of architectural and engineering site plans in its application.

Other Pangaea scores revealed similar anomalies. Noteworthy is the proliferation of zeroes despite instructions given by the Department to the review committee that a zero should only be assigned when the applicant's answer was non-responsive.[5] Additional inconsistency can be found in a snapshot of some of the other numbers on Pangaea's scorecard:

- 10 25 16 23 0 25
- 15 15 15 15 0 15
- 20 0 23 25 18 25
- 20 25 20 25 0 25
- 15 0 15 15 0 0

The zeroes are disconcerting, particularly when other review committee members awarded high or perfect scores when considering the same information on the same criterion. On this record, one can only wonder what it was that the review committee members on either side of this spectrum were or weren't seeing or considering when assessing Pangaea's application.[6]

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[5] The review committee members were instructed that "[a] score of 0 should only be used when [the applicant's answer was] non-responsive to the measure or criterion, unless otherwise indicated."

[6] Some of the appellants argue this may not all be the fault of the review committee members, suggesting they were simply asked to do far too much in

Liberty Plant raises similar questions about its scores. On one category – knowledge of botany, horticulture, and phytochemistry and the application of those sciences to the cultivation of medical marijuana – Liberty Plant observes that it received two perfect scores of thirty, a near perfect twenty-nine, a very high twenty-five, but then two scores of fifteen. The relative error of the scoring here was fifty percent. On another category – inventory management – the relative error was seventy percent, with review committee members giving a perfect twenty, a near-perfect nineteen, three above-average scores (a sixteen and two fifteens), and a sub-par six.

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too short a period of time. To illustrate this claim of "reviewer fatigue," GGB asserts that each review committee member was charged with reviewing more than 100 applications consisting of more than 53,000 pages in a span of eleven weeks or, stated another way, each member was required to evaluate more than 4800 pages per week (975 pages per day, excluding weekends and holidays). GGB argues that each reviewer was essentially "tasked with reading [the 1225-page novel, <u>War and Peace</u>] <u>nearly four times in a single week</u>." In response, it has been argued that this allegation of "reviewer fatigue," even if true, does not necessarily mean that the review committee ended up scoring appellants too low; it is just as likely that it could have led to scoring them too high. But that only supports another argument that we will later discuss: that without an explanation for the inconsistent scores, no one can know for sure whether they were produced by "reviewer fatigue," a misunderstanding of the criteria, or the worth of the applicant's responses. Without an explanation from the Department, one can only speculate why inconsistent scores were so frequently rendered.

Consideration of the applicant's past history of paying business taxes was judged on a scale of zero to twenty-five. The scores received by Liberty Plant had a relative error of ninety-six percent because it was awarded: twenty-four, twenty, three fifteens, and a zero. Altus received similar discrepant scores: twenty-four, twenty-three, fifteen, five, and two zeroes. Bloom's experience was not much different, receiving: two twenty-fives, a twenty-four, a fifteen, and two zeroes. Harvest received three twenty-fives, a twenty, an eighteen, and a zero.

In five categories, the scoring for Liberty Plant revealed a relative error of 100% despite the production of considerable information responsive to the question. In one of these categories – calling for certified financial statements, including a balance sheet, income statement, and a statement of cash flow – Liberty Plant received two perfect twenty-fives, a twenty, a ten, and two zeroes. Harvest received two twenty-fives, two twenties, an eighteen, and a zero. Altus received a wide array of scores: twenty-five, twenty-three, fifteen, ten, five, and zero. Not one of the six review committee members had the same view of Altus's response as any other member.

Liberty Plant's response to a category about collective bargaining agreements was awarded two perfect tens, two eights, and two zeroes. On this category, Harvest received two tens, a nine, a seven, and two zeroes. Similarly disturbing in its variety of scores from perfect to non-responsive, was the confusion about a category that sought information about whether the applicant was women-owned, minority-owned, or veteran-owned. Altus received: twenty-three, twenty, ten, and three zeroes. Bloom received two perfect twenty-fives, an eighteen, two fifteens, and a zero. And Harvest, which asserted that its majority owner is an African-American woman, inexplicably received only one twenty-five, as well as a fifteen, a ten, and three zeroes.[7]

Another criterion that provide inconsistent scores was one that sought the applicant's plans to dedicate funding or other resources for research. Liberty Plant received four perfect tens and two zeroes.[8]

GGB had a similar experience but describes it in different terms that similarly persuade us there's simply something wrong with the scoring:

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[7] The confusion may arise – but ought to have been explained in the final agency decisions – from the fact that some applicants had applied for but had not by that time received certifications about minority ownership.

[8] To add to the scoring anomalies on this category, Liberty Plant refers us to the fact that in its identical submission in another geographic region, it received five perfect tens and one eight. This means that the two reviewers who assigned the same answer a zero in one region gave Liberty Plant a ten or eight when judging the same response for purposes of another region; put in statistical terms the same reviewers on the same applicant's identical answer had relative error of either 80 or 100%.

> [O]ne reviewer awarded GGB a total of 625 points whereas two other reviewers awarded it in excess of 900 points, a difference of more than 300 points. In other words, if these individual scores were placed on a traditional secondary school grading scale (0-100) by dividing the individual scores by 10, GGB received the equivalent of an "F" from one reviewer and an "A" from two others. More astonishingly, the delta between the lowest individual score (625) and the second-lowest individual score (782) is 157 points whereas the delta between the second-lowest individual score and the highest individual score (938) is slightly lower at 156 points.

GGB does not limit its concerns to its own situation but points out that almost half of the 146 applicants had composite average scores that varied by more than 300 points between the highest and the lowest and, for a handful of applicants, the composite average score varied by more than 600 points, an extraordinary discrepancy when considering that the total amount of points available on an application was 1000.[9]

Bloom's approach is similar. Bloom argues that one reviewer consistently gave it much lower scores on all categories than the other reviewers, noting that, collectively, five reviewers gave it scores of 912, 920, 942, 981, and 989, while

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[9] GGB also provided detail about the discrepancies between reviewers on various categories like those that we already discussed with regard to Pangaea and Liberty Plant. For brevity's sake we do not specifically mention those categories in which, like other appellants, GGB received both perfect scores and zeroes.

the sixth gave it only a 625, and that when this anomaly is averaged with the other consistent scores, its average was pulled down and its final score finished out of the money.

The Department has done little to justify these anomalies or explain why they should be disregarded. We would characterize the Department's contentions as falling into two general assertions: (1) the divergent scores in some instances are the product of "each member appl[ying] his or her unique expertise to the scoring process," and (2) all applicants were subject to the same process and, therefore, all buoyed or dragged down by the varying scores. The former is unconvincing because it runs counter to the fact that the Department provided each review committee member the same set of instructions that it presumably sought to have applied in the same way, as well as the rather obvious likelihood that the Department did not intend – nor should it have intended – to allow reviewers' personal views to enter into the calculus. We are also unpersuaded by the Department's false-equivalency argument. It is certainly true that the winning and losing applicants were subjected to the same review committee, and there may be evidence of similar inconsistent scoring of the winning applications,[10] but that doesn't mean that they were entirely treated the same way.

The Department also asserts that it ameliorated the consequences of an occasional outlying score by taking the average of all the scores of the six review committee members. To be sure, averaging will naturally reduce the impact of an outlier on the overall scores, but not so much when there are multiple outlying scores. Take, for example, one set of marks received by Pangaea that included three perfect fifteens and three zeroes. After the committee averaged those numbers, Pangaea received an average score of seven-and-one-half, a score that has no kinship with a single vote that Pangaea received.[11]

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[10] For example, of the scores of all successful applicants on the women-, minority-, or veteran-owned business criterion, some were relatively consistent but others weren't:

Columbia Care	2	0	0	22	0	25
GTI	15	20	15	24	0	0
JG	10	0	0	23	0	0
MPX	25	25	25	23	25	25
NETA	20	25	15	23	25	25
Verano	25	25	25	24	25	25

[11] GGB and Bloom both argue that the Department could have avoided these types of anomalies – or at least reduced their detrimental impact on the accuracy of the review committee's work – by "censoring"; that is, by removing some of the data to produce a more reasoned result. Bloom suggests the Department should have eliminated the scores of one review committee member who

There is no escaping the fact that some of these scores simply "don't compute" and that, no matter how the Department and the other respondents may attempt to slice it, the results are still unsettling.[12]

B

Having expressed our views about scoring, we turn to the parties' arguments about the standard of appellate review. As observed earlier, this is one of those issues influenced by our view of the scoring.

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repeatedly gave Bloom lower scores than the other members. GGB appears to suggest removing particular outlying scores. Due to many factors, including bias, the scoring method in some sporting events – particularly during the Cold War – called for the removal of the highest and lowest scores and averaging the rest, thereby reducing the degree of relative error and rendering the score more accurate. The simplicity of that approach is appealing but it won't result in sufficient adjustments with some scores, such as where Pangaea received three perfect fifteens and three zeroes; the average remains the same even if one high and one low score are eliminated. In any event, if such adjustments are to be made, it is for the Department to make them. Our role extends to determining whether the Department's processes are or are not arbitrary, capricious, or unreasonable; we will not intervene to the point of imposing a better system or determining what a better system would be.

[12] The Department and other respondents argue that we have already given approval of a similar selection method when reviewing final agency decisions rendered in 2011. See In re Inst. for Health Rsch., No. A-0069-11 (App. Div. Aug. 22, 2013). We need not recount the differences between the arguments posed in that case and those presented here. It suffices to observe that our decision in that case was not published and has no precedential impact or interest. R. 1:36-3. We have referred to this unpublished opinion elsewhere in this opinion only for historical-background purposes.

Bloom, GGB, Liberty, and Pangaea argue that we need not afford any deference to the Department's evaluation process, the scores, or the ultimate selection of winning applicants. They claim the Department lacks specialized knowledge in the area of medical marijuana, lacks expertise because it has conducted only one prior request-for-application process related to ATC permits, and because, as Bloom puts it, the review committee members were "representative[s] of different State agencies and largely evaluated matters outside the scope of their individual skills and expertise." Because our view of the scoring issues requires a remand even if we were to apply the most deferential standard of review, we find it necessary to add only a few comments on this issue.

As a general matter, the judicial capacity to review agency actions is "limited." Pub. Serv. Elec. and Gas Co. v. N.J. Dep't of Env't Prot., 101 N.J. 95, 103 (1985). An agency's "final quasi-judicial decision" should be affirmed unless there is a "clear showing" that it is "arbitrary, capricious, or unreasonable, or that it lacks fair support in the record." In re Herrmann, 192 N.J. 19, 27-28 (2007). In examining a challenge to a final agency decision, we are generally limited to determining whether the agency action violates "express or implied legislative policies," whether the decision is supported by "substantial evidence in the record," and whether, "in applying the legislative policies to the facts, the agency clearly erred by reaching a conclusion that could not reasonably have been made upon a showing of the relevant factors." Pub. Serv. Elec. and Gas, 101 N.J. at 103. An appellate court's "strong inclination" must be to "defer to agency action that is consistent with the legislative grant of power." Lower Main St. Assocs. v. N.J. Hous. and Mortg. Fin. Agency, 114 N.J. 226, 236 (1989). This inclination is strong "when the agency has delegated discretion to determine the technical and special procedures to accomplish its task," In re Application of Holy Name Hosp. for a Certificate of Need, 301 N.J. Super. 282, 295 (App. Div. 1997) – as the Department claims here – and should be "construed liberally when the agency is concerned with the protection of the health and welfare of the public," Barone v. Dep't of Hum. Servs., 210 N.J. Super. 276, 285 (App. Div. 1986). But, "[t]he interest of justice" is always a valid invitation for intervention, and a reviewing court is free "to abandon its traditional deference . . . when an agency's decision is manifestly mistaken." Outland v. Bd. of Trs. of the Teachers' Pension and Annuity Fund, 326 N.J. Super. 395, 400 (App. Div. 1999).

In short, when we defer, we defer because of an agency's "technical expertise, its superior knowledge of its subject matter area, and its fact-finding role." Messick v. Bd. of Review, 420 N.J. Super 321, 325 (App. Div. 2011). This rationale, however, "is only as compelling as is the expertise of the agency, and this generally only in technical matters which lie within its special competence." In re Boardwalk Regency Corp., 180 N.J. Super. 324, 333 (App. Div. 1981). See, e.g., Clowes v. Terminix Int'l, Inc., 109 N.J. 575, 588 (1988) (deferring to Division on Civil Rights' expertise in recognizing acts of discrimination, but not to its findings on an employee's diagnosis of alcoholism, which it was "no better able to evaluate . . . than is a reviewing court"); Cooley's Anemia & Blood Rsch. Found. for Child., Inc. v. Legalized Games of Chance Control Comm'n, 78 N.J. Super. 128, 140 (App. Div. 1963) (recognizing that courts "generally defer to the special expertness and broad experience of an administrative agency in its general field, but not in the same degree in all cases[;] [i]t depends upon the issues . . .").

As we have already observed, the Department established a review committee consisting of members purportedly possessing the Department's own expertise, as well as members of other disciplines, since it included a member from the Department of Agriculture and one from the Department of Treasury.[13]

[13] We see no reason to question this approach. The Legislature charged the Department with the task of ascertaining the best applicants, and we find nothing

Yet, each member was required to vote on all criteria, meaning that the Agriculture member was called upon to assess applicants' financial capacities, while the Treasury member was required to appraise applicants' horticultural capabilities. Despite this cross-over into areas not likely within a member's bailiwick,[14] each member's vote was equally weighed; in other words, the Agriculture member's vote on financial matters possessed the same value as the Treasury member's vote on that same subject.

We do not know who the review committee members were, nor do we even know what their backgrounds might have suggested about the caliber of their opinions concerning matters beyond what their Department affiliation might suggest. Accordingly, it is unclear on this record the extent to which we should defer to the scores rendered by the review committee and adopted by the Department.

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arbitrary, capricious, or unreasonable in the Department's fulfillment of that obligation in creating a multi-member review committee by enlisting representatives from other departments, including the Departments of Agriculture and Treasury. We are satisfied that the Department acted in accordance with the legislative mandate in taking this approach. We question – but do not now decide in light of the remand we mandate today – whether the votes should have been weighted whenever a member voted on a matter outside the member's expertise or, if the Department chooses not to weight such votes, whether a score left un-skewed is entitled to deference.

[14] The record contains nothing about the alleged expertise or background of any member because the Department has kept their identities confidential.

The Department must address the numerous questions posed about its scoring procedures and explain the basis for its resolution of the remand proceedings before we can ever adequately review whatever final agency decisions come from those proceedings. So, we need not reach any definitive conclusion about the standard of appellate review applicable here. We would urge the Department, however, to make findings that take into consideration our concerns.

We commend to the Department the standard expressed by our Supreme Court sixty years ago. Even then, the Court recognized that this standard was nothing new; instead, the Court stated that it was already then "axiomatic in this State" that

> an administrative agency acting quasi-judicially must set forth basic findings of fact, supported by the evidence and supporting the ultimate conclusions and final determination, for the salutary purpose of informing the interested parties and any reviewing tribunal of the basis on which the final decision was reached so that it may be readily determined whether the result is sufficiently and soundly grounded or derives from arbitrary, capricious or extra-legal considerations.
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> [Application of Howard Sav. Inst. of Newark, 32 N.J. 29, 52 (1960); see also In re Issuance of Permit by Dep't of Env't Prot., 120 N.J. 164, 172 (1990).]

Whether the Department's process may be labelled quasi-judicial is beside the point. The Department clearly relied in its final agency decisions on the values assigned by its review committee and the mathematical results that those values yielded; it claims those are its findings. In justifying the reasonableness of its determinations, the Department refers to its processes but without explaining away the questions patently arising from them. The Department's final agency decisions provide only a net opinion by giving us nothing more than the computations made from the raw data lacking the "why and wherefore" of the decisions rendered. Cf. Davis v. Brickman Landscaping, Ltd., 219 N.J. 395, 410 (2014) (recognizing that an expert renders an inadmissible net opinion when failing to provide "the why and wherefore" that supports the opinion). Instead, the Department – by issuing final agency decisions without first allowing disappointed applicants an opportunity to challenge the findings at the agency level – has left it to us to hear those arguments for the first time while simultaneously arguing that we must defer to its findings and conclusions on issues it has not yet had the opportunity to hear. To ensure the production of a final agency decision worthy of deference, the Department must find a way to listen to and resolve questions from the disappointed applicants, and then explain its resolution of those complaints before expecting our endorsement of the results.

C

Compassionate Care argues that the record on appeal is insufficient to provide a basis for review because the Department did not release the applications of the selected applicants without "heavy" redactions. GGB makes the same argument, and further complains that the Department redacted the names of the six review committee members, making it "impossible" for applicants to "ascertain whether any of the reviewers held [any] bias[es]." Liberty Plant makes similar arguments.

By way of background on this point, we initially observe that the request for applications advised that applications would be "generally subject to public release pursuant to [OPRA] and/or [sic] the common law," but that "proprietary and other types of information contained in the applications may be exempt from public disclosure," and an applicant could designate "specific information" that it felt should be exempt from disclosure. The request for applications explained that if the Department withheld a designated part of an application when responding to an OPRA request, and the requester posed a challenge, the applicant might be required to intervene and defend its assertion that the information was exempt from disclosure.

The Department also informed prospective applicants at the mandatory pre-application conference of their ability to designate portions of their submissions as "confidential, trade secrets, proprietary, commercial or financial information, or information which, if disclosed, would give a competitive advantage or disadvantage." The Q&A document stated that any disclosure of information by the Department would be "consistent with [OPRA's] requirements" and that applicants would need to submit a memo delineating those portions of their applications they felt were confidential, proprietary, or otherwise exempt from disclosure if they wanted such portions redacted in responses to OPRA requests. The names of the review committee members were also redacted in the Department's response to OPRA requests.

In their submissions to this court, appellants have not provided full versions of every successful application, even with redactions. GGB and Liberty Plant, the appellants who have asserted that the Department should have released the winners' materials without redactions, included only portions of their own applications in their appendices: GGB submitted its entire application but with very significant redactions and many blacked out passages; Liberty Plant submitted just four pages of its application.

In considering these arguments about the sufficiency of the record on appeal, we first recognize that appellants were given notice of the possibility that if they filed an OPRA request asking for any other entities' applications, they might receive redacted versions. The request for applications afforded every applicant the opportunity to ask the Department to withhold specific portions of its application. Some applicants, including those chosen to proceed with the permitting process, apparently requested significant redactions of their submissions. The Department honored the terms of its request for applications and should not now be put in the position of dishonoring that understanding because of the happenstance of these appeals. In fact, N.J.A.C. 8:64-6.4 states that the record in an appeal from a final agency decision in this context "shall be" the applications at issue with attached supporting documents "excluding information deemed exempt pursuant to [OPRA]."

Second, N.J.S.A. 47:1A-6 provides that a person who is denied access to a record by its custodian may "institute a proceeding to challenge the custodian's decision by filing an action in Superior Court . . . ; or . . . file a complaint with the General Records Council established pursuant to [N.J.S.A. 47:1A-7]."

Appellants did not avail themselves of either of these avenues to address their dissatisfaction with the redactions in the documents they received in response to their OPRA requests. Had they done so, the chosen tribunal could have decided whether the winning applications or the names of the review committee members were exempt from disclosure under OPRA.

Third, even if the current appeals were an appropriate forum to address appellants' arguments, OPRA permitted the Department to withhold the information it had redacted. N.J.S.A. 47:1A-1.1 states that the definition of "government record" does not include: "trade secrets and proprietary commercial or financial information obtained from any source"; "emergency or security information or procedures for any buildings or facility which, if disclosed, would jeopardize security of the building or facility or persons therein"; "security measures and surveillance techniques which, if disclosed, would create a risk to the safety of persons, property, electronic data or software"; or "information which, if disclosed, would give an advantage to competitors or bidders."

The request for applications required applicants to submit several types of highly technical and scientific information about their marijuana strains, growing methods, pest-control methods, manufacturing procedures, and available products. It also sought information about applicants' proposed site layouts, security measures, and financial information. While we can only hypothesize about the likely outcome, it seems reasonable to assume that any redacted portions contained information exempt from disclosure under OPRA. That GGB and Liberty Plant submitted heavily redacted or reduced versions of their own bids into the record on appeal suggests they view this information as proprietary and are unwilling to reveal to their competitors or the public the technical details of their operations. For the same reason, the argument that such information from others should have been included in the record on appeal is without merit.

In short, we must recognize that we are hampered by the record's limitations in our ability to assess whether the final agency decisions were arbitrary, capricious, reasonable, or unsupported by the record. Had – among other possible approaches – the Department conducted a brief internal review process after inviting those disappointed by the results to express their objections or questions and after allowing respondents an opportunity to respond to those exceptions – the Department could have pinpointed the areas of controversy and explained for us its view of the exceptions filed. That way, once an appeal was filed, we could have better appreciated the need for a record containing those materials – whether still redacted or submitted confidentially – that would assist our determination of whether the final agency decisions were arbitrary, capricious, unreasonable, or unsupported by the record.

So, while we draw no specific conclusion about appellants' arguments on this point, in remanding we leave the matter for the Department's further consideration with the hope that it will appreciate the difficulties we face in reviewing a final agency decision absent a full and understandable record.

We would add, however, that we see no merit in the argument that the Department was obligated to reveal the identities of the review committee members. N.J.S.A. 47:1A-1.1 exempts "inter-agency or intra-agency advisory, consultative, or deliberative material" from disclosure under OPRA. This deliberative process privilege "permits the government to withhold documents that reflect advisory opinions, recommendations, and deliberations comprising part of a process by which governmental decisions and policies are formulated." In re Liquidation of Integrity Ins. Co., 165 N.J. 75, 83 (2000). Upholding this privilege is "necessary to ensure free and uninhibited communication within governmental agencies so that the best possible decisions can be reached." Educ. Law Ctr. v. N.J. Dep't of Educ., 198 N.J. 274, 286 (2009). In this regard, the Supreme Court observed that

> [f]ree and open comments on the advantages and disadvantages of a proposed course of governmental management would be adversely affected if the civil servant or executive assistant were compelled by publicity to bear the blame for errors or bad judgment properly chargeable to the responsible individual with power to decide and act.
>
> [Id. at 286 (quoting Kaiser Aluminum & Chem. Corp. v. United States, 157 F. Supp. 939, 945-46 (Ct. Cl. 1958)).]

Knowing that their identities could ultimately be revealed could have an impact on review committee members. Moreover, advance revelation of their identities could lead to mischief; applicants could use that knowledge to attempt to lobby or influence members. And even if we assume that these public officials would be beyond such influence, the mere potential of such lobbying could have the effect of diminishing public confidence in the committee's performance.

We, thus, respond to the arguments about the content of the record by referring them to the Department for further consideration in light of what we have said. But we do reject on its merits the argument that the Department was required to divulge the identities of the review committee members.

D

Bloom argues that the Department improperly failed to provide any agency-level procedure for unsuccessful applicants to protest the Department's rejection of their applications and selection of the six winners. GGB, Liberty Plant, and Pangaea make the same argument. Harvest similarly argues that the absence of an agency hearing "violat[ed] longstanding tenets of New Jersey administrative law" and deprived disappointed applicants of a chance to "address errors or otherwise present law and facts challenging [the Department's] decisions."

We agree that the Department was required to do more than compile and tabulate the votes and declare winners based on that raw computation. As appellants have demonstrated, and as we discussed earlier, there are many scores that are patently discordant. Capable review committee members, armed with the same instructions, should not produce such inconsistent results. Red flags should have gone up in instances where, for example, two reviewers gave perfect scores, two reviewers gave middling scores, and two reviewers gave zeroes or, for that matter, anytime that a zero was scored on a criterion on which other reviewers gave high scores. N.J.S.A. 24:6I-7(e) imposed on the Department to "verify" its results, and we believe that charge required more than just checking its arithmetic. The very nature of the undertaking required not just accurate computations but a search for odd or outlying scores that could unfairly skew the results. We have already demonstrated how in many instances the "relative error" in judging a criterion was too high to be acceptable, whatever the undertaking. And, beyond the Department's bald assertion that it engaged in quality control,[15] there is no evidence of that in the record on appeal. We believe that the statutory obligation that the Department "verify" its results obligated the Department to invoke procedures that would allow parties to question their scores and obtain an explanation before the rendering of final agency decisions.

Some appellants have argued they were entitled to a full-blown hearing that would require the calling of witnesses and cross-examination. We're not so sure. It may be enough that the Department allow a brief period of time for disappointed applicants to assert what they believe are problems with the scores they and others received, allow for responses from successful applicants, and then engage in both an examination of those complaints and an explanation of

[15] In the review committee's recommendation report to the Department, it is asserted – without further explanation – that scoring was completed on December 10, 2018, and that the scoring "was subjected to a quality control review, which was completed on Wednesday, December 12, 2018." Absent is any evidence that the review committee or the Department attempted to harmonize the scoring discrepancies or to explain why those scores are not inconsistent or questionable.

how those complaints were resolved or rejected. A further analysis and verification of the winning applicants may not require an evidentiary hearing, but we leave to the Department in the first instance to determine the best way of going about its statutory obligation to verify its results.

In the final analysis, we conclude that by failing to engage in such an additional process, the Department has essentially left it for us to field – in the first instance – appellants' objections to the scoring and to determine whether there is something wrong with the results without receiving from the Department an adequate explanation for why the scores aren't wrong or – in legal terms – aren't arbitrary, capricious or unreasonable. We do not think the Legislature intended for this court to be the clearing house for any problems in the process, or to determine the mathematical reasonableness of the results obtained through the process devised by the Department. In deferring to the idea that it is the Department that should decide who are the winners and losers, we decline the invitation to be the Department's quality-control committee.

In fact, in deferring to the idea that it is the executive branch, not the judicial branch, that must make the ultimate decision as to who should move on in the permitting stage, we will not dictate to the Department what it is that it should do following today's remand, other than to hold that it must engage in some sort of additional process for receiving and considering the appellants' contentions and must explain its determinations on those contentions. We will not decide or impose on the Department whether it should conduct a plenary hearing, whether it should create a quality control committee to hear, consider, and make recommendations about appellants' concerns, or whether it should devise some other system for resolving appellants' complaints. We hold only that in the absence of some procedure for ensuring and verifying the reviewing committee's conclusions, the results previously produced and adopted in the final agency decisions must be deemed arbitrary, capricious, unreasonable, and untethered to the record, and cannot, therefore, be sustained at this time.

So, in this spirit, we conclude that appellants are correct that they were not afforded the process due under the applicable legislation and the Administrative Procedure Act, and we remand so the Department may provide that process. We intervene in the administrative proceedings that have taken place so far to ensure the public's confidence in both the results achieved at the agency level so far and to ensure that future similar proceedings will be likewise subjected to a measure of scrutiny at the agency level that will guarantee the process does not produce determinations that are arbitrary, capricious or unreasonable. We so hold not because it betters our ability to review the agency decisions but because of the overriding public interest. As we have said before in bidding matters,[16] "[b]oth the public interest and the public's perception" that the process is "fair, competitive and trustworthy are critical components and objectives." Muirfield Constr. Co. v. Essex Cty. Improvement Auth., 336 N.J. Super. 126, 137-38 (App. Div. 2000).

E

For the same reasons, it follows that the final agency decisions do not contain the type of findings sufficient to command appellate deference. As noted earlier, the final agency decisions in question outline the manner in which the Department went about its task and then set forth the raw scores that culminated in a rejection of appellants' applications. Those decisions present little more than sets of numbers that declare the appellants placed out of the money. Appellants argue that those sets of numbers inadequately express the decisions rendered. We agree.

As is well-established, if an administrative agency's findings are "supported by substantial credible evidence in the record as a whole," a

[16] There are many similarities in the Department's manner of finding worthy entities to move on in the permitting stage to the way in which public bidding is conducted. We do not, however, need now to decide whether our approach in reviewing bidding matters is applicable in all respects here.

reviewing court "must accept them." Outland, 326 N.J. Super. at 400. But, an agency's discretion "must be exercised in a manner that will facilitate judicial review." R & R Mktg., LLC v. Brown-Forman Corp., 158 N.J. 170, 178 (1999). As a result, when "acting quasi-judicially," the agency "must set forth basic findings of fact, supported by the evidence and supporting the ultimate conclusions and final determination." Howard Sav. Inst. of Newark, 32 N.J. at 52. This practice allows a reviewing court to "readily determine[]" whether the agency's decision is "sufficiently and soundly grounded or derives from arbitrary, capricious or extralegal considerations." Ibid.

In short, administrative agencies must "articulate the standards and principles that govern their discretionary decisions in as much detail as possible." Van Holten Grp. v. Elizabethtown Water Co., 121 N.J. 48, 67 (1990) (quoting Crema v. Dep't of Env't Prot., 94 N.J. 286, 301 (1983)). And they must make findings "to the extent required by statute or regulation, and provide notice of those [findings] to all interested parties." In re Issuance of a Permit, 120 N.J. at 173. If "the absence of particular findings hinders or detracts from effective appellate review," a matter may be remanded to an administrative agency "for a clearer statement of findings and later reconsideration." In re Vey, 124 N.J. 534, 544 (1991). See, e.g., Green v. State Health Benefits Comm'n, 373 N.J. Super

408, 416 (App. Div. 2004) (reversing and remanding where agency decision contained only "bald assertion" that certain care was not covered under insurance plan); Lambertville Water Co. v. N.J. Bd. of Pub. Util. Comm'rs, 153 N.J. Super. 24, 29 (App. Div. 1977) (remanding where agency decision was "devoid of any analysis" explaining choice and use of formula for calculations). A court may also remand a matter "[w]here the agency record is insufficient," so that it may be "fully develop[ed]." ACLU of N.J. v. Hendricks, 233 N.J. 181, 201 (2018).

In expressing our agreement with those appellants that have argued the final agency decisions do not contain sufficient findings or the expression of an adequate rationale for the conclusions reached, we again observe that the absence of any explanation for those scores that seem – on the present record – at least in part inexplicable demands that we remand for further proceedings. To be sure, "[a]ll of the evidential data" before an agency "need not be repeated or even summarized, nor need every contention be exhaustively treated." Howard Sav. Inst. of Newark, 32 N.J. at 53. But an agency decision must reveal enough of the agency's thought process so that a reviewing court may determine "without question or doubt what facts and factors led to the ultimate conclusions reached." Ibid. We have traditionally striven to accept an agency's findings even when they "are not nearly so clear, full and well organized" as they could be, but, in the final analysis, we must be able to "understand fully the meaning of the decision and the reasons for it." Ibid.

We have been given numerous reasons to doubt the sufficiency of the final scores that led to the decisions under review. As noted, these final agency decisions were the product of the scoring instructions given to the review committee members. They were directed to "[e]valuate each application and assign a score up to the maximum point value for each measure," then "tally [those] scores on the paper copy" of the application. The instructions then directed the members to "provide a short[,] written description to justify the assigned score." The review committee's recommendation report did not include any descriptions of individual reviewers' scores, the final agency decisions distributed to applicants did not refer to any, and the Department's OPRA response did not include any documents like those described in the instructions.

The final agency decisions provide only the scores resulting from the work of the review committee. We do not have any evidence that the Department ensured that the members understood or followed instructions, and there is no evidence that the scores were either verified in some manner or whether anomalies, which are revealed even in the limited record before us, have been harmonized in some reasonable, non-arbitrary way.

F

Appellants have raised some discrete issues that should not go unmentioned but, because we remand, will for the most part be left to the Department to consider further and provide an explanation for its disposition of these arguments:

> (1) mainly Bloom, but others as well, argue some of the criterion are "vague and subjective" and confused applicants about what was being sought;
>
> (2) Bloom, GGB, Liberty Plant, and Pangaea argue in various ways that some of the Department's criteria were based on regulations that had been proposed but not adopted by the time the request for applications was issued;
>
> (3) Harvest argues that the Department acted improperly by deciding – after applications were submitted – to limit applicants for approval to one ATC permit;
>
> (4) Compassionate Care argues that the Department's selection of MPX to proceed with the permitting process for an ATC in Atlantic City should be overturned because the Department did not take into consideration Compassionate Care's intention to open a satellite location in the same city;
>
> (5) GGB argues that Verano engaged in misconduct that should have precluded its selection; and

(6) Bloom's contention that the approval of NETA's application improperly authorized its operation of "a facility within 1,000 feet of a school zone."

As for those contentions we leave undecided here, we will endeavor to be brief because the Department should consider them during the remand proceedings.

First, we agree with appellants about the importance of a "common standard of competition," Twp. of Hillside v. Sternin, 25 N.J. 317, 323 (1957), and, for that reason, the request for applications should be "as definite, precise and full as practicable in view of the character" of the undertaking, James Petrozello Co. v. Twp. of Chatham, 75 N.J. Super. 173, 178 (App. Div. 1962) (quoting Waszen v. Atlantic City, 137 N.J.L. 535, 537 (Sup. Ct. 1948)). We don't agree that the inclusion of subjective criterion necessarily runs counter to that goal. In revisiting these applications and appellants' arguments about the process, the Department should entertain appellants' arguments and provide an explanation for any criterion so criticized in the remand proceedings to follow.

Second, some appellants argue that this court should intervene because the Department used criteria that were either unadopted by regulation or inconsistent with existing regulations. Bloom argues that the Department improperly waived the requirement in N.J.A.C. 8:64-6.2(a)(2) that ATC operators be involved with an acute care hospital without engaging in formal rulemaking, particularly when considering that the Department informed applicants that its evaluation of applications would be based on its then-current 2011 regulations. Despite those representations, the Department – according to Bloom – improperly based several other criteria on new regulations proposed in 2018 that had not been adopted by that time in accordance with the Administrative Procedures Act. For example, Bloom asserts that criteria seeking financial information from applicants "had no basis" in the 2011 regulations and that the injection of criteria discussed in as-yet-unadopted regulations deprived applicants of "notice of the standard to which they were to be held." GGB and Liberty Plant make the same arguments. Pangaea makes the same arguments as well, while adding an argument that "[t]he development of a scoring system may itself be considered a rule-making."

The Department informed prospective applicants at its pre-submission conference that it had proposed changes to the medicinal marijuana regulations in 2018 but that the public comment period was not over and the changes had not been officially adopted. As a result, the Department declared that "applicants [were] subject to the regulations currently in effect" at the time of submission, meaning the 2011 regulations; this was reiterated in the Q&A document. The Department also stated during the conference that it was waiving the requirement in N.J.A.C. 8:64-6.2 that a permit holder have "documented involvement [with] an acute care hospital," explaining that the Department had found this to be "somewhat impracticable" and advising that the formal repeal of this requirement had been proposed in the new regulations. At the pre-scoring meeting, the review committee was also told to evaluate applications in accordance with the original 2011 regulations.

N.J.S.A. 52:14B-4 mandates that prior to the adoption of a regulation, an agency must give at least thirty days' notice of its intended action and provide "an opportunity for all interested persons to submit data, views, or arguments in writing or orally." George Harms Constr. Co. v. N.J. Tpk. Auth., 137 N.J. 8, 18 (1994). Any proposed agency rule that "revises, rescinds or replaces" an existing rule is considered a "new rule" subject to these provisions. N.J.S.A. 52:14B-4.9. Once a regulation is in effect, it has "the force and effect of statutory law," and an administrative agency "ordinarily . . . may not disregard [it]." Van Note-Harvey Assocs., P.C. v. N.J. Sch. Dev. Auth., 407 N.J. Super. 643, 650 (App. Div. 2009).

While an administrative agency's actions must not exceed the powers conferred to it by the Legislature, "the breadth of an agency's authority encompasses all express and implied powers necessary to fulfill the legislative scheme that the agency has been entrusted to administer." In re Application of Virtua-West Jersey Hosp. Voorhees for a Certificate of Need, 194 N.J. 413, 422-23 (2008). Thus, agencies are "allowed some leeway to permit them to fulfill their assigned responsibilities." Id. at 423.

Notwithstanding, due process requires that substantive procedural standards control agency discretion. Crema, 94 N.J. at 301. The regulated community reasonably expects "that known and uniform rules, standards, interpretations, advice and statements of policy" will be applied by state agencies. Cath. Fam. & Cmty. Servs. v. State-Operated Sch. Dist. of Paterson, 412 N.J. Super. 426, 442 (App. Div. 2010). An agency also may not use its power to interpret its regulations as a means of amending them or adopting new ones. Venuti v. Cape May Cty. Constr. Bd. of Appeals, 231 N.J. Super 546, 554 (App. Div. 1989). Overall, when an agency's action "could not have been fairly anticipated or addressed" because neither the enabling statute nor applicable regulations provided for it, the action is not a proper exercise of discretion. Crema, 94 N.J. at 302.

When the Department issued its 2018 request for applications, N.J.A.C. 8:64-6.2(a) provided that a committee would evaluate applications for ATC permits "on the following general criteria":

> 1. Submission of mandatory organizational information;
>
> 2. Documented involvement of a New Jersey acute care general hospital in the ATC's organization;
>
> 3. Ability to meet overall health needs of qualified patients and safety of the public;
>
> 4. Community support and participation; and
>
> 5. Ability to provide appropriate research data.
>
> [See 50 N.J.R. 1398(a).]

The new version of this regulation, which became effective on May 20, 2019, removed the requirement of an acute care hospital's involvement and added new criteria to be evaluated: "experience in cultivating, processing, or dispensing marijuana in compliance with government-regulated marijuana programs"; "history of compliance with regulations and policies governing government-regulated marijuana programs"; "ability and experience of the applicant in ensuring adequate supply of marijuana"; and "workforce and job creation plan, including plan to involve women, minorities, and military veterans in ATC ownership and management and experience with collective bargaining in the cannabis and other industries." N.J.A.C. 8:64-6.2(a).

In proceeding on the basis of anticipated changes in its regulatory scheme, the Department did not necessarily act arbitrarily, capriciously, and unreasonably. N.J.A.C. 8:64-7.11, which was effective at the time of the request for applications, provides that the Department "may waive a requirement regarding the operations of [an] ATC" if it determines that it "is necessary to achieve the purpose of the [Compassionate Use] Act and provide access to patients who would otherwise qualify for the use of medicinal marijuana . . . and does not create a danger to the public health, safety or welfare." The Department informed prospective applicants in advance of the submission date that it was waiving the requirement that applicants be involved with an acute care hospital before this requirement was formally removed by the 2019 update to the regulations because it was "impracticable." We reject the argument that this was improper in light of the Department's power to waive such an obligation under N.J.A.C. 8:64-7.11; indeed, the waiver increased the pool of possible applicants and may have raised the quality of the pool as well. Because applicants were advised of this in advance, the waiver was fair and treated all applicants equally.

We also reject the argument that the Department improperly considered elements of pending regulations. When the request for applications was issued, the Compassionate Use Act did not set forth any particular standards under which the Department was required to evaluate applications.[17] Instead, N.J.S.A. 24:6I-7(b) stated that the Department must require that an applicant "provide such information as [it] determines to be necessary pursuant to regulations adopted pursuant to [the Compassionate Use Act]." The Department had set forth some mandatory evaluation criteria in N.J.A.C. 8:64-6.2, but N.J.A.C. 8:64-6.1(b)(1) more generally provides that the Department must give notice of "eligibility criteria and a statement of the general criteria by which [it] shall evaluate applications."

We agree that, as a general matter, the Compassionate Use Act afforded the Department considerable discretion in selecting applications. It did not "shackle" the Department to a set of specific standards but instead allowed it the "ability to be flexible and responsive to changing conditions." Natural Med., 428 N.J. Super. at 271 (quoting Texter, 88 N.J. at 385). Because all prospective applicants were fully informed of the criteria in the request for applications, at the pre-application conference, and in the Q&A document, the criteria were "fairly anticipated" by the regulated community. Crema, 94 N.J. at 302.

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[17] N.J.S.A. 24:6I-7.2(c), (d), and (e), effective as of July 2, 2019, set forth in detail many criteria the Department must now evaluate when reviewing applications for cannabis cultivator, manufacturer, and dispensary permits.

We further reject Pangaea's argument that the Department's scoring system could be considered "rulemaking" subject to the requirements of the Administrative Procedure Act. "Not every action of an agency, including informal action, need . . . be subject to the formal notice and comment requirements." In re Dep't of Ins.'s Ord. Nos. A89-119 and A90-125 and the Adoption of N.J.A.C. 11:3-16A, 129 N.J. 365, 382 (1992).

Third, Harvest argues that the Department acted improperly when it decided, after applications were submitted, that vendors could be approved for only one ATC permit and that it should have included its method for ranking the three regions of the state in the request for applications instead of waiting until applications were submitted. Harvest goes so far as to say this action "[left] the award process subject to . . . [the] possibility of partiality and fraud" because applicants that did not have the best scores in a region could be chosen, while applicants with higher scores could be passed over because they had already been chosen elsewhere, raising the possibility that reviewers could "steer[]" awards toward "favored vendors."

We reject this contention because the process was similar to that utilized in the first round of ATC permitting in 2011. In its final agency decisions in that prior proceeding, the Department explained that it had decided not to allow any applicant to hold more than one permit; the fact that in this second round the Department informed applicants after the fact that they would be limited to one permit each was hardly surprising. The Department also explained its reasoning: a more diverse pool of ATC operators would limit the effects of one operator's crop failures or other difficulties on the Program as a whole. This rationale is not arbitrary, capricious, or unreasonable. The timing is a little more troublesome – the Department waiting until after applications were submitted – but there is nothing in the record to suggest that Harvest or other applicants would have decided to apply in more or fewer regions if they had known they could hold only one permit.[18]

Fourth, Compassionate Care argues that the Department's selection of MPX to proceed with the permitting process for an ATC in Atlantic City should be invalidated because the Department improperly failed to evaluate whether applicants' proposed ATC locations would promote "geographic diversity" and "how the location[s] . . . will increase patient access across the state," which Compassionate Care argues it was "required to do."

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[18] In fact, all other things being equal, had applicants been allowed to hold multiple permits, only three entities would have been chosen to proceed with permitting: MPX and NETA in the central and southern regions, and GTI and NETA in the northern region.

Compassionate Care, one of the six entities selected in the first round of ATC permitting in 2011, operates an ATC in Egg Harbor Township. In April 2018, the Department invited the original six ATC owners to submit applications to waive the prohibition on satellite locations in N.J.A.C. 8:64-7.9, so they could open dispensaries in additional places. Later that same month, Compassionate Care applied for "satellite waivers" for three dispensaries, one in Atlantic City and two in Camden County.[19]

In September 2018, Compassionate Care submitted a street address for its proposed location in Atlantic City and was quickly advised by the Department that it could pursue the permitting process for an Atlantic City dispensary. The following month, Compassionate Care told the Department it was "reconsidering its satellite locations and was looking at other potential sites."

Through the proceedings now in question, the Department selected for the southern region MPX, which planned to locate its dispensary in Atlantic City. When ruling on Compassionate Care's motion for a stay pending appeal on this issue, the Department stated that it did not consider "the potential locations of theoretical satellite dispensaries," not only characterizing that information as

[19] In May 2018, Compassionate Care advised the Department that it was no longer pursuing one of the Camden County locations but was looking into a location in Burlington County.

"speculative," but also finding that Compassionate Care’s "conduct and discussions with the Department over the [previous] several months" showed a "lack of commitment to opening a satellite location in Atlantic City." Specifically, the Department referred to several pieces of information and documents Compassionate Care had not provided regarding its plan to operate the satellite dispensary. It declared that considering Compassionate Care's or any other existing ATC permittee's proposed satellite location when selecting applicants under the 2018 request for applications would have been inappropriate because it would have allowed "maneuvering" by such permittees to limit their future competition's location options. We find no merit in Compassionate Care's argument.

N.J.S.A. 24:6I-7(a)(3)[20] states that there must be "at least two [ATCs] each in the northern, central, and southern regions of the State." Nothing else in the Act or the regulations DOH has promulgated pursuant to N.J.S.A. 24:6I-16 refers to the specific location of ATCs. It is true that the result of the 2011 request for applications led to the Department choosing Foundation Harmony, the applicant with the highest score that had not yet been chosen in another

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[20] In the version of N.J.S.A. 24:6I-7 in effect during the administrative proceedings in question, L. 2013, c. 160, the same language was employed at subsection -7(a).

region, as the first northern region winner. Because both Foundation Harmony and the next-highest scorer had proposed to locate their ATCs in Secaucus, the Department bypassed the second-place finisher and chose the next entity in line, explaining: "Taking into account the need for geographic diversity to improve patient access . . . [t]he Department does not believe that locating two ATCs in the same municipality to serve the seven-county [n]orthern region is in the best interest of the public." Inst. for Health Rsch., slip op. at 4. Compassionate Care argues that the Department has departed from this view by allowing an entity to operate in Atlantic City near where Compassionate Care has contemplated opening a satellite facility and has instead adopted a new view that geographic diversity may frustrate the purpose of the ATC Program.

In rejecting Compassionate Care's argument, we need not consider whether what was once deemed by the Department as important in 2011 precludes a different view in 2018 or after. The fact is that the Department did not choose an applicant to operate an ATC in a municipality where another existed. MPX will be the first ATC in Atlantic City, which will further the Compassionate Use Act's mandate that the Department ensure a sufficient number of ATCs to serve the needs of eligible patients. When MPX was selected, Compassionate Care had not been issued a permit for a dispensary in

Atlantic City, and the record suggests that it was far from committed to opening a satellite facility there. It was not arbitrary or capricious of the Department to fail to consider the hypothetical possibility that Compassionate Care might pursue an interest in Atlantic City. Indeed, consideration of noncommittal plans by one ATC to open a satellite office in another location could have had the very undue affect of impeding worthy applicants. We find nothing arbitrary or capricious in the Department's approach on this discrete issue.

Fifth, GGB argues that Verano engaged in "highly unethical" or even "criminal conduct" in formulating its application and, therefore, should not have been selected to go forward with permitting in the central region. GGB specifically alludes to the fact that Verano's application revealed that it entered into "host community agreements" (HCAs) with Elizabeth and Rahway, where it intended to locate its dispensary and cultivation site, as part of its efforts to demonstrate the community support required by the request for applications. GGB claims these HCAs were unethical because they provided that if Verano was selected it would make contributions to these municipalities. GGB would have these donations characterized as "bribes" to the municipalities in exchange for written letters of support that Verano could use in its application.

Among other things, the request for applications asked applicants to provide "written verification of the approval of the community or governing body of the municipality in which the [ATC] is or will be located" and for the applicants to "describe their ties to the local community and history of community involvement," including but not limited to involvement with local non-profits and community organizations, business and investment ties, and local hiring plans. At the pre-application conference, the Department explained that it was "looking for some form of documentation that the municipal government [was] in favor of an [ATC] operating in that jurisdiction and [would] not . . . interfere and impede the [permitting] process."

Verano's HCAs with Elizabeth and Rahway state that in the event Verano's application was successful and it completed the permitting process to operate its dispensary in Elizabeth and its cultivation center in Rahway, it would make immediate "contributions" to those cities and further contributions at the end of every year it was in business. Verano also agreed to give priority to local businesses to provide services like plumbing and waste removal to its facilities, to hire local employees whenever possible, and to participate in "community cleanup/rehabilitation initiatives," and Elizabeth and Rahway agreed to work with Verano to advise it regarding "research, community benefits, and employee training programs."

The HCAs, however, also stated that Elizabeth and Rahway were "under no obligation" to use Verano's contributions "in any particular manner," but that they would use them "in accordance to prior conversations and agreements." They also explained that by accepting Verano's "donations," the municipalities made "no representation or promise that [they would] act on any license or permit request in any particular way other than by [their] normal and regular course of conduct and in accordance with their rules and regulations and any statutory guidelines." Verano also included an Elizabeth resolution in its application that stated the mayor and council believed Elizabeth would benefit from the location of an ATC within its borders, "subject to compliance with terms and conditions to be agreed upon, provision of an agreed upon host community benefit fee, and compliance with all applicable City Ordinances, Permits and Approvals."

Other applicants included materials in their applications related to agreements made with municipalities. For example, JG submitted a letter from Ewing Township in which the mayor expressed support for its application and stated that JG had shown a "commitment to invest in Ewing" and "collaborate with the Township." JG's application also included a "Letter of Intent for Host Community Agreement with Ewing Township," which is completely redacted in the record. Pangaea entered into a "memorandum of understanding" with Ewing Township in which it promised to "provide financial assistance" to the municipality for purposes of rehabilitating and upgrading local parks and recreational facilities in exchange for Ewing offering "support and assistance to Pangaea in securing facilities and necessary approvals" in the town to operate its ATC. Ewing issued letters stating its approval of Pangaea's intent to locate its operations in the town and passed a municipal resolution to that effect.

It is not readily apparent to us that there is something wrong or unethical about the HCAs in question. Indeed, such agreements are actually required in a similar Massachusetts program. Massachusetts requires applicants for medical marijuana permits to negotiate HCAs with municipalities where they propose to locate. 935 Mass. Code Regs. 500.101(1)(a)(8) – (2019). An HCA "may include a community impact fee for the host community," provided that the fee is "reasonably related to the costs imposed upon the municipality by the operation of the marijuana establishment." Mass. Gen. Laws ch. 94G, § 3(d) – (2017). Although the Compassionate Use Act does not contain those requirements, and New Jersey need not model its methods after Massachusetts's, it is worth noting that another state has found HCAs valuable to the expansion of its program, rather than rejecting them as unfair tactics by permit applicants.

More importantly, the question posed by GGB has not yet been addressed by the Department in explaining the reasons for granting and denying the applications submitted under the 2018 request for applications. We think that GGB's assertion – assuming it has any bearing on its own application[21] – should be in the first instance taken up in the Department, and we do not foreclose its consideration in the remand proceedings that will follow today's decision.

Sixth, Bloom has argued – in a footnote in its appeal brief – that NETA should not have had its application approved because it was seeking to operate a facility within 1000 feet of a school zone. Other than that bald assertion and NETA's equally bald denial – calling Bloom's allegation "unfair and untrue" – we have little more in the record to consider whether this argument has merit. As we have for some of these other issues, we will leave this for further consideration in the remand proceedings.

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[21] We are unsure of the relevance of GGB's opposition to Verano's accepted application since GGB applied in the northern region and was not in competition with Verano in the central region.

G

The parties have also offered different views about potential remedies or how the status quo should be altered or remain unchanged if – as we have now determined – a remand is required. Some contend that we should vacate the final agency decisions in question and remand for more fulsome proceedings in the Department. Others argue we should grant them approval in their chosen region or remand for rescoring. For example, Harvest argues – in relying on our bidding decision in Van Note-Harvey, 407 N.J. Super. at 651 – that we should simply "direct [the Department] to add Harvest to its list of approved applicants." Harvest argues that if its application had been properly scored, it would have been awarded one of the six top spots and that the equitable result is not to deprive one of the successful applicants of its award but to simply add Harvest to the list. One respondent – Verano – while seeking to vindicate the final agency decisions also expresses some support for application of the remedy imposed in Van Note-Harvey, arguing that "if the [c]ourt is inclined to grant any relief at all, it should be relief that expands the roster of licensed ATC operators, not relief that continues and prolongs the current bottleneck situation, which is contrary to the Legislature's declared policy of compassion." Verano's position is that, whatever we do, we should not upset the progress made by the successful applicants to date:

> The worst thing that could happen from these appeals, and the one thing that should not be allowed to happen, is to backslide or regress. The six selected applicants should be allowed to move forward with their planned operations, even if the [c]ourt finds Pangaea or any of the other applicants to be entitled to some relief.

There is some appeal in that argument, considering the long delays in implementing the Compassionate Use Act.

Granting appellants relief in the form of awarding them additional positions without depriving the successful applicants of their positions may be tempting, but it is too facile a result even when considering that voters just approved the legalization of recreational marijuana use[22] that will likely generate an increased need for permits. But we think it is not our place to alter the amount of permits that may issue; such questions reside with the Legislature and whatever direction given by the Legislature to the Department.

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[22] New Jersey voters were given the opportunity to answer the following question: "Do you approve amending the Constitution to legalize a controlled form of marijuana called 'cannabis'?" At the polls on November 3, 2020, two-thirds of the voters said yes. See Tracey Tully, Recreational Marijuana Legalized by New Jersey Voters, N.Y. Times (Nov. 3, 2020), https://www.nytimes.com/2020/11/03/nyregion/nj-marijuana-legalization.html (last visited Nov. 12, 2020).

Van Note-Harvey is a narrowly-defined decision in inapposite circumstances. There, the Schools Development Authority requested proposals for site consultants for school construction projects for a three-year period. Id. at 646. In ranking the applicants, the Authority took steps that we found were inconsistent with applicable regulations; those steps caused Van Note to fall in the rankings, ultimately depriving it of eligibility. Id. at 648. After finding the Authority had failed to properly apply its regulations, we considered the appropriate remedy and concluded "the fairest outcome" was to "expand" the Authority's list of eligible consultants to include Van Note. Id. at 651. Importantly, unlike what some appellants argue here, we did not override the agency's determination as to the number of eligible consultants that would be permitted. Instead, we noted that when the request for proposals was issued, a determination had not been made as to "the final number of site consultants to be selected," only an "estimate[] that up to nine firms might be chosen." Id. at 646. After we compelled the addition of Van Note, the list of eligible consultants was increased to eight and, so, did "not expand the list of eligible contractors beyond the number that had originally [been] contemplated." Id. at 651.

Appellants argue that we should take a similar approach here, but that would require us to disregard the Department's decision to limit licensing to six entities – two in each region. As we have emphasized throughout this opinion, our power to intervene is limited; to put it simply, we may determine only whether the agency proceedings and the results obtained were arbitrary, capricious, or unreasonable. We have no license to increase the number of successful applicants beyond six as the means for moving these proceedings more quickly to the next step. In fact, it is far from clear that any further proceedings will move any appellant into the top six. We are too far in the dark to approve or reject the final agency decisions, so how could we possibly conclude that some of these unsuccessful applicants should be permitted to move forward in the process?

Beyond remanding for further proceedings, we decline to impose any of the interim relief sought by appellants and otherwise leave the status quo undisturbed. We do not, however, preclude the Department from rendering relief to the appellants pending – or in place[23] – of its fulfillment of our mandate.

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[23] That is, we see no reason why the Department could not grant Van Note-Harvey-type relief to appellants rather than engage in the remand proceedings that we believe are otherwise required. We simply conclude that it is beyond our jurisdiction to impose that relief.

III

For all these reasons, we have considerable concerns about the Department's processes and the results produced that – without further agency proceedings and explanation – would leave us to conclude that the decisions in question are arbitrary, capricious and unreasonable. We therefore vacate the final agency decisions in question and remand for further administrative proceedings in conformity with the spirit of this opinion. All requests for interim relief are denied without prejudice to the completion of any further proceedings, which we assume will occur expeditiously.

Vacated and remanded. We do not retain jurisdiction.

I hereby certify that the foregoing
is a true copy of the original on
file in my office.

CLERK OF THE APPELLATE DIVISION

* * *

Appendix

<u>Northern Region</u>

*NETA NJ, LLC	932.17
*GTI New Jersey, LLC	927.33
Bloom Medicinals of PA, LLC	894.83
Liberty Plant Sciences, LLC	894.67
GGB New Jersey, LLC	823.67

Southern Region

*MPX New Jersey[24]	958.17
#NETA NJ, LLC	932.17
*Columbia Care New Jersey, LLC	929
Harvest of New Jersey, LLC	911.17
Altus New Jersey, LLC	901.67
Liberty Plant Sciences, LLC	897.17
Bloom Medicinals of PA, LLC	894.83

Central Region

#MPX New Jersey	958.17
#NETA NJ, LLC	932.17
#Columbia Care New Jersey, LLC	929
#GTI New Jersey, LLC	927.33
*Verano NJ, LLC	920.67
*JG New Jersey, LLC	913.33
Altus New Jersey, LLC	901.67
Bloom Medicinals of PA, LLC	894.83
Pangaea Health & Wellness, LLC	801.67

[24] The asterisk (*) denotes a chosen applicant. The pound sign (#) denotes a bypassed applicant selected in another region.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

PENNSYLVANIA PROFESSIONAL LIABILITY JOINT UNDERWRITING ASSOCIATION,	:	**CIVIL ACTION NO. 1:18-CV-1308**
	:	**(Chief Judge Conner)**
Plaintiff	:	
v.	:	
TOM WOLF, in his Official Capacity as Governor of the Commonwealth of Pennsylvania, *et al.*,	:	
Defendants	:	

MEMORANDUM

In May of this year, we entered judgment in Pennsylvania Professional Liability Joint Underwriting Ass'n v. Wolf ("JUA I"), No. 1:17-CV-2041 (M.D. Pa.), declaring portions of Act 44 of 2017, P.L. 725, No. 44 ("Act 44"), to be violative of the Takings Clause of the Fifth Amendment to the United States Constitution and permanently enjoining enforcement of the Act's operative provisions. Finding the Pennsylvania Professional Liability Joint Underwriting Association (the "Joint Underwriting Association" or "Association") to be a private entity and its assets to be private property, we concluded that the state cannot expropriate to its own use funds held in the Association's coffers.

The General Assembly responded by enacting Act 41 of 2018, P.L. 273, No. 41 ("Act 41"), on June 22, 2018. Act 41 deploys JUA I as a blueprint, endeavoring to avoid the constitutional infirmities that felled Act 44. Specifically, Act 41 purports to transform the Joint Underwriting Association into a governmental entity housed within the Commonwealth's Insurance Department ("Department") and operating under the control and oversight of the Commonwealth's Insurance Commissioner ("Commissioner"). It also seeks to accomplish indirectly what JUA I forbade the state from doing directly—forcing the transfer of the Association's assets to the Department. By order of July 18, 2018, we preliminarily enjoined enforcement of Act 41 pending merits review of the Joint Underwriting Association's constitutional claims. The parties' cross-motions for summary judgment are now before the court.

I. Factual Background & Procedural History[1]

The factual backdrop of this litigation is outlined *in extenso* in this court's summary judgment opinion in JUA I and our preliminary injunction opinion in this action, familiarity with which is presumed. See generally JUA I, 324 F. Supp. 3d 519 (M.D. Pa. 2018); Pa. Prof'l Liab. Joint Underwriting Ass'n v. Wolf ("JUA II"), 328 F. Supp. 3d 400 (M.D. Pa. 2018). We reiterate salient facts for context in addressing the parties' Rule 56 arguments.

A. The Joint Underwriting Association

The Joint Underwriting Association was established by statute as a nonprofit association organized under the laws of the Commonwealth of Pennsylvania. The

[1] Local Rule 56.1 requires that a motion for summary judgment pursuant to Federal Rule of Civil Procedure 56 be supported "by a separate, short, and concise statement of the material facts, in numbered paragraphs, as to which the moving party contends there is no genuine issue to be tried." LOCAL RULE OF COURT 56.1. A party opposing a motion for summary judgment must file a separate statement of material facts, responding to the numbered paragraphs set forth in the moving party's statement and identifying genuine issues to be tried. Id. Unless otherwise noted, the factual background herein derives from the parties' Rule 56.1 statements of material facts. (See Docs. 33, 38, 41, 45, 52, 55, 56, 58). To the extent the parties' statements are undisputed or supported by uncontroverted record evidence, the court cites directly to the statements of material facts.

General Assembly created the Association in 1975 in response to a decline in the availability of medical malpractice insurance in the Commonwealth. (Doc. 33 ¶ 3). The Association was initially established and organized by the Pennsylvania Health Care Services Malpractice Act of 1975, P.L. 390, No. 111 (the "CAT Fund Statute").

The CAT Fund Statute authorized the Commissioner to either "establish and implement" or "approve and supervise" a "plan" for ensuring that medical professional liability insurance is made "conveniently and expeditiously" available to providers in the Commonwealth who cannot obtain insurance on the open insurance market. See CAT Fund Statute, § 801 (codified prior to repeal at 40 PA. STAT. AND CONS. STAT. ANN. § 1301.801). Section 801 provided that the plan "may be implemented by a joint underwriting association," id., and Section 803 permitted insurers to consult and agree with each other as to "organization, administration and operation of the plan" and rates for coverage, id. § 803(a) (codified prior to repeal at 40 PA. STAT. AND CONS. STAT. ANN. § 1301.803). An "Ad Hoc Industry Committee" of insurers submitted the Joint Underwriting Association's original proposed plan of operations to the then-Commissioner, who approved same on December 30, 1975. (Doc. 33 ¶¶ 7-8). The plan established a 12-member board of directors, one member of which was appointed by the Commissioner, and vested authority in the board to "decide all matters of policy and have authority to exercise all reasonable and necessary powers relating to the operation of the Association which are not specifically delegated by the plan to others or reserved to members of the Association." (Id. ¶¶ 9, 11). The statute authorized the Commissioner to dissolve the plan if he deemed it unnecessary and authorized the Association to borrow funds from the state in the event of a deficit. CAT Fund Statute, §§ 803(b), 808 (codified prior to repeat at 40 PA. STAT. AND CONS. STAT. ANN. §§ 1301.803(b), -.808). The Association was granted Section 501(c)(6) status by the Internal Revenue Service in 1976 and has since maintained that status. (Doc. 33 ¶¶ 12-14).

The General Assembly repealed the CAT Fund Statute on March 20, 2002, replacing it with the current statutory framework, the Medical Care Availability and Reduction of Error Act ("MCARE Act"), 40 PA. STAT. AND CONS. STAT. ANN. § 1303.101 *et seq.* The MCARE Act is a sweeping piece of legislation, with an overarching goal of ensuring a "comprehensive and high-quality health care system" for the citizens of the Commonwealth. Id. § 1303.102(1). Among other things, the MCARE Act establishes the Medical Care Availability and Reduction of Error Fund ("the MCARE Fund"), id. §§ 1303.711-.716, as a "special fund" within the state treasury to be administered by the Department, id. §§ 1303.712(a), -.713(a). The Fund offers a secondary layer of medical professional liability coverage for physicians, hospitals, and other health care providers and is funded primarily by annual assessments on those providers as a condition to practice in the Commonwealth. See id. § 1303.712(d)(1).

The MCARE Act continued operation of the Joint Underwriting Association. Id. § 1303.731(a). Unlike the MCARE Fund, the Association was not established as a "special fund" or a traditional agency within the Commonwealth's governmental structures. See id.; cf. id. §§ 1303.712(a), -.713(a). Instead, the General Assembly "established" the Association as "a nonprofit joint underwriting association to be known as the Pennsylvania Professional Liability Joint Underwriting Association."

Id. § 1303.731(a). Like its predecessor, the MCARE Act mandates membership in the Association for insurers authorized to write medical professional liability insurance in the Commonwealth. Id.

The MCARE Act requires the Association to offer medical professional liability insurance to health care providers and entities who "cannot conveniently obtain medical professional liability insurance through ordinary methods at rates not in excess of" rates applicable to those similarly situated. Id. § 1303.732(a). The Act sets forth broad parameters for achieving this objective, tasking the Association to ensure that its insurance is conveniently and expeditiously available, offered on reasonable and not unfairly discriminatory terms, and subject only to the payment of a premium for which payment plans must be made available. Id. § 1303.732(b)(1)-(5). The MCARE Act prescribes four "duties" for the Association. Id. § 1303.731(b). It requires the Association to (1) submit a plan of operations to the Commissioner for approval, (2) submit rates and any rate modifications for Department approval, (3) offer insurance as described *supra*, and (4) file its schedule of occurrence rates with the Commissioner. See id. § 1303.731(b)(1)-(4).

The Association, like other insurers licensed to operate within the Commonwealth, is "supervised" by the Department through the Commissioner. Id. § 1303.731(a); see, e.g., id. §§ 221.1-a to -.15-a, 1181-99. The MCARE Act otherwise provides that all "powers and duties" of the Association "shall be vested in and exercised by a board of directors." Id. § 1303.731(a). The board's composition, and all of the Association's operative principles, are set forth in a plan of operations developed by the Association with Department assistance and approval. (See Doc.

33 ¶¶ 38-41); JUA I, 324 F. Supp. 3d at 536. The existing plan establishes a 14-member board of directors, which consists of the current Association president; eight representatives of member companies chosen by member voting; one agent or broker elected by members; and four health care provider or general public representatives who may be nominated by anyone and are appointed by the Commissioner. (Doc. 33 ¶ 38). Under the plan, the Association may be dissolved (1) "by operation of law" or (2) at the request of its members, subject to Commissioner approval. (Id. ¶ 40). The plan provides that, "[u]pon dissolution, all assets of the Association, from whatever source, shall be distributed in such manner as the Board may determine subject to the approval of the Commissioner." (Id. ¶ 41).

The Joint Underwriting Association writes insurance policies directly to its insured health care providers, and those policyholders pay premiums directly to the Association. (See id. ¶ 52). The Association is funded exclusively by policyholder premiums and investment income generated therefrom. (Id. ¶¶ 46, 49, 50-51). It is not and has never been funded by the Commonwealth, (id. ¶ 49), and it has historically held all premiums and investment funds in private accounts in its own name, (Doc. 41 ¶¶ 8-9; Doc. 52 ¶¶ 8-9; see also Doc. 58 ¶¶ 8-9). Prior to enactment of Act 41, the MCARE Act insulated the Commonwealth from the Association's debts and liabilities. See 40 PA. STAT. AND CONS. STAT. ANN. § 1303.731(c); (Doc. 33 ¶ 32). The Association has never borrowed money to fund its operations, either in its current form or under the CAT Fund Statute which authorized the Association to borrow from the state. (Doc. 33 ¶¶ 19, 50). In the event of a deficit, the Association's plan of operations contemplates assessments on members in the form of a loan as one method of keeping the Association afloat. (See Doc. 33-6 at 3). The Association has never assessed its members under this provision. (Doc. 33 ¶ 46).

The Association maintains contingency funds—its "reserves" and its "surplus"—which allow the Association to fulfill its insurance obligations in the event of greater-than-anticipated claims or losses. See JUA I, 324 F. Supp. 3d at 525-26; (see also Doc. 33 ¶¶ 60, 62, 64, 72-74). An insurer's "reserves" are the "best estimate of funds . . . need[ed] to pay for claims that have been incurred but not yet paid." (See Doc. 33 ¶ 72). Its "surplus" represents "capital after all liabilities have been deducted from assets." (See id. ¶ 73). The surplus operates as a "backstop" to ensure that unforeseen events do not impede an insurer's ability to meet obligations to its insureds. (See id. ¶ 74). As of December 31, 2016, the Joint Underwriting Association maintained a surplus of $268,124,502. (Id. ¶ 58).

B. Recent Legislative Acts Concerning the Association

On July 13, 2016, Governor Wolf signed into law Act 85 of 2016, P.L. 664, No. 85 ("Act 85") (codified prior to repeal at 72 PA. STAT. AND CONS. STAT. ANN. § 1726-C). Act 85 is wide-ranging in scope, but its principal effect was to amend the General Appropriation Act of 2016 and balance the Commonwealth's budget. Act 85, § 1. Among other things, Act 85 provided for certain transfers to the Commonwealth's General Fund. See id. § 1(7). Pertinent here, Section 18 of Act 85 amended the Commonwealth's Fiscal Code to require a $200,000,000 transfer to the General Fund from the Joint Underwriting Association, repayable over a five-year period that was to begin in July 2018. Id. § 18.

The Association did not transfer funds to the Commonwealth pursuant to Act 85. (Doc. 33 ¶ 93). On May 18, 2017, the Association commenced a lawsuit, also pending before the undersigned, challenging the constitutionality of Act 85. See Pa. Prof'l Liab. Joint Underwriting Ass'n v. Albright, No. 1:17-CV-886, Doc. 1 (M.D. Pa. May 18, 2017). At the parties' request, that litigation has been held in abeyance pending resolution of appeals filed in JUA I.

On October 30, 2017, Governor Wolf signed Act 44 into law in another attempt to bring balance to the state budget. Act 44, § 1. Therein, the General Assembly expressly repealed Act 85. Id. § 13. Act 44, *inter alia*, purported to amend the Commonwealth's Fiscal Code to include certain "findings" concerning the Joint Underwriting Association's relationship to the Commonwealth and the nature of its unappropriated surplus. Id. § 1.3. Specifically, the General Assembly "found" that the Association is an "instrumentality of the Commonwealth" and "[m]oney under the control of the [Association] belongs to the Commonwealth." Id. Act 44 then mandated a monetary transfer from the Association to the state—$200,000,000 to the State Treasurer for deposit in the General Fund—for appropriation to the Department of Human Services. Id. Act 44 contained a "sunset" clause threatening to abolish the Association if it failed to make the transfer. Id.

The Association responded with a second lawsuit, JUA I, challenging the constitutionality of Act 44. We preliminarily enjoined enforcement of Act 44 and accelerated proceedings on the merits of the Association's claims. JUA I, No. 1:17-CV-2041, 2017 WL 5625722 (M.D. Pa. Nov. 22, 2017). On May 17, 2018, we issued a memorandum opinion concluding that the Association is a private entity and its surplus funds are private property that the Commonwealth cannot take without just compensation. JUA I, 324 F. Supp. 3d at 538. We entered judgment in favor of the Association, declaring Act 44 to be violative of the Fifth Amendment and permanently enjoining enforcement of the provisions thereof relevant to the Association. Both the Commonwealth and the General Assembly appealed our judgment to the Third Circuit Court of Appeals. See Pa. Prof'l Liab. Joint Underwriting Ass'n v. Wolf, No. 18-2323 (3d Cir.). The appeals remain pending.

On June 22, 2018, Governor Wolf signed into law the legislation subject to this lawsuit. Act 41 is the General Assembly's third attempt in as many years to gain access to the Association's funds. The Act endeavors to fundamentally reshape the Joint Underwriting Association and alter its governance structure to give the Commonwealth direct control of the Association's assets and operations. See Act 41, §§ 3-5. Specifically, Act 41 does the following:

(1) Finds that "placing the Association within the Department will give the Commissioner more oversight of expenditures and ensure better efficiencies in the operation of the Association";

(2) Declares that the Association "shall continue as an instrumentality of the Commonwealth" and "shall operate under the control, direction and oversight of the Department";

(3) Replaces the Association's current member-led board with a state-controlled board, consisting of three gubernatorial appointees and one member appointed by each of the president *pro tempore* and the minority leader of the Pennsylvania Senate and the speaker and the minority leader of the Pennsylvania House of Representatives, with the chair of the board to be appointed by the Governor;

(4) Installs a new executive director to be hired by the Commissioner and compensated by the Commonwealth, to whom authority to act on behalf of the Association will be transferred within 30 days of the Act's effective date;

(5) Assumes Commonwealth liability for any claims or liabilities of the Association arising under its insurance policies;

(6) Mandates that the new board prepare and submit a new plan of operations to the Commissioner for approval within 60 days of the Act's effective date;

(7) Articulates with specificity the duties and responsibilities of and the authority granted to the new board; and

(8) Provides that all documents, papers, and assets in the Association's possession shall be transferred to the Department within 30 days of the Act's effective date.

Id. § 3. Act 41 was scheduled to take effect on July 22, 2018. Id. § 7.

C. Procedural History

The Joint Underwriting Association commenced this lawsuit with the filing of a verified complaint on June 28, 2018, subsequently filing an amended complaint on July 3, 2018. Therein, the Association challenges the constitutionality of Act 41 under 42 U.S.C. § 1983. The Association asserts that Act 41 violates the Substantive Due Process Clause (Count I), the Takings Clause (Count II), and the Contract Clause (Count III). It seeks declaratory and injunctive relief pursuant to Section 1983 and the Declaratory Judgment Act, 28 U.S.C. § 2201 (Count IV). The amended complaint identifies two groups of defendants: Tom Wolf, Governor of the Commonwealth, and Jessica K. Altman, Insurance Commissioner of Pennsylvania, whom we will refer to as the "executive defendants," and a group we refer to as the "legislative defendants," comprising Joseph B. Scarnati, President *Pro Tempore* of the Senate; Jay Costa, Minority Leader of the Senate; Michael Turzai, Speaker of the House of Representatives; and Frank Dermody, Minority Leader of the House of Representatives.[2] All defendants are sued in their official capacities.

The Association moved for a temporary restraining order and preliminary injunction contemporaneously with the commencement of this case. We denied the request for temporary restraining order and expedited proceedings on the request for a preliminary injunction. Following oral argument on July 6, 2018, we granted the Association's motion and preliminarily enjoined enforcement of Act 41 pending merits review of the Association's claims. See generally JUA II, 328 F. Supp. 3d 400. Cross-motions for summary judgment filed by the Joint Underwriting Association, the executive defendants, and the legislative defendants are ripe for disposition.

II. Legal Standard

Through summary adjudication, the court may dispose of those claims that do not present a "genuine dispute as to any material fact" and for which a jury trial would be an empty and unnecessary formality. FED. R. CIV. P. 56(a). The burden of proof tasks the non-moving party to come forth with "affirmative evidence, beyond the allegations of the pleadings," in support of its right to relief.

[2] The amended complaint also names the General Assembly of the Commonwealth of Pennsylvania as a defendant. The General Assembly waived service, rendering its answer due by August 27, 2018. (Doc. 16). To date, counsel has not entered an appearance on behalf of the General Assembly and no answer has been filed on its behalf. All filings by the legislative defendants have been made solely under the names of the four individual elected leaders and cannot be fairly construed as having been filed on behalf of the General Assembly itself.

Pappas v. City of Lebanon, 331 F. Supp. 2d 311, 315 (M.D. Pa. 2004); see also Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986). This evidence must be adequate, as a matter of law, to sustain a judgment in favor of the non-moving party on the claims. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250-57 (1986); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587-89 (1986). Only if this threshold is met may the cause of action proceed. See Pappas, 331 F. Supp. 2d at 315.

Courts are permitted to resolve cross-motions for summary judgment concurrently. See Lawrence v. City of Phila., 527 F.3d 299, 310 (3d Cir. 2008); see also Johnson v. Fed. Express Corp., 996 F. Supp. 2d 302, 312 (M.D. Pa. 2014); 10A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 2720 (3d ed. 2015). When doing so, the court is bound to view the evidence in the light most favorable to the non-moving party with respect to each motion. FED. R. CIV. P. 56; Lawrence, 527 F.3d at 310 (quoting Rains v. Cascade Indus., Inc., 402 F.2d 241, 245 (3d Cir. 1968)).

III. Discussion

The Joint Underwriting Association raises four claims in its amended complaint. The Association asserts *first*, that Act 41 violates its right to substantive due process; *second*, that Act 41 is an unconstitutional taking of private property; *third*, that Act 41 substantially interferes with the Association's contracts with its insureds and its members; and *fourth*, that it is entitled to a declaration that Act 41 is unconstitutional for each of the above reasons pursuant to the Declaratory

Judgment Act, 28 U.S.C. § 2201. As in JUA I, we begin and end our analysis with the Association's Takings Clause claim.

A. The Association's Takings Clause Claim

Section 1983 of Title 42 of the United States Code creates a private cause of action to redress constitutional wrongs committed by state officials. 42 U.S.C. § 1983. The statute is not a source of substantive rights, but serves as a mechanism for vindicating rights otherwise protected by federal law. Gonzaga Univ. v. Doe, 536 U.S. 273, 284-85 (2002); Kneipp v. Tedder, 95 F.3d 1199, 1204 (3d Cir. 1996). To state a Section 1983 claim, plaintiffs must show a deprivation of a "right secured by the Constitution and the laws of the United States . . . by a person acting under color of state law." Kneipp, 95 F.3d at 1204 (quoting Mark v. Borough of Hatboro, 51 F.3d 1137, 1141 (3d Cir. 1995)). Defendants do not dispute that they are state actors. We must thus determine whether Act 41 deprives the Association of rights secured by the Fifth Amendment to the United States Constitution.

We have previously articulated the fundamental principles of takings law, see JUA I, 324 F. Supp. 3d at 528-29, and those principles have equal application here. The Takings Clause of the Fifth Amendment prohibits the government from taking private property for public use without just compensation. U.S. CONST. amend. V. The Takings Clause is made applicable to the states by the Fourteenth Amendment. See U.S. CONST. amend. XIV; Murr v. Wisconsin, 582 U.S. __, 137 S. Ct. 1933, 1942 (2017) (citing Chi., B. & Q. R. Co. v. Chicago, 166 U.S. 266 (1897)). It applies not only to the taking of real property, but also to government efforts to take identified funds of money. See, e.g., Phillips v. Wash. Legal Found., 524 U.S. 156, 160, 164-65 (1998); Webb's Fabulous Pharms., Inc. v. Beckwith, 449 U.S. 155, 164-65 (1980). Takings claims generally fall into two categories—physical and regulatory. See Yee v. City of Escondido, 503 U.S. 519, 522-23 (1992).

Our decision in JUA I applied these settled principles in the context of the unique constitutional question then before us. Because the parties' summary judgment motions concenter upon JUA I, we briefly revisit the *ratio decidendi* undergirding that decision.

1. JUA I

JUA I rejected arguments by Governor Wolf and the General Assembly that the Joint Underwriting Association is either the state itself or an arm thereof with no constitutional rights against its creator. We found Governor Wolf's reliance on the United States Supreme Court's decision in Lebron v. National Railroad Passenger Corp., 513 U.S. 374 (1995), which supplied "guideposts" for courts to assess whether a defendant is a government actor subject to Section 1983 liability, to be misplaced. JUA I, 324 F. Supp. 3d at 531-32. And we disagreed with the General Assembly that, by virtue of its statutory roots, the Association is akin to a political subdivision with "no privileges or immunities" against its state creator. Id. at 530-32 (quoting Williams v. Mayor of Balt., 289 U.S. 36, 40 (1933)).

Drawing on a body of illustrative federal and state court decisions,[3] we observed that courts typically look to a number of nonexhaustive considerations in assessing the public-versus-private nature of state-affiliated insurance associations, including "the nature of the association's function, the degree of control reserved in the state (or the level of autonomy granted the association), and the statutory treatment, if any, of the entity, in addition to the nature of the funds implicated." Id. at 535. We carefully examined the Association's enabling legislation, the nature of the Association's function and the manner in which it performed that function, its governance and operational structure, the relative lack of Commonwealth control and the total dearth of Commonwealth responsibility, and the private source of the Association's funds before holding that both the Association and its assets are overwhelmingly private in nature. Id. at 535-38.

As to the Association itself, we determined that it is "at its core, an insurance company," funded exclusively by privately-paid premiums and largely indistinguishable from other private insurers in the Commonwealth. Id. at 535-36. Of greater import than the Association's function was its near-total independence from the state. We rejected defendants' assertion that the Commonwealth retained authoritative control over the Association, observing that the MCARE Act vested all

[3] Those decisions are Mississippi Surplus Lines Ass'n v. Mississippi, 261 F. App'x 781 (5th Cir. 2008) (nonprecedential), Asociación de Subscripción Conjunta del Seguro de Responsabilidad Obligatorio v. Flores Galarza, 484 F.3d 1 (1st Cir. 2007), Arroyo-Melecio v. Puerto Rican American Insurance Co., 398 F.3d 56 (1st Cir. 2005), Texas Catastrophe Property Insurance Ass'n v. Morales, 975 F.2d 1178 (5th Cir. 1992), Medical Malpractice Insurance Ass'n v. Cuomo, 541 N.E.2d 393 (N.Y. 1989), and Medical Malpractice Insurance Ass'n v. Superintendent of Insurance, 533 N.E.2d 1030 (N.Y. 1988). We reexamine several of these decisions in detail *infra*.

"powers and duties" of the Association "in and [to be] exercised by" its member-led board of directors. Id. (alteration in original) (quoting 40 PA. STAT. AND CONS. STAT. ANN. § 1303.731(a)). We found that a limitation on rate-setting and a requirement that the Commissioner approve deficits were not meaningfully distinguishable from regulations applicable to other private insurers in the Commonwealth. Id. at 536-37. And we noted that it was not the MCARE Act but the Association's own plan of operations which set procedures for dissolution. Id. at 537. Hence, we held that the Association is no more a Commonwealth entity "than any other private insurer authorized to write insurance in the state." Id.

Turning to the nature of the Association's surplus funds, we noted that the Association has never received public funding and that the MCARE Act (as it then-existed) expressly disclaimed state responsibility for the Association's debts and liabilities. Id. at 537-38 (citing 40 PA. STAT. AND CONS. STAT. ANN. § 1303.731(c)). We also underscored that the Association is sustained exclusively by private premiums, "paid by private parties in exchange for private insurance coverage," as well as investment income and interest generated on those premiums. Id.

For these many reasons, we held as a matter of law that the Joint Underwriting Association is a private entity and that its surplus funds are private property. Id. at 538. We observed that the Commonwealth made a choice when it created the Association in 1975, and that its choice has present-day constitutional consequences:

> The legislature had the option to tightly circumscribe the Association's operations and composition of its board, to establish the Association as a special fund within the

> state's treasury, or to retain meaningful control in any number of other ways. That the General Assembly chose to achieve a public health objective through a private association has a perceptible benefit: it assures availability of medical professional liability coverage throughout the Commonwealth at no public cost. By the same token, it also has a consequence: the General Assembly cannot claim *carte blanche* access to the Association's assets.

Id. (citations omitted). The result, we said, is that the Commonwealth cannot take private property acquired by the Association without just compensation. Id.

The *essentia* of our holding in JUA I is that the state "released the Association from any residual sovereign mooring" when it relinquished control of the Association to the board and disclaimed responsibility therefor. JUA II, 328 F. Supp. 3d at 410 (quoting JUA I, 324 F. Supp. 3d at 538). The question raised in the matter *sub judice* is whether the Commonwealth, through Act 41, can reclaim the Association as a purely governmental entity and gain access to its surplus funds. The Association asks the court to assign *res judicata* effect to our judgment in JUA I and answer this inquiry in the negative. Defendants rejoin that the answer is an unequivocal "yes," insisting that the court either reconsider and abandon JUA I or find it to be distinguishable given the new statutory landscape brought by Act 41.

2. *Issue Preclusion*

The Joint Underwriting Association invokes the doctrine of issue preclusion, also referred to as collateral estoppel. Federal law of issue preclusion derives from the Restatement (Second) of Judgments, which provides that "[w]hen an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim." B & B Hardware, Inc. v. Hargis Indus., Inc., 575 U.S. __, 135 S. Ct. 1293, 1303 (2015) (quoting RESTATEMENT (SECOND) OF JUDGMENTS § 27 (AM. LAW INST. 1980)); Nat'l R.R. Passenger Corp. v. Pa. Pub. Util. Comm'n, 288 F.3d 519, 525 (3d Cir. 2002) (same). Four elements are prerequisite to application of issue preclusion: "(1) the identical issue was previously adjudicated; (2) the issue was actually litigated; (3) the previous determination was necessary to the decision; and (4) the party being precluded from relitigating the issue was fully represented in the prior action."[4] Jean Alexander Cosmetics, Inc. v. L'Oreal USA, Inc., 458 F.3d 244, 249 (3d Cir. 2006) (citation omitted). The Third Circuit has also considered two additional elements, to wit: "whether the party being precluded 'had a full and fair opportunity to litigate the issue in question in the prior action,'" and "whether the issue was determined by a final and valid judgment." Id.

The Joint Underwriting Association contends that resolution of the dispositive issue in this case begins and ends with JUA I. But collateral estoppel generally will not apply when "controlling facts or legal principles have changed significantly since the [prior] judgment." Karns v. Shanahan, 879 F.3d 504, 514 (3d Cir. 2018) (alteration in original) (quoting Montana v. United States, 440 U.S. 147,

[4] The executive defendants articulate a somewhat different formulation, quoting from the Third Circuit's decision in Gregory v. Chehi, 843 F.2d 111, 122 (3d Cir. 1988). (Doc. 57 at 3-4). The court in Gregory was applying Pennsylvania law to determine the preclusive effect of a Pennsylvania state court judgment. Id. at 116, 122. Because JUA I is a federal court decision on a federal question, we apply federal law of preclusion. See Doe v. Hesketh, 828 F.3d 159, 171 (3d Cir. 2016) (citing Paramount Aviation Corp. v. Agusta, 178 F.3d 132, 145 (3d Cir. 1999)).

155 (1979)). We are here presented with a different legislative act and a different constitutional question than were before us in JUA I. At issue there was whether the Joint Underwriting Association was a public or private entity, and whether its funds were public or private property. See JUA I, 324 F. Supp. 3d at 529-38. We held that both the Association and its funds were private in nature and that the state could not take those funds without just compensation. See id. at 538.

The issue now before the court is different. As we have already framed it, the dispositive inquiry is "[w]hether the Commonwealth can now recapture the Association through *post hoc* legislation—irrespective of private rights and interests accrued by the Association over more than four decades"—without constitutional consequence. See JUA II, 328 F. Supp. 3d at 410-11. Our disposition of the Fifth Amendment issue raised by Act 41 is assuredly informed by JUA I. And many of the same constitutional concerns are implicated by this newest legislation. But the enactment of Act 41 alters the legal landscape, compelling scrutiny anew. Accordingly, we cannot find that the issues raised in JUA I are "identical" to the issues presently before the court.

3. *Merits*

We turn to the merits and begin from a simple premise: the Association, as it existed on May 17, 2018, is a private entity, and its funds are private property that cannot be taken by the government without just compensation. See JUA I, 324 F. Supp. 3d at 538. From there, the parties' arguments take three divergent tacks. The executive defendants contend that Act 41 merely complies with JUA I by implementing criteria set forth therein to reconstitute the Association as a public entity. The legislative defendants assert that the holding in JUA I is in error, that the Joint Underwriting Association is a public entity in which the Commonwealth alone is interested, and that the state can do with the Association what it pleases. And the Association maintains that Act 41, like its predecessor Act 44, effects an unconstitutional taking of its private property. The court addresses each argument *seriatim*.

a. Executive Defendants: Answering JUA I

The executive defendants rely on Act 41 itself as the answer to the constitutional inquiry before the court. They remonstrate that Act 41 checks each of the boxes drawn by JUA I to transform the Association into a Commonwealth entity. (See Doc. 44 at 6-11). They answer the court's inquiry of whether the state can retrospectively recapture a private entity and assume ownership of its private property with a firm but wholly unsupported "yes." (Id. at 6-9).

We expressed skepticism at the preliminary injunction stage with respect to this contention, which we construed as intimating that "with a legislative vote and the stroke of the Governor's pen, what were private funds yesterday may become public funds tomorrow." JUA II, 328 F. Supp. 3d at 410. We further observed that, notwithstanding the "wide leeway" rightly accorded to legislative prerogative, the executive defendants had offered no jurisprudential support for their claim that the Commonwealth could transfigure into public property what the court had already declared to be private. Id. at 410 (quoting Holt Civic Club v. City of Tuscaloosa, 439 U.S. 60, 71 (1978)).

The executive defendants offer no meaningful response to our expressed concerns. They move through the components parts of Act 41, explaining how each "answers" and satisfies the public-entity hallmarks found to be lacking in JUA I. (See Doc. 44 at 6-9). But they fail to provide any authority for the proposition that the state can declare public what it created as—and a court has confirmed to be—a private entity. The law is to the contrary. Indeed, the Supreme Court's takings jurisprudence expressly rejects the suggestion that the state, by legislative say-so, may make public what was previously private, admonishing that "a State, by *ipse dixit*, may not transform private property into public property without just compensation." Webb's Fabulous Pharms., Inc., 449 U.S. at 164. Accordingly, we will deny the executive defendants' motion for summary judgment on the Joint Underwriting Association's takings claim.

b. Legislative Defendants: Revisiting JUA I

The legislative defendants do not engage with the constitutionality of Act 41 directly. They approach this case similarly to JUA I, reviving their assertion that the General Assembly created the Joint Underwriting Association, and that only the Commonwealth is interested in the Association, such that the Association necessarily is a public entity and its funds public property. No change in law, fact, or perspective supports the requested departure from JUA I. It is this court's view that the legislative defendants' assertions of error are most appropriately raised in the pending direct appeal of JUA I. Nonetheless, for the sake of completeness, we respond to those arguments herein.[5]

The legislative defendants turn first to the Supreme Court's decision in Trustees of Dartmouth College v. Woodward ("Dartmouth"), 17 U.S. (4 Wheat.) 518 (1819), which they claim reinforces their assertion that the General Assembly retains "absolute discretion over the entities it creates." (Doc. 37 at 17). Defendants hold Dartmouth up for their view that a state's power over entities it creates turns exclusively on the "presence or absence of non-state interests." (Id. at 18 (emphasis omitted)). We agree that the existence of non-state interests is to be considered in assessing whether the state may wield its power, unrestrained by the federal Constitution, over an entity. We disagree, however, that this is the only relevant consideration, or that our decision in JUA I in any way conflicts with Dartmouth.

Dartmouth arose under the Contract Clause of the United States Constitution. In 1754, Reverend Eleazer Wheelock established Dartmouth College at his own and other private benefactors' expense, named trustees thereof, and applied to the crown for a charter of incorporation. Id. at 631. The charter was granted and Dartmouth College was born. Id. at 631-32. In 1816, the legislature of

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[5] The General Assembly defendants also resurrect their political subdivision standing doctrine argument. Specifically, defendants challenge this court's determination in JUA I that the extension of that doctrine recognized in Pocono Mountain Charter School v. Pocono Mountain School District, 908 F. Supp. 2d 597 (M.D. Pa. 2012), does not apply to an entity like the Joint Underwriting Association which has no municipal characteristics or powers. We again conclude that the relationship between the Commonwealth and the Association is not "sufficiently analogous" to that between a state and its municipalities to support invocation of the political subdivision standing doctrine. We incorporate and reaffirm our analysis in JUA I on this subject. See JUA I, 324 F. Supp. 3d at 530-31.

New Hampshire attempted to amend the charter to seize control of the college as a public institution. See id. at 626-27. The Dartmouth lawsuit followed.

The Supreme Court rejected the attempted takeover as a violation of the Contract Clause. The decision establishes that the United States Constitution does not bar the state from regulating its own public institutions but *does* protect private corporations as against the state. See id. at 630-31, 638. Whether an entity is a public or private institution turns not on the commercial or charitable nature of the services provided, see id. at 669-73 (Story, J., concurring), but on the entity's status *vel non* as an "instrument[] of government," see id. at 638 (Marshall, C.J.). The Court stated that a government charter is a "grant of political power" and establishes a public entity "if it create a civil institution, to be employed in the administration of the government, or if the funds of the [entity] be public property, or if the state . . . , as a government, be alone interested in its transactions." Id. at 629-30. Where it creates such an institution, the government "may act according to its own judgment, unrestrained by any limitation of its power imposed by the constitution of the United States." Id. at 630.

Concurring justices endeavored to put a finer point on the distinction. Justice Washington compared governmental entities, which he described as "the mere creature of public institution, created exclusively for the public advantage, without other endowments than such as the king, or government, may bestow upon it, and having no other founder or visitor than the king or government," with private institutions, those "endowed and founded by private persons, and subject to their control, laws and visitation, and not to the general control of the government."

Id. at 661 (Washington, J., concurring). Justice Story added that a public entity exists solely for a "public purpose[]" and "its whole interests and franchises are the exclusive property and domain of the government itself." Id. at 668-69, 672 (Story, J., concurring). By contrast, he said, where "the foundation be private, though under the charter of the government, the corporation is private." Id. at 668-69.

The legislative defendants posit that the Joint Underwriting Association is precisely the governmental instrument contemplated by Dartmouth, maintaining that the Commonwealth and only the Commonwealth is interested in its business. (Doc. 53 at 8). But as three lawsuits, more than a thousand pages of briefing, and multiple judicial opinions evince, the constitutional question *sub judice* is quite different from that presented in Dartmouth. Yes, the General Assembly did create the Association in response to a medical malpractice insurance crisis in the Commonwealth. But in the same act that created the Association, the legislature relinquished near-total control thereof and renounced responsibility therefor, establishing the Association as a nonprofit with its own statutory rights, disclaiming liability for its debts and obligations, and vesting all powers and duties in its member-led board. See JUA I, 324 F. Supp. 3d at 536. We discern no tension between Dartmouth and JUA I. The Association does not neatly fit into any of the categories of public entities described in Dartmouth: it is not, as defendants submit, "a civil institution . . . employed in the administration of the government"; it has never been funded by or endowed with "public property"; and the state has never been "alone interested in its transactions." See Dartmouth, 17 U.S. (4 Wheat.) at 629-30.

It is for this reason that we looked to other cases involving constitutional claims brought by state-created insurance associations. The legislative defendants also oppugn our assessment of those opinions, which included the Fifth Circuit's decision in Texas Catastrophe Property Insurance Ass'n v. Morales, 975 F.2d 1178 (5th Cir. 1992); the First Circuit's decisions in Asociación de Subscripción Conjunta del Seguro de Responsabilidad Obligatorio v. Flores Galarza, 484 F.3d 1 (1st Cir. 2007), and Arroyo-Melecio v. Puerto Rican American Insurance Co., 398 F.3d 56 (1st Cir. 2005); and the New York Court of Appeals' decision in Medical Malpractice Insurance Ass'n v. Superintendent of Insurance ("MMIA"), 533 N.E.2d 1030 (N.Y. 1988). In each of those cases, we determined, the courts "holistically examined the entity's relationship to the state," by examining such considerations as the "nature of the association's function, the degree of control reserved in the state (or the level of autonomy granted to the association), and the statutory treatment, if any, of the entity, in addition to the nature of the funds implicated." JUA I, 324 F. Supp. 3d at 535 (citations omitted).

The legislative defendants asseverate that these cases stand, at most, for the proposition that "a state-created entity may *sometimes* assert constitutional claims on behalf of private citizens," but only when the individual rights of those private citizens are themselves implicated. (Doc. 37 at 24 (emphasis added)). For example, in Morales, the Fifth Circuit held that the statutorily-established Texas Catastrophe Property Insurance Association (CATPOOL) was not in fact "part of the state" and had standing to sue Texas for deprivation of its right to counsel. See Morales, 975 F.2d at 1182-83. In Asociación, the First Circuit concluded that Puerto Rico's statutorily-established joint underwriting association could assert a takings claim against the government. See Asociación, 484 F.3d at 20 (quoting Arroyo-Melecio, 398 F.3d at 62). Defendants assert that these results obtained solely because member companies shared in the respective associations' profits and losses, such that the state alone was not interested in the associations' success or failure. (Doc. 53 at 12-14). According to defendants, the Constitution protected the "private interests" of the associations' members but did not protect the insurance associations themselves. (Id. at 12).

We disagreed with defendants' narrow characterization of these decisions in JUA I, and we do so again now. The Morales court did note that CATPOOL's members shared in its profits and losses. Morales, 975 F.2d at 1182-83. But it *also* observed, as we did in JUA I, that the state treasury was not liable for CATPOOL's debts or losses; that the state chose not to fund CATPOOL with taxpayer dollars and had elected not to organize and control it within the state government itself; and that the nature of the funds in question was entirely private, to wit: "private money directed to pay private claims." Id. Channeling Dartmouth, the Morales court concluded that "[t]he act creating CATPOOL is not a 'grant of political power,' as in the case of a municipality or other political subdivision," nor is CATPOOL "'employed in the administration of the government.'" Id. at 1183 (citing Dartmouth, 17 U.S. (4 Wheat.) at 629-30). The court held that CATPOOL was not "truly a part of the state" and thus possessed and could sue for violation of its right to counsel. Id.

The First Circuit reasoned similarly in determining that Puerto Rico's statutorily-created joint underwriting association is private in nature and has standing to assert a constitutional claim against its creator. See Asociación, 484 F.3d at 20 (citing Arroyo-Melecio, 398 F.3d at 62). The court in Asociación drew on its earlier decision in Arroyo-Melecio, an antitrust case, which discussed at length the relationship between the underwriting association and the government. See id. The court recognized that the legislature created the association, dictated its form and purpose, exempted the association's profits from income taxes, and held approval power over its operating plan. See Arroyo-Melecio, 398 F.3d at 61-63. It nonetheless found that the association was not a governmental entity, highlighting that the association's members, not the government, shared in its profits and losses and bore its insurance risk alone; that the association managed its own affairs; that it had "general corporate powers" to sue and be sued, enter contracts, and hold property; that it was designated by statute as "private in nature, for profit"; and that, although the association was "under some direction by the commonwealth," the commissioner was neither a member of its board nor involved in its "day-to-day affairs." See id. Each of these factors, not just member financial interest, informed the First Circuit's conclusion that the association is more akin to an ordinary private insurer than it is part of the state. See id. The court accordingly allowed the association to bring a Section 1983 takings claim against government officials. See Asociación, 484 F.3d at 20 (citing Arroyo-Melecio, 398 F.3d at 62).

Defendants cite to the New York Court of Appeals' decision in MMIA, the only case where a court found that a statutorily-created insurer could not sue the state. The appeals court looked to the statutory scheme creating New York's Medical Malpractice Insurance Association ("MMIA") and determined that the MMIA could not directly assert a takings claim against the superintendent of insurance. See MMIA, 533 N.E.2d at 1036-37. In reaching that result, the court underscored many of the same factors that we weighed in JUA I: it noted that the state and the superintendent of insurance tightly controlled the association[6]; that the statutory framework comprehensively outlined the association's rights, duties, and obligations; that the MMIA "may operate only for fixed periods of time" and only if the superintendent of insurance deemed its function necessary; and that its "operations are subject to the Superintendent's extensive and direct control." Id. The court held that the association was part of the state and could not raise a takings claim. Id.

In closing, the court noted what it was not deciding: whether the regulations at issue may be confiscatory as to "the individual insurance companies which are members of MMIA and are required to make up any deficit which may be incurred

[6] Defendants note that, when MMIA was decided, the New York statute gave private insurer members an eight-seat majority on the MMIA board, reserving only seven seats for state appointees. (Doc. 37 at 27-28). Defendants intimate that the ceding of control to the insurer members blurs any meaningful distinction between the Commonwealth's Joint Underwriting Association and New York's MMIA. (Id.) Defendants misapprehend the court's prior analysis. We observed in JUA I that the New York statute creating the MMIA "dictat[ed] the composition of its board and its plan of operation." JUA I, 324 F. Supp. 3d at 534, 536. We did so as part of a broader analysis contrasting the "exhaustive statutory framework" governing the MMIA with the skeletal treatment accorded the Association in the MCARE Act. See id. Our point was not about who controlled the MMIA's board at any given time, but rather that the New York legislature had dictated the board's composition by statute (expressly reserving at least some seats for state appointees), whereas the MCARE Act left the question of board composition to the Association itself.

by MMIA." Id. at 1037. The legislative defendants invoke this afterthought as support for their view that a state-created institution cannot claim constitutional protection against its creator unless it is defending "*individual* property interests" in a representative capacity. (Doc. 53 at 15). We are unpersuaded that the MMIA court intended its *obiter dictum*, offered only after extensive discussion of MMIA's statutory framework and the extensive degree of state control, as the ultimate and singular delimiter of constitutional capacity to sue.[7]

As in JUA I, we again reject the suggestion that a statutorily-created insurance association may bring suit against the state only if the association's members have some personal stake in the entity—and then only on behalf of those members. We simply do not read the applicable authorities as espousing such a rule. Consequently, we maintain our holding from JUA I that a holistic approach, one which thoroughly examines the association's relationship to the state through the prism of, *inter alia*, its function, autonomy, and statutory treatment as well as

[7] We note that, even if we were to adopt the legislative defendants' construction that member interest is the lone prerequisite to suit, the record establishes that the Joint Underwriting Association's members *do* have some interest in the Association. The Association is organized as a nonprofit, and, by law, member companies do not share in profits as they did in Asociación and Morales. The Association's reserves and its surplus are its first line of financial defense in the event it suffers a loss. (See Doc. 33 ¶¶ 72-74). But thereafter, it is the Association's member insurance companies, *not* the Commonwealth, that would be held to account: under the Association's current plan of operations, members may be assessed to make up any loss until the Association can borrow sufficient funds to satisfy its deficit, repay borrowed funds, and reimburse members for assessments. (Doc. 33-6 at 3). Although the degree of member interest is not as enduring or direct as the member interest in Asociación and Morales, it is member interest nonetheless and belies defendants' assertion that the state is "alone" interested in the Association.

the nature (including the source) of its funds, best answers whether a statutorily-created nonprofit is private or public for constitutional purposes.

The Joint Underwriting Association, since its inception, has been a private institution. It has operated just like a private insurance company for decades.[8] It is privately funded and organized and has never received public funding. Until Act 41, the Commonwealth explicitly disclaimed any responsibility for the Association's debts and liabilities. The Association covers its own operating expenses and bears its own aggregate insurance risk. Its plan of operations contemplates borrowing and reimbursable member assessments, not state financial support, in the event of a deficit. In stark contrast to MMIA, the Association is subject to minimal supervision by the Commissioner, in a manner not meaningfully different from private insurers. Given all of this, we will deny the legislative defendants' request that we reconsider and abandon our analysis and holding in JUA I.

[8] The legislative defendants insist throughout their briefing that the public-private distinction should not be drawn based on "the commercial or charitable nature" of the entity's services. (See, e.g., Doc. 37 at 18-19). Drawing on Justice Story's concurring opinion in Dartmouth for the proposition that state-created entities can include commercial endeavors such as colleges, hospitals, and banks, the legislative defendants urge that "the 'commercial' purpose of a state-created entity does not remove it from [state] control." (Id. at 19 (citing Dartmouth, 17 U.S. (4 Wheat.) at 669 (Story, J., concurring)). To be quite clear, JUA I did not hold that a commercial purpose renders an institution private rather than public. Rather, we determined that an entity's function, and particularly the manner in which it accomplishes that function in relation to the state, is but one factor to consider in assessing public-versus-private status. When we examined the Joint Underwriting Association's function, we considered not only its commercial purpose, but how it effected that purpose, including the source of the funds, where its risk was borne, and its mode of operation anent the state. Each of these elements informed our overall assessment of the Association's relationship to the Commonwealth. We neither held nor intended to imply that the Association is a private entity solely because it engaged in commercial activities.

We lastly address the legislative defendants' suggestion that this court's decision in JUA I conflicts with principles of federalism and deference to state legislative action. Defendants charge that "federal courts should not wield the federal constitution like a ruler, rapping knuckles whenever they disagree with state governance." (Doc. 37 at 16). We agree, as we have at each stage of these lawsuits, that the legislature has wide discretion to experiment with its police powers. The Supreme Court observed as much in Dartmouth, stating that federal courts charged with constitutional review of state legislative acts must approach their task with "cautious circumspection." Dartmouth, 17 U.S. (4 Wheat.) at 625. That deference is not without limitation, however, and federal courts also have an obligation to hear the constitutional cases properly brought before them. See id. As the Supreme Court aptly noted, "however irksome the task may be, this is a duty from which we dare not shrink." Id. Our holdings in JUA I and here today flow not from our disagreement with exercise of legislative prerogative but from what the Fifth Amendment deems to be an unconstitutional abuse thereof.

c. **The Instant Takings Claim**

The only inquiry that remains is whether the Joint Underwriting Association is entitled to judgment as a matter of law on its Takings Clause claim. We conclude that no genuine disputes of material fact persist and that the Association is entitled to summary and declaratory judgment. Act 41 is a repackaged and more intricate version of Act 44. The new legislation endeavors to do indirectly what JUA I told the Commonwealth it could not do directly. The only difference is that Act 41 amplifies its predecessor: where Act 44 purported to take only a portion of the

Association's surplus funds, see Act 44, § 1.3, Act 41 attempts to take all of the Association's assets and to extinguish it as presently—privately—constituted, see Act 41, §§ 3-5.

The executive defendants reprise their argument that Act 41 does not contravene the Fifth Amendment because it does not "take" anything from the Joint Underwriting Association. (Doc. 44 at 9 n.1). They aver that the Association will continue to exist as a statutory entity within the Department, "albeit as a new legislative manifestation," such that "the funds are not being taken by a new owner." (Id.) We rejected this argument at the preliminary injunction stage, and we reject it again now. Act 41 transfers complete control of the Association to the Commonwealth and grants ownership and authority over the Association's assets thereto. The Act dismantles a private entity as it currently exists and transfers its assets *in toto*, as well as its administration, to the Commonwealth. There is, in this court's view, no genuine dispute as to whether Act 41 impermissibly takes the private property of a private entity without just compensation.

We acknowledge that the instant constitutional question is both novel and complex. The General Assembly must be afforded a wide berth to enact and to amend legislation in furtherance of its preferred objectives. But when it chooses to create a private entity to meet those objectives, in which the state is not alone or, indeed, at all interested, and over which the state retains virtually no control, that legislative discretion is bounded by the federal Constitution. This is precisely the case with the Joint Underwriting Association. We hold that the Fifth Amendment prohibits the Commonwealth from taking the private assets of the Association, either directly as in Act 44 or through the hostile takeover effected by Act 41, without just compensation.

B. Permanent Injunctive Relief

Before the court may grant permanent injunctive relief, the Joint Underwriting Association must prove: *first*, that it will suffer irreparable injury absent the requested injunction; *second*, that legal remedies are inadequate to compensate that injury; *third*, that balancing of the respective hardships between the parties warrants a remedy in equity; and *fourth*, that the public interest is not disserved by an injunction's issuance. See eBay, Inc. v. MercExchange, LLC, 547 U.S. 388, 391 (2006) (citations omitted). Only the executive defendants dispute the remaining prerequisites for a permanent injunction. The legislative defendants do not address the issue and ostensibly yield the point. We find permanent injunctive relief to be both appropriate and necessary.

That Act 41 works an immediate and irreparable harm upon the Association is hardly debatable. And that harm cannot be remedied by monetary damages. See JUA II, 328 F. Supp. 3d at 411. As we previously observed, and as the record bears out, Act 41 redoubles the harm of Act 44, "dismantling the Association as presently constituted, ousting its board and president to be replaced by political appointees, and forcing it to transfer *all* of its assets to the Commonwealth." Id. (citing Act 41, § 3). Sovereign immunity would foreclose an award of monetary damages in this suit against the Commonwealth, see Edelman v. Jordan, 415 U.S. 651, 663 (1974); Christ the King Manor, Inc. v. Sec'y U.S. Dep't of Health & Human Servs., 730 F.3d

291, 319 (3d Cir. 2013), such that equity alone provides the appropriate remedy, see Temple Univ. v. White, 941 F.2d 201, 214-15 (3d Cir. 1991).

The public interest generally favors vindication of constitutional rights. The executive defendants counter, as they have before, that the public also has a considerable interest in legislative discretion and an unencumbered lawmaking process reflecting the public will. Defendants proffer no concrete harm (to the government or to the public) beyond this bare assertion. Their claim of abstract injury to public interest does not outweigh the actual constitutional injury to the Association. We do not doubt that the legislative and executive defendants had the public interest in mind when enacting Act 41 and continue to act in the name of that interest. We do not question that the public interest favors a balanced budget and the free and representative exercise of the legislative prerogative. But as we have stated both in this case and its predecessor, the Commonwealth cannot achieve a legitimate end through unconstitutional means. See JUA II, 328 F. Supp. 3d at 412; JUA I, 324 F. Supp. 3d at 540. We will grant the Association's request for permanent injunctive relief.

IV. Conclusion

The executive defendants assert, and the legislative defendants imply, that our decisions in JUA I and today are "tantamount to holding that the legislative and executive branches are barred from amending . . . legislation related to the [Association]." (Doc. 57 at 29; see also Doc. 37 at 15-17). We resolutely disagree. This court does not hold, and has never held, that the General Assembly cannot repeal or amend the statute designating the Association as the state's insurer of last resort for medical professional liability coverage and assume the task of providing that coverage itself through a special fund within the Department or through a separate entity in which the state and the state alone has an interest. Counsel for the Association concedes that the General Assembly has authority to do all of these things. What happens to the Association and to its private funds at that hypothetical juncture is not before this court. We do not speculate whether the Association might, for example, continue as a private insurer and offer ordinary medical professional liability or other types of insurance. We hold only that the Commonwealth cannot take the Association's private property in the manner contemplated by Act 41.

We reiterate what we observed in closing in JUA I: when it created the Joint Underwriting Association, the General Assembly chose to solve a public health problem through a private, nonprofit association, over which the Commonwealth retained limited control, in which the Commonwealth had no financial interest, and for which the Commonwealth bore no responsibility. The Commonwealth cannot legislatively recapture this private association for the purpose of accessing its assets. The provisions of Act 41 which attempt to accomplish that objective are violative of the Takings Clause of the Fifth Amendment to the United States Constitution.

We will grant summary and declaratory judgment and permanent injunctive relief to the Joint Underwriting Association. An appropriate order shall issue.

/S/ CHRISTOPHER C. CONNER
Christopher C. Conner, Chief Judge
United States District Court
Middle District of Pennsylvania

Dated: December 18, 2018

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Phantom Fireworks Showrooms, LLC, Sky King Fireworks of Easton, Inc., Sky King Fireworks of Erie, Inc., Sky King Fireworks of Morrisville, Inc., Sky King Fireworks of Tioga, LLC, CRJ Enterprises, LLC, Petitioners	:	
v.	:	No. 21 M.D. 2018 Argued: September 13, 2018
Tom Wolf, Governor of the Commonwealth of Pennsylvania, Russell C. Redding, Secretary of the Pennsylvania Department of Agriculture, C. Daniel Hassel, Secretary of the Pennsylvania Department of Revenue, Joseph B. Scarnati, III, Pro Tempore of the Senate of Pennsylvania, Mike Turzai, Speaker of the Pennsylvania House of Representatives, Respondents	:	

BEFORE: HONORABLE MARY HANNAH LEAVITT, President Judge
HONORABLE RENÉE COHN JUBELIRER, Judge
HONORABLE ROBERT SIMPSON, Judge
HONORABLE P. KEVIN BROBSON, Judge
HONORABLE PATRICIA A. McCULLOUGH, Judge
HONORABLE MICHAEL H. WOJCIK, Judge
HONORABLE ELLEN CEISLER, Judge

OPINION
BY JUDGE SIMPSON **FILED: December 4, 2018**

Before this Court, in our original jurisdiction, is a petition for review challenging the constitutionality of the Act of October 30, 2017, P.L. 672, No. 43 (Act 43).

Petitioners are Phantom Fireworks Showrooms, LLC; Sky King Fireworks of Easton, Inc.; Sky King Fireworks of Erie, Inc.; Sky King Fireworks of Morrisville, Inc.; Sky King Fireworks of Tioga, LLC; and CRJ Enterprises, LLC (collectively, Phantom Fireworks).

Respondents are Tom Wolf, Governor of Pennsylvania (Governor Wolf), Russell C. Redding, Secretary of the Pennsylvania Department of Agriculture (Secretary Redding), and C. Daniel Hassell, Secretary of the Pennsylvania Department of Revenue (Secretary Hassell)[1] (collectively, Executive Respondents); Joseph B. Scarnati, III, President Pro Tempore of the Senate of Pennsylvania (Senator Scarnati); and Mike Turzai, Speaker of the Pennsylvania House of Representatives (Speaker Turzai).

Executive Respondents jointly and Senator Scarnati and Speaker Turzai separately filed preliminary objections to the petition for review. Phantom Fireworks opposed the preliminary objections and filed an application for summary relief concerning its constitutional challenges, which all Respondents oppose. Both the preliminary objections and the application for summary relief have been briefed and argued. They are now before us for disposition.

I. Background

Act 43 originated as House Bill (HB) 542, Printer's Number (PN) 568 of 2017. The short bill read in its entirety:

[1] The case caption incorrectly lists Secretary Hassell as C. Daniel Hassel.

AN ACT

Amending the act of March 4, 1971 (P.L. 6, No. 2), entitled 'An act relating to tax reform and State taxation by codifying and enumerating certain subjects of taxation and imposing taxes thereon; providing procedures for the payment, collection, administration and enforcement thereof; providing for tax credits in certain cases; conferring powers and imposing duties upon the Department of Revenue, certain employers, fiduciaries, individuals, persons, corporations and other entities; prescribing crimes, offenses and penalties,' in sales and use tax, providing for remote sales tax notice.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. The act of March 4, 1971 (P.L. 6, No. 2), known as the Tax Reform Code of 1971, is amended by adding a section to read:

Section 279. Remote Sales Tax Notice. -- (a) A seller in this Commonwealth or remote seller shall conspicuously provide the following notice to a purchaser in this Commonwealth upon each separate sale at retail of tangible personal property or services via an Internet website operated by the seller or remote seller:

> 'Unless you paid Pennsylvania sales tax on this purchase, you may owe a Pennsylvania use tax on this purchase based on the total sales price of the purchase in accordance with the act of March 4, 1971 (P.L. 6, No. 2), known as the Tax Reform Code of 1971. Visit www.revenue.state.pa.us for more information. If you owe a Pennsylvania use tax on this purchase, you must report and remit the tax on your Pennsylvania income tax form.'

(b) The department shall impose a fine of not less than five dollars ($5) on a seller or remote seller for each sale in which the seller or remote seller is in violation of this section.

(c) This section shall apply to sales made on or after the effective date of this section.
Section 2. This act shall take effect in 60 days.

HB 542, PN 568.

HB 542 was amended several times. In its final form, enacted as Act 43, it contains voluminous additions concerning revenue issues beyond sales tax issues.[2] Relevant here, Article XXIV of Act 43 adds a new chapter to the Tax Reform Code,[3] relocating and modifying the provisions of the Fireworks Law.[4] The modifications include expansion of permissible fireworks sales to consumers, imposition of a 12% tax (including the 6% sales tax) on those sales, and permitting peak season sales of fireworks in tents and other temporary structures. Act 43 repeals the entire former Fireworks Law.

Among its provisions concerning fireworks sales in temporary structures, Act 43 provides that sales in temporary structures are governed by the safety standards in "NFPA 1124," defined as Standard 1124 in the 2006 edition of the National Fire Protection Association (NFPA) CODE FOR THE MANUFACTURE, TRANSPORTATION, AND STORAGE OF FIREWORKS AND PYROTECHNIC ARTICLES

[2] For example, Act 43 as enacted includes a section concerning tobacco settlement funds received by the Commonwealth.

[3] Act of March 4, 1971, P.L. 6, as amended, 72 P.S. §§9401-9416.

[4] The former law was Act of May 15, 1939, P.L. 134, as amended, 35 P.S. §§1271-1278.

(Code) "or any subsequent edition" of that Code. Pet. for Review, Ex. A at 33. This definition is significant to our reasoning below.

Phantom Fireworks asserts, and Respondents do not dispute, that NFPA 1124 has been amended in subsequent editions of the NFPA Code. According to Phantom Fireworks,[5] in the 2013 edition, NFPA Code 1124 was similar to the 2006 edition. However, the NFPA withdrew NFPA Code 1124 in 2014. The current edition of the NFPA Code, published in 2017, contains no safety standards for retail sales of consumer fireworks.

In the course of the various amendments to HB 542, its title also expanded substantially. In its final form, the title included the phrase "providing for fireworks," referring to Article XXIV of Act 43, titled simply "Fireworks." Pet. for Review, Ex. A at 2, 32.

II. Issues

Phantom Fireworks contends Act 43 violates the following several provisions of the Pennsylvania Constitution. Adding the provisions of the Fireworks Law, including its safety provisions, to the text of Act 43 violates the original purpose rule of Article III, Section 1. Similarly, by including provisions governing sundry subjects in addition to the original tax provision, Act 43 violates the single subject requirement of Article III, Section 3. By burying a short descriptor, "providing for fireworks," in its lengthy title, Act 43 also violates Article III, Section 3's requirement that a bill's title contain a clear expression of its subject matter.

[5] We recite the amendments as represented by Phantom Fireworks for background purposes only.

Further, by failing to set forth the entire text of the repealed Fireworks Law, Act 43 violates the repealed text publication requirement in Article III, Section 6. In addition, by providing that sales in temporary structures will be governed by NFPA standards in the 2006 or any subsequent edition, Act 43 impermissibly delegates legislative authority in violation of Article II, Section 1.

There is considerable overlap in the preliminary objections filed by the Executive Respondents, Senator Scarnati, and Speaker Turzai. The various preliminary objections allege failure to join the Commonwealth and the Attorney General as indispensable parties, lack of standing, improper inclusion of the Executive Respondents as parties, non-ripeness of Phantom Fireworks' claims, improper pleading of a request for relief as a separate count of the petition, and sovereign immunity of Executive Respondents.

Phantom Fireworks argues its claims present questions of law appropriate for resolution by summary relief. Respondents disagree that Phantom Fireworks is entitled to any relief, but they do not contend that summary disposition of the issues is inappropriate. In fact, Senator Scarnati asserts a counter-request for summary relief, seeking dismissal of all counts of the petition for review.

There is substantial overlap in the parties' briefing of issues relating to the preliminary objections and the request for summary relief. Accordingly, we dispose of all issues, including the preliminary objections, the request for summary relief, and the counter-application for summary relief, in a single decision.

III. Preliminary Objections[6]
A. Proper Parties
1. Nonjoinder of Indispensable Parties

A party is indispensable when its rights are so connected with the claims of the litigants that no relief can be granted without infringing on those rights. Pa. State Educ. Ass'n v. Pa. Dep't of Educ., 516 A.2d 1308 (Pa. Cmwlth. 1986) (citing Piper Aircraft Corp. v. Ins. Co. of N. Am., 417 A.2d 283 (Pa. Cmwlth. 1980)). Section 7540 of the Declaratory Judgments Act, 42 Pa. C.S. §7540(a), defines an indispensable party as any person who has or claims "any interest which would be affected by the declaration." Id. A Commonwealth agency whose interest will be affected by a declaration sought against another is an indispensable party. Pa. State Educ. Ass'n (citing Piper; Pleasant Twp. v. Erie Ins. Exch., 348 A.2d 477 (Pa. Cmwlth. 1975)).

Here, Senator Scarnati argues that both the Commonwealth and the Attorney General are indispensable parties whose nonjoinder deprives this Court of original jurisdiction. We disagree.

Both Pa. R.C.P. No. 235 and Pa. R.A.P. 521 state clearly that while a party challenging the constitutionality of a statute must notify the Attorney General of the challenge, the Attorney General may, but need not, intervene in order to be heard on the issue of constitutionality. See MCT Transp. v. Phila. Parking Auth., 60

[6] In ruling on preliminary objections, this Court accepts as true all well-pleaded allegations of material fact and all inferences reasonably deducible from those facts. Key v. Dep't of Corr., 185 A.3d 421 (Pa. Cmwlth. 2018). However, we need not accept unwarranted inferences, conclusions of law, argumentative allegations, or expressions of opinion. Id. For this Court to sustain preliminary objections, it must appear with certainty that the law will permit no recovery. Id. We resolve any doubt in favor of the non-moving party. Id.

A.3d 899 (Pa. Cmwlth.) (en banc), aff'd, 81 A.3d 813 (Pa. 2013), aff'd sub nom. MCT Transp. Inc. v. Phila. Parking Auth., 83 A.3d 85 (Pa. 2013) (Attorney General was not indispensable party in constitutional challenge where he received notice of petition for review and chose not to represent the Commonwealth). Moreover, if the Attorney General files a brief on the constitutional issue, the Commonwealth will thereafter be deemed an intervening party. If the Attorney General were an indispensable party, there would be no need either for intervention or for rules allowing the Attorney General to be heard without deciding to intervene. Similarly, if the Commonwealth were an indispensable party, there would be no need for a provision deeming the Commonwealth a party upon the Attorney General's decision to intervene.

As support for his argument, Senator Scarnati cites City of Philadelphia v. Commonwealth, 838 A.2d 566 (Pa. 2003) (Phila. I). Like this case, Phila. I concerned Article III constitutional challenges to the validity of a statute. However, "'the mere fact that a challenged statute may be declared unconstitutional does not, of itself, make the Commonwealth an indispensable party.'" Ballroom, LLC v. Commonwealth, 984 A.2d 582, 589 (Pa. Cmwlth. 2009) (quoting Pa. Sch. Bds. Ass'n v. Commonwealth Ass'n of Sch. Adm'rs., Teamsters Local 502, 696 A.2d 856, 867 (Pa. Cmwlth. 1997)).

Contrary to Senator Scarnati's representation, Phila. I does not stand for the proposition that the Attorney General is an indispensable party in an action challenging the constitutionality of a statute. To the contrary, although the Governor and the Secretary of the Commonwealth were parties in Phila. I, the Attorney

General was not a named party, and our Supreme Court expressly held that no other parties needed to be joined beyond those already participating in the action. Phila I. Moreover, although the Court observed that the Commonwealth was a named party, it did not hold that the Commonwealth was an indispensable party.

We conclude that neither the Commonwealth nor the Attorney General is an indispensable party. We overrule Senator Scarnati's preliminary objection in that regard.

2. Standing

Senator Scarnati asserts Phantom Fireworks lacks capacity to sue because it lacks standing to bring this action. Standing, a prerequisite to bringing a civil action, is a question of law. Fumo v. City of Phila., 972 A.2d 487 (Pa. 2009). Phantom Fireworks argues it has standing under both the traditional legal analysis and the limited exception to the general rule denying taxpayer standing to challenge the constitutionality of a statute. We agree.[7]

a. Traditional Standing Analysis

The concept of standing mandates that the party must have a substantial, direct, and immediate interest in the outcome of the litigation. Fumo. A substantial interest in the outcome of litigation is one that surpasses the common interest of all citizens in procuring obedience to the law. Pa. Fed'n of Dog Clubs v. Commonwealth, 105 A.3d 51 (Pa. Cmwlth. 2014) (citing Johnson v. Am. Standard,

[7] Speaker Turzai argues Phantom Fireworks lacks standing to challenge any provisions of Act 43 not related to fireworks. This apparently is an oblique reference to a provision concerning tobacco settlement funds. In light of our conclusion below relating to severability, we need not decide that issue.

8 A.3d 318 (Pa. 2010); Fumo). A direct interest requires a causal connection between the asserted violation and the harm complained of. Id. An interest is immediate when the causal connection is not remote or speculative. Id.

In Allegheny County v. Monzo, 500 A.2d 1096 (Pa. 1985), our Supreme Court affirmed standing based on the petitioner's economic disadvantage, where a county motel room tax burdened motels competing with out-of-county establishments. Motels throughout the county incurred increased tax expenses, but those near the county line could not easily recoup those expenses by raising room rates because of price competition from nearby motels across the county line not burdened by the county tax. Because the tax's operation significantly affected and harmed the in-county motels, they had standing to challenge the tax. Id.; see also William Penn Parking Garage, Inc. v. Pittsburgh, 346 A.2d 269 (Pa. 1975) (tax on public parking, although ostensibly imposed on parking patrons, was causally linked to harm to parking garage operators' businesses, giving them standing to challenge the tax).

Similarly, here, Phantom Fireworks alleges it must compete for sales with vendors in temporary structures having much lower overhead than brick and mortar facilities. Having, in addition, lower licensing fees and little or no expense for safety features under Act 43, those vendors have a cost advantage, and thus a competitive pricing advantage. Phantom Fireworks' pricing disadvantage constitutes significant, direct harm and therefore confers standing to challenge Act 43. See Monzo; William Penn Parking.

b. Taxpayer Standing

In addition, Phantom Fireworks argues it has standing as a taxpayer, separate from its standing under the traditional analysis. In general, status as a taxpayer does not alone confer standing to challenge the constitutionality of a statute. Stilp v. Gen. Assembly, 940 A.2d 1227 (Pa. 2007) (Stilp III) (citing Application of Biester, 409 A.2d 848 (Pa. 1979)). However, an exception to the general rule provides standing to a taxpayer who demonstrates a stronger interest in the litigation than that of other taxpayers. Id. This exception arises from a public policy of enabling the citizenry to assert statutory challenges that might otherwise be prevented by standing issues. Id.; see also Pittsburgh Palisades Park, LLC v. Commonwealth, 888 A.2d 655 (Pa. 2005).

Taxpayer standing requires the party asserting it to satisfy five factors:

> (1) the governmental action would otherwise go unchallenged;
>
> (2) those directly and immediately affected by the complained of matter are beneficially affected and not inclined to challenge the action;
>
> (3) judicial relief is appropriate;
>
> (4) redress through other channels is unavailable; and
>
> (5) no other persons are better situated to assert the claim.

Pa. Dog Clubs, 105 A.3d at 58 (quoting Pittsburgh Palisades, 888 A.2d at 662; Consumer Party of Pa. v. Commonwealth, 507 A.2d 323, 329 (Pa. 1986), overruled on other grounds, Pennsylvanians Against Gambling Expansion Fund, Inc. v.

Commonwealth, 877 A.2d 383 (Pa. 2005) (PAGE)) (internal quotation marks and footnote omitted).

Here, Phantom Fireworks meets all five requirements for taxpayer standing. The absence of other civil actions concerning Act 43's constitutionality suggests it will go unchallenged if Phantom Fireworks is denied standing. See Pa. Dog Clubs. The other entities directly affected by Act 43 are the vendors selling fireworks in temporary structures, which benefit from the expansion of legally permissible product lines, without the concomitant expense of safety features Phantom Fireworks must provide in its brick and mortar stores. Thus, the vendors using temporary structures will not be inclined to challenge the amendment to Act 43. Id. Judicial relief is proper because determining the constitutionality of a statute is a judicial duty. Id. No reasonably available alternate channel to challenge Act 43 is apparent. Id. Because Phantom Fireworks purportedly holds the largest market share of fireworks sales in Pennsylvania (at least until the enactment of Act 43), it appears no other entity adversely affected by Act 43 is better situated to challenge the constitutionality of its fireworks provisions. None of the parties pointed to any such entity.[8]

Accordingly, Phantom Fireworks has standing alternately under the taxpayer standing exception.

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[8] Unlike in Pittsburgh Palisades Park, LLC v. Commonwealth, 888 A.2d 655 (Pa. 2005), on which Executive Respondents rely, nothing in the pleadings here suggests a special interest among legislators in challenging Act 43. Executive Respondents do not contend Act 43 was "contested hotly" before its enactment, nor that any provision of Act 43 "strips the General Assembly and [its] successors of the ability to amend [Act 43's] provisions." Id. at 662.

3. Executive Respondents as Parties

Executive Respondents argue they are not proper parties to this action. We agree as to Governor Wolf, but disagree as to the other Executive Respondents.

Phantom Fireworks and Executive Respondents agree that in accordance with Allegheny Sportsmen's League v. Ridge, 790 A.2d 350 (Pa. Cmwlth. 2002), the Governor is not a necessary party to a declaratory judgment action challenging the constitutionality of a statute where the head of the executive agency responsible for implementing and defending that statute is already a party. See also Leonard v. Thornburgh, 467 A.2d 104 (Pa. Cmwlth. 1983) (en banc) (Governor not required to participate in action challenging constitutionality of tax statute, where Secretary of the Department of Revenue was a party and represented Governor's interests; avoiding unnecessary duplication of parties was more efficient and expeditious). Further, Governor Wolf is not an indispensable party merely because he signed the challenged statute into law. Howard v. Commonwealth, 957 A.2d 332 (Pa. Cmwlth. 2008) (citing Pa. Sch. Bds. Ass'n).

Here, as Executive Respondents correctly observe, the Department of Revenue is responsible for receiving the tax funds generated under Act 43. The Department of Agriculture is responsible for the licensing and inspection duties set forth in Article XXIV (pertaining to fireworks), the portion of Act 43 at issue. Both Secretary Redding and Secretary Hassell are named parties. Therefore, Governor Wolf is not a necessary party.

However, we discern no merit in Executive Respondents' argument that Secretary Hassell and Secretary Redding should be dismissed from this action. As discussed above, Allegheny Sportsmen's League and Leonard support retaining as parties the heads of administrative agencies responsible for implementing a statute and defending it against constitutional challenges.

Stilp v. Commonwealth, 910 A.2d 775 (Pa. Cmwlth. 2006), aff'd, 974 A.2d 491 (Pa. 2009) (Stilp II), cited by Executive Respondents, does not support their argument. This Court in Stilp II concluded the determination of proper parties in that case was governed by Phila. I. In turn, Phila. I included participation as parties by both legislative and executive branch respondents. Moreover, the Stilp II action included both the Governor and the state Treasurer among the respondents, in addition to state legislative leaders. The discussion of necessary parties focused on whether additional legislators should be required, not whether the executive parties were indispensable.

Accordingly, we determine that Governor Wolf is not a necessary party, because the heads of the two administrative agencies charged with implementing and defending the provisions of Article XXIV of Act 43 are already parties. We dismiss Governor Wolf from this action. However, Secretary Hassell and Secretary Redding are necessary parties, and we will not dismiss them from the action.

B. Ripeness

Speaker Turzai further contends Phantom Fireworks' claim seeking declaratory and injunctive relief is not ripe. We discern no merit in this argument.

"[T]he doctrine of ripeness concerns the timing of a court's intervention in litigation." Phila. Entm't & Dev. Partners, L.P. v. City of Phila., 937 A.2d 385, 392 (Pa. 2007). "The basic rationale underlying the ripeness doctrine is 'to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements.'" Id. (quoting Abbott Labs v. Gardner, 387 U.S. 136, 148 (1967)).

However, the Declaratory Judgments Act, 42 Pa. C.S. §§7531-7541, provides a relatively lenient standard for ripeness in declaratory judgment actions. The Declaratory Judgments Act is remedial in nature. 42 Pa. C.S. §7541(a). "Its purpose is to settle and to afford relief from uncertainty and insecurity with respect to rights, status, and other legal relations, and is to be liberally construed and administered." Id. An action is ripe for adjudication under the Declaratory Judgments Act where it presents "the ripening seeds of a controversy." Wecht v. Roddey, 815 A.2d 1146, 1150 (Pa. Cmwlth. 2002).

Here, Phantom Fireworks alleges it is already experiencing business losses arising from competition by transient vendors. Further, as Act 43 expressly authorizes sales by such vendors, Phantom Fireworks has no legal recourse to recover its business losses from them. It can only hope to address such losses going forward by means of this lawsuit. Phantom Fireworks' challenge to Act 43 is therefore ripe for adjudication.

This Court's decision in City Council of Philadelphia ex. rel. City of Philadelphia v. Commonwealth, 806 A.2d 975 (Pa. Cmwlth. 2002) (Phila. II), vacated and remanded, 847 A.2d 55 (Pa. 2004), on which Speaker Turzai relies, is distinguishable. In Phila. II, the petition did not allege any loss of revenue, and any future loss would be recoverable through normal legal channels. Moreover, and of significance, our Supreme Court vacated and remanded the matter for a decision on the merits, rejecting this Court's initial conclusion that the controversy was not ripe.

Philadelphia Entertainment is likewise distinguishable. In that case, the petitioner challenged the constitutionality of a zoning ordinance that had not been enforced or applied. By contrast, Act 43 is a taxing statute, and its provisions are in force. Moreover, the authorized sale of fireworks in temporary structures, the main target of Phantom Fireworks' petition, has occurred. As stated above, Phantom Fireworks alleges in its pleading that it is already suffering losses in sales because of the competitive edge Act 43 gives to transient competitors.[9]

We conclude this case is ripe for adjudication.

C. Failure to Answer Preliminary Objections

Phantom Fireworks did not file an answer to any of the preliminary objections, although it briefed its opposition to them. Senator Scarnati argues that the lack of a responsive pleading by Phantom Fireworks entitles him to prevail by

[9] The other two authorities Speaker Turzai cites in his ripeness discussion are inapt because they do not involve ripeness, but rather, mootness. See In re Gross, 382 A.2d 116 (Pa. 1978); Harris v. Rendell, 982 A.2d 1030 (Pa. Cmwlth. 2009), aff'd per curiam, 992 A.2d 121 (Pa. 2010).

default regarding his preliminary objections asserting failure to join necessary parties and lack of capacity to sue (standing).[10]

Pa. R.C.P. No. 1028(a)(5) includes lack of capacity to sue and nonjoinder of a necessary party among the bases for preliminary objections. Pa. R.C.P. No. 1028(c)(2) suggests these categories of preliminary objections "cannot be determined from facts of record." Therefore, if the respondent filing preliminary objections endorses them with a notice to plead, the petitioner must file a response, to the extent required under Pa. R.C.P. No. 1029.

Senator Scarnati endorsed his preliminary objections with a notice to plead. Therefore, we must determine whether Rule 1029 required Phantom Fireworks to file a responsive pleading on the issues of nonjoinder and standing.

Rule 1029 governs the effect of failure to deny averments in a pleading. Pa. R.C.P. No. 1029(a) requires the responding party to admit or deny each averment of fact in the preceding pleading. "Averments in a pleading to which a responsive pleading is required are admitted when not denied specifically or by necessary implication." Pa. R.C.P. No. 1029(b). By contrast, "[a]verments in a pleading to which no responsive pleading is required shall be deemed to be denied." Pa. R.C.P. No. 1029(d). Thus, whether Phantom Fireworks had to file a responsive pleading admitting or denying Senator Scarnati's preliminary objections concerning

[10] Senator Scarnati also demurred to all counts of the petition for review. He does not assert that Phantom Fireworks had any obligation to answer the averments of the preliminary objections comprising the demurrers.

indispensable parties and standing depends on whether those preliminary objections contained averments of fact.

Phantom Fireworks insists it did not need to answer Senator Scarnati's preliminary objections concerning nonjoinder and standing because they "contain no facts as to which a responsive pleading was required or could possibly have been useful." Pet'rs' Br. at 27. We agree.

Our review of Senator Scarnati's preliminary objections reveals that those asserting nonjoinder of a necessary party and lack of standing aver only conclusions of law, not disputed facts. See Preliminary Objections by Respondent Senator Joseph B. Scarnati, III ¶¶6-22. Accordingly, Phantom Fireworks did not have to respond to those averments.[11] Rather, they are deemed denied under Pa. R.C.P. No. 1029(d).

D. Failure to Brief Immunity Defense

In their preliminary objections, Executive Respondents raised the defense of sovereign immunity. However, Phantom Fireworks asserts Executive

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[11] In his preliminary objection relating to necessary parties, Senator Scarnati also argued Phantom Fireworks failed to provide notice to the Attorney General of Pennsylvania that it was challenging the constitutionality of a statute. We observe that a notice to the Attorney General is attached to the petition for review. Moreover, Senator Scarnati did not brief that issue. Therefore, he has waived it. Triage, Inc. v. Pa. Dep't of Transp., 537 A.2d 903 (Pa. Cmwlth. 1988).

In any event, waiver is not a mandatory sanction for failure to give the requisite notice to the Attorney General; rather, the court may stay the action to allow notice and time for the Attorney General to be heard, or may simply proceed without a response from the Attorney General. See Pa. R.C.P. No. 235; Mosley v. Pittsburgh Pub. Sch. Dist., Civ. Action No. 07-1560, 2008 U.S. Dist. LEXIS 42189 (W.D. Pa. May 27, 2008).

Respondents waived that preliminary objection because they did not brief the issue of sovereign immunity in support of their preliminary objections. We agree. A party waives a preliminary objection it does not support in its brief. Triage, Inc. v. Pa. Dep't of Transp., 537 A.2d 903 (Pa. Cmwlth. 1988). We therefore overrule Executive Respondents' preliminary objection asserting sovereign immunity.[12]

E. Separate Count Asserting Request for Relief

Senator Scarnati moves to strike Count V pursuant to Pa. R.C.P. No. 1020(a), arguing it is not a cause of action, but merely a request for relief. This argument is without merit.

Pa. R.C.P. No. 1020(a) requires: "Each cause of action and any special damage related thereto shall be stated in a separate count containing a demand for relief." Thus, on its face, Rule 1020(a) only requires that a cause of action and any related "special damage" must be stated in the same count.

The Pennsylvania Rules of Civil Procedure do not define "special damage." However, Pennsylvania courts apply "special damage" to mean calculable monetary losses, such as out-of-pocket expenses. See, e.g., McGlawn v. Pa. Human Relations Comm'n, 891 A.2d 757, 775-76 (Pa. Cmwlth. 2006) (including in "special damages" specific fees, premiums, and interest, but not embarrassment and humiliation); Agriss v. Roadway Express, Inc., 483 A.2d 456, 474 (Pa. Super. 1984) (equating "special damages" with "concrete economic loss computable in dollars").

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[12] We note, however, that notwithstanding a waiver of the immunity defense in connection with preliminary objections, a party may still reassert that defense in its answer, if any, to the petition for review, following disposition of the preliminary objections. Triage.

A request for injunctive relief is equitable in nature. It is the antithesis of a legal claim for calculable money damages. Therefore, we conclude Rule 1020(a) is inapplicable to a demand for declaratory and injunctive relief.

Moreover, when considering preliminary objections regarding claims seeking equitable relief, this Court has discretion to disregard pleading imperfections. See Nagle v. Pa. Ins. Dep't, 406 A.2d 1229 (Pa. Cmwlth. 1979), rev'd in part on other grounds sub nom. Pechner v. Pa. Ins. Dep't, 452 A.2d 230 (Pa. 1982). To the extent Count V may be deemed defective, we disregard any such defect here. In light of our disposition of the other preliminary objections and the application for summary relief, any pleading defect is immaterial. Therefore, we deny the motion to strike.

IV. Request for Summary Relief

Pa. R.A.P. 1532(b) allows this Court to enter judgment upon application any time after the filing of a petition for review, when the applicant's right to relief is clear. Taglienti v. Dep't of Corr., 806 A.2d 988 (Pa. Cmwlth. 2002). We may grant summary relief where the dispute is legal rather than factual, but not where there are disputes of fact. Id. (citing Milton S. Hershey Med. Ctr. v. Commonwealth, 788 A.2d 1071 (Pa. Cmwlth. 2001)). We review the record in the light most favorable to the opposing party and resolve all doubts concerning the existence of a genuine issue of material fact in favor of that party. Taglienti (citing P.J.S. v. Pa. State Ethics Comm'n, 723 A.2d 174 (Pa. 1999)).

An application for summary relief is appropriate where a party asserts a challenge to the constitutionality of a statute and no material facts are in dispute.

Phila. Fraternal Order of Corr. Officers v. Rendell, 701 A.2d 600 (Pa. Cmwlth. 1997) (citing Magazine Publishers v. Dep't of Revenue, 618 A.2d 1056 (Pa. Cmwlth. 1992), aff'd, 654 A.2d 519 (Pa. 1995)).

Here, our review of the various Respondents' briefs reveals no dispute of fact. The parties argue solely questions of law relating to the constitutionality of Act 43. Therefore, consideration of Phantom Fireworks' request for summary relief concerning its constitutional challenges is appropriate at this time.

A. Legal Standard of Constitutionality

"[I]n interpreting a constitutional provision, we view it as an expression of the popular will of the voters who adopted it, and, thus, construe its language in the manner in which it was understood by those voters." Washington v. Dep't of Pub. Welfare, 188 A.3d 1135, 1149 (Pa. 2018) (citing Stilp v. Commonwealth, 905 A.2d 918 (Pa. 2006) (Stilp I)). "[W]e do not consider such language in a 'technical or strained manner, but are to interpret its words in their popular, natural and ordinary meaning.'" Id. (quoting Scarnati v. Wolf, 173 A.3d 1110, 1118 (Pa. 2017)). "'[W]e must favor a natural reading which avoids contradictions and difficulties in implementation, which completely conforms to the intent of the framers and which reflects the views of the ratifying voter.'" Id. (quoting In re Bruno, 101 A.3d 635, 659 (Pa. 2014); Commonwealth ex rel. Paulinski v. Isaac, 397 A.2d 760, 766 (Pa. 1979)). "'[O]ur ultimate touchstone is the actual language of the Constitution itself.'" Id. (quoting Stilp I, 905 A.2d at 939).

There is a strong presumption in the law that legislative enactments are constitutional. Christ the King Manor v. Dep't of Pub. Welfare, 911 A.2d 624 (Pa.

Cmwlth. 2006) (en banc), aff'd per curiam, 951 A.2d 255 (Pa. 2008) (citing PAGE). A court will not declare a statute unconstitutional unless the constitutional violation is clear, palpable, and plain. Id. The court will resolve all doubts in favor of constitutionality. Id. Thus, a party challenging the constitutionality of a statute has a heavy burden of persuasion. Id.

B. Article III Challenges

1. Background and Purpose of Article III

When interpreting the Pennsylvania Constitution, courts consider both the circumstances surrounding enactment of its provisions and the probable construction the voters placed on it. Washington (citing Scarnati). In Washington, our Supreme Court examined the historical and legal background of Article III of the Pennsylvania Constitution, as well as the fundamental purposes the voters intended the provisions of Article III to serve. See id.

In the period during and after the Civil War, special interest legislation was commonplace, enabled by abuses and insufficient controls in the legislative process. Id. Deceptive titles of bills, mixing disparate subjects in omnibus legislation, and hasty amendments without notice to lawmakers, all caused the voters to lose faith in the General Assembly's performance of its constitutional mandate to represent their interests. Id. Consequently, in 1873, an overwhelming majority of voters approved a constitutional convention so that amendments to the Pennsylvania Constitution could address these abuses. Id. Article III was a product of that convention. Id. "[T]he overarching purpose of [the] restrictions on the legislative process contained in Article III was to furnish essential constitutional safeguards to ensure our Commonwealth's government is open, deliberative, and accountable to the people it serves." Id. at 1147. "[A]s these provisions are mandatory constitutional directives from the people, not mere advisory guidelines, the General Assembly must comply with them in the course of the legislative process." Id.

Article III, Section 1 provides: "No law shall be passed except by bill, and no bill shall be so altered or amended, on its passage through either House, as to change its original purpose." PA. CONST. art. III, §1. The objective of Article III, Section 1 was to halt the practice of adding, at various stages of the legislative process, provisions unrelated to a bill's original purpose. Washington. By eliminating such stealth tactics, legislators considering the bill would have sufficient notice of all its provisions and could cast informed votes. Id. Article III, Section 1 is unchanged since its enactment in 1874. Id.

Article III, Section 3 provides: "No bill shall be passed containing more than one subject, which shall be clearly expressed in its title, except a general appropriation bill or a bill codifying or compiling the law or a part thereof." PA. CONST. art. III, §3. Article III, Section 3 serves the dual purposes of preventing enactment of laws that could not pass on their own, and promoting thorough scrutiny of single subject bills. Pa. State Ass'n of Jury Comm'rs v. Commonwealth, 64 A.3d 611 (Pa. 2013).

Our Supreme Court recognizes that the nature of the legislative process includes some changes as a bill passes through each house in the General Assembly. Washington. In considering constitutional challenges under Article III, Sections 1 and 3 (as well as 4),[13] courts apply a "germaneness" analysis. Id. at 1151. "This test requires examination of the original subject of the bill and then a determination of whether 'the amendments to the bill added during the legislative process are germane to and do not change the general subject of the bill.'" Id. (quoting Stilp I, 905 A.2d at 959; Pa. Sch. Bds. Ass'n v. Commonwealth Ass'n of Sch. Adm'rs, 805 A.2d 476, 488 (Pa. 2002)). "Amendments are germane to the original general subject matter of a bill if both the subject of the amendments and the subject of the original contents of the bill 'have a nexus to a common purpose.'" Id. (quoting Commonwealth v. Neiman, 84 A.3d 603, 612 (Pa. 2013)). "In other words, the subject of the amendments and the subject of the original bill language must constitute 'a unifying scheme to accomplish a single purpose.'" Id. (quoting Neiman, 84 A.3d at 612; Phila. I, 838 A.2d at 589). "In making this determination, a reviewing court may hypothesize a 'reasonably broad' unifying subject; however such a hypothetical subject cannot be unduly expansive, lest the purpose of the constitutional provision be defeated." Id. at 1152 (quoting Phila. I, 838 A.2d at 589).

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[13] Phantom Fireworks does not challenge Act 43 on the basis of Article III, Section 4, the section at issue in Washington v. Department of Public Welfare, 188 A.3d 1135 (Pa. 2018). However, our Supreme Court's recent analysis of Article III, Section 4 in Washington is directly applicable in this case:

> Our [Supreme] Court utilizes the same germaneness test [used in analyzing Article III, Section 4 challenges] to determine whether the manner of passage of a bill violates Article III, Section 1 and Article III, Section 3; thus a finding that amendments to a bill made during the legislative process are not germane to the subject of its original provisions will also support a determination that the bill's passage violated these constitutional provisions as well.

Id. at 1151 n.33 (citing Stilp v. Commonwealth, 905 A.2d 918, 919 (Pa. 2006); Pennsylvanians Against Gambling Expansion Fund, Inc. v. Commonwealth, 877 A.2d 383, 410 (Pa. 2005)). We note that our Supreme Court decided Washington after all briefing of the preliminary objections and application for summary relief in this case was complete.

2. Phantom Fireworks' Article III Challenges

a. Original Purpose of Bill

The original bill that eventually became Act 43 was HB 542. That short bill contained only a proposed amendment adding a section to the Tax Reform Code that required remote sellers to notify Pennsylvania buyers of their sales and use tax obligations, and imposed fines for failure to do so.

As ultimately enacted, Act 43 contained voluminous additions to HB 542, including Article XXIV, Fireworks, the article challenged here by Phantom Fireworks. Thus, the changes made to the original bill were extensive. However, in hypothesizing reasonably broad purposes for legislative bills, our Supreme Court has viewed extensive amendments as still within the overarching purposes of the original bills.

In Stilp I, the original bill's only provision sought to assure that the Governor would be the highest-paid executive officer in the Commonwealth. Id. Subsequent voluminous additions to the bill prior to its passage added significant raises in compensation to the judiciary and the General Assembly, as well as to high-ranking executive officers. Id. Our Supreme Court rejected an original purpose challenge to the bill as passed. The Court found both the original bill and the final version as amended related to the overarching subject of compensation for government officials. Id.

In PAGE, the original bill would merely have allowed police to perform criminal background checks and fingerprinting of persons in the horse racing industry. Id. As finally enacted, the bill was more than 140 times longer than its original form and included provisions authorizing and regulating slot machines within the Commonwealth. Id. Our Supreme Court found no violation of Article III, Section 1. The Court determined both the original and final versions of the bill related to the regulation of gambling. Id.

This Court likewise views a bill's original purpose broadly. In City of Philadelphia v. Rendell, 888 A.2d 922 (Pa. Cmwlth. 2005), the original bill revised residency requirements for parking authority members, clarified police officers' voting rights, and authorized municipalities to remove fluoride from their drinking water. The final bill mandated that the parking authority would continue administering and enforcing on-street parking regulations, and that net parking revenues would be directed to the Philadelphia School District. Id. The original provisions concerning police officers' voting rights and removal of fluoride from municipal water supplies were not in the final bill. Id. Nonetheless, this Court rejected an original purpose challenge to the constitutionality of the final bill as enacted. We concluded that both the original and final versions of the bill served the same overarching purpose of regulating parking authorities. Id.

This Court also rejected an original purpose challenge in Common Cause v. Commonwealth, 710 A.2d 108 (Pa. Cmwlth. 1998), aff'd per curiam, 757 A.2d 367 (Pa. 2000). There, the original bill contained only provisions regarding seasonal registrations of vehicles. As amended, the final bill contained voluminous additions concerning vehicle registration fees, highway maintenance funding allocations, trucking regulations, fuel taxes, and laws governing mass transit. Id.

We determined the original and final versions of the bill related to the same general subject, vehicular transportation. Id.

Here, Phantom Fireworks argues Act 43's fireworks provisions pertain mainly to health and safety rather than taxes. However, the decisions above demonstrate that neither the volume of the additions to the original bill nor the expansion of the subject matter's parameters will give rise to a violation of Article III, Section 1, provided the original and final versions fall under the same broad, general subject area. Consistent with the decisions discussed above, we conclude that the broad overarching purpose of both original HB 542 and the final version as passed by the General Assembly is taxation and revenue generation.

Therefore, we discern no violation of Article III, Section 1.

b. Single Subject and Clear Title Requirements

As discussed above, there were two legislative practices that the framers and the electorate sought to eliminate with their adoption of Article III, Section 3. The first involved the insertion into a single bill of a number of distinct and independent subjects of legislation in order to deliberately hide the real purpose of the bill. Washington; Leach v. Commonwealth, 118 A.3d 1271 (Pa. Cmwlth. 2015), aff'd, 141 A.3d 426 (Pa. 2016). The second was the practice of "logrolling," which involves "embracing in one bill several distinct matters, none of which could singly obtain the assent of the legislature, and procuring its passage by combining the minorities who favored the individual matters to form a majority that would adopt them all." Leach, 118 A.3d at 1279 (quoting Neiman, 84 A.3d at 611). "[T]he single-subject requirement prevents the attachment of riders that could not become law on their own to popular bills that are certain to pass." Id.

Accordingly, our Supreme Court interprets Article III, Section 3 as mandating that a final bill enacted by the General Assembly meet two specific criteria: "First, the title of the bill must clearly express the substance of the proposed law. [Phila. I] Second, the differing topics within the bill must be 'germane' to each other …." Jury Comm'rs, 64 A.3d at 616; see Neiman, 84 A.3d at 612 (quoting Jury Comm'rs).

Here, Petitioners contend Act 43 does not satisfy either criterion. We disagree.

i. Single Subject Requirement

Guided by the principles our Supreme Court articulated in Washington and Neiman, we cannot conclude that Act 43 clearly, palpably and plainly violates the single subject requirement set forth in Article III, Section 3 of the Pennsylvania Constitution. Although Act 43 includes provisions relating to taxation, fireworks, and tobacco settlement revenue, they all fall within the single unifying subject of revenue generation. Accord PAGE, 877 A.2d at 396 (unifying subject of "regulation of gaming" was sufficient to satisfy Article III, Section 3's single subject requirement); Christ the King Manor, 911 A.2d at 635 (unifying subject of "regulation of publicly funded healthcare services" was sufficient to satisfy Article III, Section 3's single subject requirement).

Act 43's fireworks provisions include a new 12% consumer fireworks tax, as well as seller application and licensing fees. Pet. for Review, Ex. A at 37. The insertion of additional fireworks-related provisions does not destroy the overarching purpose of taxation and generating revenue.

Further, our Supreme Court directs that "where the provisions added during the legislative process assist in carrying out a bill's main objective, or are otherwise 'germane' to the bill's subject as reflected in the title, the requirements of Article III, Section 3 are met." PAGE, 877 A.2d at 395.

While certain provisions related to the regulation of fireworks may not directly relate to taxation, those provisions undoubtedly "assist in carrying out" Act 43's "main objective," which is revenue generated from an expanded and modernized fireworks market. Stated differently, Act 43 adds a new tax rate for fireworks, distributes tax revenue from the sale of fireworks, broadens the tax base by expanding fireworks sales, and attempts to ensure that tax revenues from fireworks sales are generated safely.

There are other constitutional issues related to Act 43, as discussed below. However, for these reasons, we discern no violation of Article III, Section 3's single subject requirement.

ii. Clear Expression of Title Requirement

"Although Article III, Section 3 mandates that a bill's subject be set forth in its title, it does not require a title to be an index or a synopsis of the bill's contents." Christ the King Manor, 911 A.2d at 635 (citing PAGE); see also

DeWeese v. Weaver, 824 A.2d 364, 372 (Pa. Cmwlth. 2003) (en banc) ("The title serves as a signal not a précis of the bill's contents."). "Indeed, to require the title to catalogue every provision of a bill might not only make the title unworkably long, but might foster the very problems that the requirement was meant to prevent." PAGE, 877 A.2d at 405-06. As this Court explained,

> Article III, Section 1 was not intended to tyrannize legislators with pedantic and picayune standards for drafting a bill's title. Commonwealth v. Stofchek, [185 A. 840 (Pa. 1936)]. The focus should be on the substance of the bill, not its title. The constitutional mandate is intended only to prevent fraudulent efforts to sneak legislation past unknowing legislators or the Governor. Id. In short, as difficult as it may be to have a statute declared unconstitutional for failing to clear the low fence of germaneness, it is that much harder to set aside a statute for the reason that it moved through the legislative process under a deceptive title.

DeWeese, 824 A.2d at 372 n.15.

A party challenging constitutionality under Article III, Section 3's "clear expression of title" requirement must show "either (1) that the legislators and the public were actually deceived as to the act's content at the time of passage, or (2) that the title on its face is such that no reasonable person would have been on notice as to the act's contents." Christ the King Manor, 911 A.2d at 635 (emphasis in original).

Here, as Phantom Fireworks acknowledges, the title of Act 43 includes an indication that it is "providing for fireworks." Pet. for Review, Ex. A at 1. The petition for review fails to aver or show that legislators or members of the public were actually deceived as to Act 43's contents at the time of passage. Therefore, Phantom Fireworks does not satisfy the first prong of a clear title analysis. See Christ the King Manor.

In applying the second prong of a clear title analysis, we likewise examine the title at the time of passage. Here, we conclude that the final title of Act 43, expressly listing "providing for fireworks" among the primary topics covered within the bill, Pet. for Review, Ex. A at 1, sufficiently places reasonable persons on notice as to the contents of Act 43. See PAGE. Contrary to Phantom Fireworks' assertion, nothing more is required. Id. at 406 ("a title does not need to express each and every subtopic contained in the bill …").

The decisions relied on by Phantom Fireworks, Sears v. Corbett, 49 A.3d 463 (Pa. Cmwlth. 2012), rev'd and vacated sub nom. Sears v. Wolf, 118 A.3d 1091 (Pa. 2015) and Provident Life & Trust Co. v. Hammond, 79 A. 628 (Pa. 1911), do not compel a different result. Ruling on preliminary objections in Sears, this Court determined that two acts redirecting tobacco settlement monies violated Article III, Section 3's clear expression of title requirement. On further appeal, however, our Supreme Court reversed, and also expressly "vacated" this Court's "opinions on preliminary objections and summary relief," including our discussion regarding Article III, Section 3. Sears v. Wolf, 118 A.3d at 1105 (emphasis added). Thus, Phantom Fireworks cannot rely on that decision in support of its arguments here.[14]

[14] We admonish litigants from citing vacated opinions without fully acknowledging negative subsequent history.

In Hammond, the Supreme Court held that the title of a 1907 amendatory enactment was defective because the date of approval of the original act, as recited in the title of the amending act, was incorrect. There was no such act of the date specified; therefore, the title was fatally defective. Hammond is inapposite here; this case does not involve the title of a statute referencing another statute that does not exist.

For these reasons, we see no violation of Article III, Section 3's clear expression of title requirement.

c. Repealed Text Requirement

Act 43 expressly repealed the former Fireworks Law, 35 P.S. §§1271-78. Citing PAGE, Phantom Fireworks contends the General Assembly's failure to include in Act 43 the entire text of the Fireworks Law, in brackets, violated the requirement of Article III, Section 6 of the Pennsylvania Constitution that "no law shall be revived, amended, or the provisions thereof extended or conferred, by reference to its title only, but so much thereof as is revived, amended, extended or conferred shall be re-enacted and published at length." PA. CONST. art. III, §6.

Our Supreme Court's decision in PAGE applies generally to Article III constitutional issues. See Christ the King Manor. Pertinent here, the statute at issue in PAGE repealed a section of an earlier statute. The repeal provision simply referred to the repealed statute by its citation and popular name. The new statute did not contain the repealed language in brackets. The Court observed that Article III aims to require full notice of all proposed legislative enactments, so legislators and the public can see exactly what changes are under consideration, without the need to refer back to the prior version for comparison. PAGE. Therefore, the Court concluded, "Article III, [S]ection 6 requires, with regard to a directed, specific repealer, the effectuation of which is not otherwise apparent from the associated bill, that as much of the law that is expressly repealed by the bill must be published at length." Id. at 412.

However, in Christ the King Manor, this Court sustained a demurrer to a constitutional challenge similar to Phantom Fireworks' repealed text challenge here. The petitioners challenged the constitutionality under Article III, Section 6 of a statutory amendment altering the scope of permissible regulations concerning nursing care reimbursements during a specified period. In that case, the amendment did not contain a specific repeal of the prior law. This Court found the petition failed to state an Article III, Section 6 claim for two reasons. First, the new amendment was more "in the nature of a temporary inconsistency rather than the directed, specific repeal or amendment which is the subject of the constitutional provision." Id. at 639. Second, and of significance here, the petitioners did not allege that any member of the General Assembly was misled by the absence of the entire text of the prior law. Id. Based on that reasoning and the strong presumption of constitutionality accorded a statute, this Court agreed with the respondents in Christ the King Manor that the petitioners failed to present a viable constitutional challenge to the defective repeal. Id.

Here, the repealer at issue is substantially similar to that in PAGE. However, Phantom Fireworks, like the petitioners in Christ the King Manor, failed to allege that anyone was misled by the absence of the full text of the Fireworks Law in brackets within Act 43. In light of the presumption of constitutionality and our disposition of the other issues in this case, we deny summary relief on this issue.

C. Delegation of Legislative Authority

Phantom Fireworks challenges Act 43's definition of a "temporary structure" as including "temporary retail sales stands, tents, canopies and membrane structures meeting the specifications of NFPA 1124." Act 43 defines "NFPA 1124" as "The National Fire Protection Association Standard 1124, [CODE FOR THE MANUFACTURE, TRANSPORTATION, AND STORAGE OF FIREWORKS AND PYROTECHNIC ARTICLES], 2006 edition, or any subsequent edition." Pet. for Review, Ex. A at 33 (emphasis added). Phantom Fireworks argues that regulating temporary structures by reference to NFPA 1124, as Act 43 defines that term, constitutes an unconstitutional delegation of legislative authority by the General Assembly. We are constrained to agree.

Our Supreme Court's decision in Protz v. Workers' Compensation Appeal Board (Derry Area School District), 161 A.3d 827 (Pa. 2017) controls the delegation issue in this case. At issue in Protz was a provision of the Workers' Compensation Act[15] relating to impairment rating evaluations (IREs) of workers' compensation claimants. Section 306(a.2) of the Workers' Compensation Act, 77 P.S. §511.2(1),[16] required physicians performing IREs to apply the methodology provided in "the most recent edition" of the American Medical Association [AMA] GUIDES TO THE EVALUATION OF PERMANENT IMPAIRMENT (GUIDES). Protz, 161 A.3d

[15] Act of June 2, 1915, P.L. 735, as amended, 77 P.S. §§1-1041.4, 2501-2708.

[16] Added by Act of June 24, 1996, P.L. 350.

at 830 (quoting 77 P.S. §511.2(1)). The Court found this statutory provision violated Article II, Section 1 of the Pennsylvania Constitution, which vests all legislative power in the General Assembly. Protz, 161 A.3d at 830.

As the Supreme Court explained, "when the General Assembly empowers some other branch or body to act, our jurisprudence requires 'that the basic policy choices involved in "legislative power" actually be made by the [l]egislature as constitutionally mandated.'" Id. at 833 (quoting Tosto v. Pa. Nursing Home Loan Agency, 331 A.2d 198, 202 (Pa. 1975)). "This constraint serves two purposes. First, it ensures that duly authorized and politically responsible officials make all of the necessary policy decisions, as is their mandate per the electorate …. [S]econd, it seeks to protect against the arbitrary exercise of unnecessary and uncontrolled discretionary power." Id. (citing William Penn Parking Garage).

Accordingly, when the General Assembly assigns any authority or discretion to execute or administer a law, "the Constitution imposes two fundamental limitations. First, … the General Assembly must make 'the basic policy choices,' and second, the legislation must include 'adequate standards which will guide and restrain the exercise of the delegated administrative functions.'" Id. at 833-34 (quoting PAGE, 877 A.2d at 418). As the Court observed further, a permissible delegation of legislative authority must "include concrete measures to channel the [delegatee's] discretion, … safeguards to protect against arbitrary, ad hoc decision making, such as a requirement that the [delegatee] hold hearings, allow for public notice and comment, or explain the grounds for its [decisions] in a reasoned opinion subject to judicial review." Id. at 835 (citing and discussing W. Phila. Achievement Charter Elementary Sch. v. Sch. Dist. of Phila., 132 A.3d 957 (Pa. 2016)).

Applying these principles in Protz, the Court found the General Assembly's delegation of authority to the AMA failed to provide any of the necessary safeguards. Without any policy statement or other limiting parameters, the AMA could create any formula, including one that would yield a loss of disability benefits for every claimant, or alternatively, for no claimant. Id. Moreover, it could change the formula at will, potentially with such frequency that no one could keep up with the changes, or alternatively, with such infrequency as to fall behind recent medical advances. Id. It could add new provisions or remove existing ones. Id.

The Court also observed that the General Assembly failed to "require that the AMA hold hearings, accept public comments, or explain the grounds for its methodology in a reasoned opinion, which then could be subject to judicial review. Further, the AMA physicians who author the GUIDES are, of course, not public employees who may be subject to discipline or removal." Id. at 836 (citing Tosto).

Here, the provisions of Act 43 at issue suffer from the same constitutional defects as the AMA standards in Protz. The General Assembly delegated authority to the NFPA without providing any of the safeguards required to conform that delegation of authority to constitutional strictures. The General Assembly provided no policy statement or other limiting parameters, leaving the NFPA free to create, alter, or remove, as frequently or infrequently as it chooses, any standard it chooses concerning temporary structures used to sell fireworks.

Moreover, without statutory controls, NFPA drafters may be open to influence by trade groups or individuals whose interests may or may not match those of the electors.

Moreover, as in Protz, the General Assembly here failed to include in Act 43 any provisions that would require the NFPA to hold hearings, accept public comments, or explain the grounds for its safety standards in reasoned opinions which are subject to judicial review. Similarly, the private individuals who draft the NFPA's safety standards are not public employees subject to discipline or removal by the General Assembly or any public agency. Notably, although Act 43 does contemplate safety inspections of the temporary structures, neither the General Assembly nor the inspectors have any control over the safety standards to be applied in those inspections. Cf. Protz 161 A.3d at 836 (physician performing IRE is constrained by law to follow the AMA's methodologies, with "no power to limit the AMA's delegated authority").

Speaker Turzai urges us to construe Act 43 in a manner that will render it constitutional, by simply reading the definition of NFPA 1124 as limited to its 2006 version. We are not free to do so. The plain language of the definition refers to the 2006 edition of NFPA 1124 "or any subsequent edition." We cannot ignore the clear language of Act 43 as drafted. Accord Protz, 161 A.3d at 839 (Court would not construe statute requiring "most recent edition" of AMA methodologies to mean the specific edition in effect when the statute was enacted).

For all of these reasons, we conclude that Act 43's provisions relating to temporary structures violate Article II, Section 1 of the Pennsylvania Constitution, as an impermissible delegation of legislative authority by the General Assembly.

D. Severability

Having determined that Act 43's provisions relating to temporary structures unconstitutionally delegate legislative authority to the NFPA, we next consider whether we may sever the unconstitutional provisions of Act 43 and thereby leave the remainder of the statute intact. We conclude the portions of Act 43 relating to temporary structures are severable from the other provisions of Act 43.

Pennsylvania public policy favors severability of statutes containing unconstitutional provisions. Annenberg v. Commonwealth, 757 A.2d 338 (Pa. 2000) (citing Pa. Dep't of Educ. v. First Sch., 370 A.2d 702 (Pa. 1977)).

> The provisions of every statute shall be severable. If any provision of any statute or the application thereof to any person or circumstance is held invalid, the remainder of the statute, and the application of such provision to other persons or circumstances, shall not be affected thereby, unless the court finds that the valid provisions of the statute are so essentially and inseparably connected with, and so depend upon, the void provision or application, that it cannot be presumed the General Assembly would have enacted the remaining valid provisions without the void one; or unless the court finds that the remaining valid provisions, standing alone, are incomplete and are incapable of being executed in accordance with the legislative intent.

1 Pa. C.S. §1925.

The legislature's intent is of primary significance in determining severability. Nextel Commc'ns of the Mid-Atlantic, Inc. v. Commonwealth, 171 A.3d 682 (Pa. 2017), cert. denied sub nom. Nextel Commc'ns of the Mid-Atlantic, Inc. v. Pa. Dep't of Revenue, ___ U.S. ___, 138 S. Ct. 2635 (2018). The touchstone of legislative intent is whether, with the unconstitutional portion of a statute removed, the legislature would prefer what remains of the statute to no statute at all. Id. (citing D.P. v. G.J.P., 146 A.3d 204 (Pa. 2016)). We are also mindful that we should remove as little language as possible. D.P. (citing Ayotte v. Planned Parenthood of N. New England, 546 U.S. 320 (2006)); see Commonwealth v. Killinger, 888 A.2d 592 (Pa. 2005).

Here, there is no question that the provisions of Act 43 outside Article XXIV do not relate to fireworks and will not be affected by striking any language from that Article. The real question is whether we may sever the unconstitutional portions of Article XXIV while leaving the remainder of the Article intact. As Act 43 is fundamentally a tax/revenue statute, we conclude that the General Assembly intended and would prefer to retain as much of Article XXIV as possible in order to minimize the effect of the unconstitutional language on the Commonwealth's revenues. Therefore, we will sever the language referring to the delegatee, "NFPA 1124," and to "Temporary structure" from the rest of Article XXIV.

However, severing the offending language of Act 43 requires removing several provisions in Article XXIV relating to temporary structures. Act 43's definitions of "NFPA 1124" and "Temporary structure" contain the actual language effecting the unconstitutional delegation of legislative authority. However, without a definition of "Temporary structure," other provisions of Article XXIV referring to temporary structures are impossible to apply. See 1 Pa. C.S. §1925. Therefore, those references must be severed from the rest of the statute as well.

The mere fact that we must sever multiple provisions is not in itself an obstacle to severance as long as the remaining provisions of the statute can be applied without the severed language. Cf. Protz, 161 A.3d at 841 (although prevalence of the offending language does not by itself preclude severance, Court would not sever that language when the remainder would be incomprehensible). Based on our analysis above, we conclude Article XXIV, Sections 2407, 2408, and 2410 of Act 43 contain provisions that are impossible to apply without the definition of "temporary structure" in Article XXIV, Section 2401. Severing those provisions will leave the remaining portions of Article XXIV, as well as the rest of Act 43, complete and "capable of being executed in accordance with the legislative intent." 1 Pa. C.S. §1925.

Senator Scarnati advances a different severance remedy: severance of the phrase "or any subsequent edition" from the definition of "NFPA 1124" in Act 43. We reject this alternate severance approach. As in Protz, the insurmountable delegation problem here arises from the nature of the delegatee (NFPA) and its processes, in addition to utter confusion over which edition of the NFPA safety standards controls. The problem with the nature of the delegatee and its processes cannot be solved by removing the phrase "or any subsequent edition."

E. Cross-Application for Summary Relief

Senator Scarnati requests summary relief dismissing all claims asserted by Phantom Fireworks, on the basis that they fail as a matter of law. In light of our disposition of the application for summary relief, we grant the cross-application as to Counts II through V.

V. Conclusion

Based on the foregoing discussion, we dismiss Governor Wolf from this action.

We declare the following portions of Act 43 unconstitutional and enjoin their enforcement, as violative of Article II, Section 1 of the Pennsylvania Constitution:

1. Article XXIV, Section 2401, definitions of "NFPA 1124" and "Temporary structure";
2. Article XXIV, Section 2407, first clause: "Except as provided in section 2410" (the main section relating to temporary structures);
3. Article XXIV, Section 2408(a)(1)(ii) (relating to application fees for temporary structures);
4. Article XXIV, Section 2408(b)(4) (relating to annual license fees for temporary structures);
5. Article XXIV, Section 2408(c)(2) (relating to license issuance and inspections of temporary structures);
6. Article XXIV, Section 2410 (relating to temporary structures).

We overrule all other preliminary objections and deny all other relief sought in the petition for review.

We grant the cross-application for summary relief as to Counts II through V of the petition for review. We deny the cross-application as to Count I.

ROBERT SIMPSON, Judge

Judge Fizzano Cannon did not participate in the decision in this case.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Phantom Fireworks Showrooms, LLC, Sky King Fireworks of Easton, Inc., Sky King Fireworks of Erie, Inc., Sky King Fireworks of Morrisville, Inc., Sky King Fireworks of Tioga, LLC, CRJ Enterprises, LLC, Petitioners	:	
v.	:	No. 21 M.D. 2018
Tom Wolf, Governor of the Commonwealth of Pennsylvania, Russell C. Redding, Secretary of the Pennsylvania Department of Agriculture, C. Daniel Hassel, Secretary of the Pennsylvania Department of Revenue, Joseph B. Scarnati, III, Pro Tempore of the Senate of Pennsylvania, Mike Turzai, Speaker of the Pennsylvania House of Representatives, Respondents	:	

O R D E R

AND NOW, this 4th day of December, 2018, upon consideration of the preliminary objections filed by all Respondents, the preliminary objection of Governor Wolf asserting improper joinder is **SUSTAINED** and Governor Wolf is dismissed as a party to this action. All other preliminary objections by all Respondents are **OVERRULED**.

Upon consideration of Petitioners' application for summary relief, the application is **GRANTED** as to Count I of the petition for review. The following portions of Act 43 are declared unconstitutional as violative of Article II, Section 1 of the Pennsylvania Constitution, and their enforcement is hereby enjoined:

1. Article XXIV, Section 2401, definitions of "NFPA 1124" and "Temporary structure";
2. Article XXIV, Section 2407, first clause: "Except as provided in section 2410" (the main section relating to temporary structures);
3. Article XXIV, Section 2408(a)(1)(ii) (relating to application fees for temporary structures);
4. Article XXIV, Section 2408(b)(4) (relating to annual license fees for temporary structures);
5. Article XXIV, Section 2408(c)(2) (relating to license issuance and inspections of temporary structures);
6. Article XXIV, Section 2410 (relating to temporary structures).

Petitioners' application for summary relief is **DENIED** as to Counts II through V of the petition for review.

Senator Scarnati's cross-application for summary relief as to Counts II through V is **GRANTED** and those Counts are **DISMISSED**. The cross-application as to Count I is **DENIED**.

____
ROBERT SIMPSON, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

AES Compassionate Care, LLC, BAY, LLC, Chamounix Ventures, LLC, Cresco Yeltrah, LLC, GTI Pennsylvania, LLC, GuadCo, LLC, Ilera Healthcare, LLC, Keystone Center of Integrative Wellness, LLC, Pennsylvania Medical Solutions, LLC, Standard Farms, LLC, and The Healing Center, LLC, Petitioners	:	
	:	No. 233 M.D. 2018
v.	:	
	:	Heard: May 2, 2018
Rachel L. Levine, MD, Acting Secretary, Pennsylvania Department of Health, Respondent	:	

BEFORE: HONORABLE PATRICIA A. McCULLOUGH, Judge

OPINION NOT REPORTED

MEMORANDUM OPINION
BY JUDGE McCULLOUGH FILED: May 22, 2018

Before this Court is a request for a preliminary injunction regarding the regulations enacted pursuant to the Medical Marijuana Act (Act)[1] to the extent they might unlawfully permit the commercial sale of medical marijuana in contravention of the Act. Specifically, an application for preliminary injunction was filed by AES Compassionate Care, LLC, BAY, LLC, Chamounix Ventures, LLC, Cresco Yeltrah, LLC, GTI Pennsylvania, LLC, GuadCo, LLC, Ilera Healthcare, LLC, Keystone Center

[1] Act of April 17, 2016, P.L. 84, 35 P.S. §§10231.101-10231.2110.

of Integrative Wellness, LLC, Pennsylvania Medical Solutions, LLC, Standard Farms, LLC, and The Healing Center, LLC (collectively, Petitioners) for special relief in the nature of a preliminary injunction, seeking to enjoin Rachel L. Levine, MD, Acting Secretary of Health, from applying the March 17, 2018 temporary regulations (Regulations), 28 Pa. Code §§1210.21-1210.37, relating to implementation of the academic research provisions of Chapter 20 of the Act, 35 P.S. §§10231.2001-10231.2003.

The Medical Marijuana Act and the Chapter 20 Regulations

The Act, which took effect on May 17, 2016, establishes a framework for the legalization of medical marijuana in the Commonwealth for certain medical conditions. The expressed legislative intent of the Act is to

> (i) Provide a program of access to medical marijuana which balances the need of patients to have access to the latest treatments with the need to promote patient safety.
>
> (ii) Provide a safe and effective method of delivery of medical marijuana to patients.
>
> **(iii) Promote high quality research into the effectiveness and utility of medical marijuana.**

35 P.S. §10231.102 (emphasis added).

The Act identified the Pennsylvania Department of Health (Department) as the Commonwealth agency responsible for administering the Act and authorized the Department to promulgate regulations, including temporary regulations to carry out the same. 35 P.S. §§10231.301, 1023.1107. In accord with this authority, the Department promulgated the Regulations at issue here, which were published on March 17, 2018, and made immediately effective.

A. Chapter 6 of the Act

Under section 603(d) of the Act, the Department established six medical marijuana regions. 35 P.S. §10231.603(d).[2] Chapter 6 of the Act set forth two types of entities authorized to receive a permit to operate as a medical marijuana organization and grow, process, or dispense marijuana: grower/processors and dispensaries. 35 P.S. §10231.601.[3] Section 616 of the Act set forth limitations on the number of permits the

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[2] This section states:

> The [D]epartment shall establish a minimum of three regions within this Commonwealth for the purpose of granting permits to grower/processors and dispensaries and enforcing this [A]ct. The [D]epartment shall approve permits for grower/processors and dispensaries in a manner which will provide an adequate amount of medical marijuana to patients and caregivers in all areas of this Commonwealth. The [D]epartment shall consider the following when issuing a permit:
>
> (1) Regional population.
>
> (2) The number of patients suffering from serious medical conditions.
>
> (3) The types of serious medical conditions.
>
> (4) Access to public transportation.
>
> (5) Any other factor the [D]epartment deems relevant.

35 P.S. §10231.603(d).

[3] This section states:

Department could initially issue. Specifically, the Department was authorized to issue up to 25 grower/processor permits and 50 dispensary permits, the recipients of which would be limited to dispensing at **a maximum of three separate locations.** 35 P.S. §10231.616 (emphasis added).[4] Further, section 616 provided, "No more than five

---

> The following entities shall be authorized to receive a permit to operate as a medical marijuana organization to grow, process or dispense medical marijuana:
>
> > (1) Grower/processors.
> >
> > (2) Dispensaries.

35 P.S. §10231.601.

[4] This section states:

> The following limitations apply to approval of permits for grower/processors and dispensaries:
>
> > (1) The [D]epartment may not initially issue permits to more than 25 growers/processors.
> >
> > (2) The [D]epartment may not initially issue permits to more than 50 dispensaries. Each dispensary may provide medical marijuana at no more than three separate locations.
> >
> > (3) The [D]epartment may not issue more than five individual dispensary permits to one person.
> >
> > (4) The [D]epartment may not issue more than one individual grower/processor permit to one person.
> >
> > (5) No more than five grower/processors may be issued permits as dispensaries. If the number of growers/processors is increased under section 1202[] no

grower/processors may be issued permits as dispensaries." *Id.* These five entities are referred to as "vertically integrated" entities. *See* 35 P.S. §10231.1901.[5]

In January 2017, the Department announced it would issue permits in phases. In Phase I, it would issue up to 12 grower/processor permits, with no more than 2 permits in each of the 6 medical marijuana regions, and up to 27 dispensary permits distributed throughout the 6 regions, apparently in accordance with population concentration. Department of Health, Office of Medical Marijuana Bulletin No. 17-21, at 73 (Issued Jan. 7, 2017).

From February 20, 2017, through March 20, 2017, the Department accepted applications for medical marijuana grower/processor permits and/or dispensary permits. The Department received 457 applications: 177 for growers/processors and 280 for dispensaries. On June 20, 2017, the Department issued 12 grower/processor permits and, on June 29, 2017, the Department issued 27 dispensary permits.

> more than 20% of the total number of growers/processors may also be issued permits as dispensaries.
>
> (6) A dispensary may only obtain medical marijuana from a grower/processor holding a valid permit under this [A]ct.
>
> (7) A grower/processor may only provide medical marijuana to a dispensary holding a valid permit under this [A]ct.

35 P.S. §10231.616.

[5] Section 1141.21 of the Regulations defines "Health care medical marijuana organization" as a "vertically integrated health system approved by the Department to dispense medical marijuana or grow and process medical marijuana, or both, in accordance with a research study under sections 1901--1908 of the [A]ct." 28 Pa. Code §1141.21.

On March 24, 2018, the Department indicated that it would accept applications for Phase II from April 5, 2018, to May 18, 2018, after which it would grant the 13 remaining grower/processor permits and the 23 remaining dispensary permits. Department of Health, Office of Medical Marijuana Bulletin No. 18-462, at 1782-83 (Issued Mar. 24, 2018).

B. Chapter 19 of the Act

The Act also designed two types of medical marijuana research programs. The first, found in Chapter 19, directed the Department to develop a research program in which "vertically integrated health systems," as that term is defined in Chapter 19,[6] approved by the Department, would be able to grow and process medical marijuana to conduct research studies involving patients with serious medical conditions, upon authorization by the United States Food and Drug Administration (FDA) and the United States Drug Enforcement Administration (DEA). *See generally* 35 P.S. §§10231.1901-10231.1908. However, as Petitioners note in their petition for review, this program has not come to fruition since marijuana remains an illegal Schedule I drug under the Federal Controlled Substances Act, and health systems, which rely heavily on federal reimbursement funds via Medicaid and Medicare, are unwilling to jeopardize that funding by engaging in federally prohibited activity, *i.e.*, growing, processing, and dispensing marijuana. (Petitioners' Amended Petition for Review at 22-23.) Further, Petitioners note that, even if such health systems were willing to take that risk, the FDA and DEA are unlikely to grant their approval. *Id.*

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[6] Section 1901 of the Act defines "Vertically integrated health system" as "[a] health delivery system licensed under the act of July 19, 1979 (P.L. 130, No. 48),[] known as the Health Care Facilities Act, in which the complete spectrum of care, including primary and specialty care, hospitalization and pharmaceutical care, is provided within a single organization." 35 P.S. §10231.1901.

C. Chapter 20 of the Act

The second research program contemplated by the Act is set forth in Chapter 20. By way of background, the Act originated in the Pennsylvania Senate as Senate Bill 3 of 2015; however, in March 2016, Chapter 20 of the Act, entitled "Academic Clinical Research Centers," was added by House amendment. Chapter 20 permits qualifying Academic Clinical Research Centers (ACRCs) to form partnerships with Clinical Registrants (CRs) to conduct research studies. 35 P.S. §§10231.2001-10231.2003. Section 2001 of the Act defines an ACRC as "[a]n accredited medical school within this Commonwealth that operates or partners with an acute care hospital licensed within this Commonwealth," and a CR as an entity that

> (1) holds a permit as both a grower/processor and a dispensary; and
>
> (2) has a contractual relationship with an [ACRC] under which the [ACRC] or its affiliate provides advice to the entity, regarding, among other areas, patient health and safety, medical applications and dispensing and management of controlled substances.

35 P.S. §10231.2001. Pertinent here, the aforementioned limitations of section 616 of the Act, 35 P.S. §10231.616, which restricted the Department to initially issuing no more than 25 grower/processor permits and 50 dispensary permits (5 of which could be vertically-integrated), does not apply to this Chapter. Section 2002 of the Act, entitled "Clinical registrants,"[7] states,

> **Notwithstanding the limitations in section 616,**[] the [D]epartment may register u**p to eight [CRs]**. Each entity may provide medical marijuana **at not more than six separate locations.** The total number of locations authorized to dispense medical marijuana under this section

[7] Throughout the proceedings, Petitioners refer to these entities as "super-permittees."

shall not exceed 48. The following apply with respect to this category of [CR]:

(1) A [CR] must pay the fees and meet all other requirements under this [A]ct for obtaining a permit as a grower/processor and a dispensary, except as provided under section 607(1)(vi) and (2)(vi).

(2) The [CR] must have a minimum of $15,000,000 in capital. The [D]epartment shall verify the capital requirement.

(3) The [CR] must comply with all other requirements of this [A]ct regarding growing, processing and dispensing medical marijuana.

35 P.S. §10231.2002 (emphasis added).

The final section of Chapter 20, section 2003, entitled "Research Study," states the following:

Notwithstanding any provision of this [A]ct to the contrary, the [D]epartment may, upon application, **approve the dispensing of medical marijuana by a [CR] to the [ACRC] for the purpose of conducting a research study.** The [D]epartment shall develop the application and standards for approval of such dispensing by the [CR]. The following apply to the research study:

(1) The [CR] shall disclose the following information to the [D]epartment in its application:

(i) The reason for the research project, including the reason for the trial.

(ii) The strain of medical marijuana to be used and the strength of the medical marijuana to be used in the research study.

> (iii) The anticipated duration of the study.
>
> (iv) Evidence of approval of the trial by an accredited institutional review board, including any other required regulatory approvals.
>
> (v) Other information required by the [D]epartment, except that the [D]epartment may not require disclosure of any information that would infringe upon the [ACRC]'s exclusive right to intellectual property or legal obligations for patient confidentiality.

> (2) The [ACRC] shall provide its findings to the [D]epartment within 365 days of the conclusion of the research study or within 365 days of publication of the results of the research study in a peer-reviewed medical journal, whichever is later.
>
> (3) The [D]epartment shall allow the exchange of medical marijuana seed between [CRs] for the conduct of research.

35 P.S. §10231.2003 (emphasis added).

D. Chapter 20 Regulations

Pursuant to section 1107 of the Act,[8] on March 17, 2018, the Department published Regulations promulgating Chapter 20 of the Act, which took effect immediately. 28 Pa. Code §§1210.21-1210.37.

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[8] As noted previously, this section authorizes the Department to promulgate temporary regulations, which would expire two years following their publication, in order to "facilitate prompt

The Regulations define an ACRC as "[a]n accredited medical school in this Commonwealth that operates or partners with an acute care hospital licensed and operating in this Commonwealth." 28 Pa. Code §1210.21. In order to become a certified ACRC, an entity must file an application that includes:

> (1) The legal name, address and telephone number of the accredited medical school and the name, telephone number and professional e-mail address of an individual at the accredited medical school who will be the primary contact for the Department during the Department's review of the application.
>
> (2) The legal name, address and telephone number of the acute care hospital that is operated by or partnered with the accredited medical school and the name, telephone number and professional e-mail address of an individual at the accredited medical school who will be the primary contact for the Department during the Department's review of the application.
>
> (3) An affidavit, on a form prescribed by the Department, disclosing any payments to the accredited medical school or any of its affiliates made by a person with whom **the accredited medical school intends to enter into a research contract for purposes of operating as an approved [CR]** or by any principal or financial backer of the person, up to

implementation" of the Act. 35 P.S. §10231.1107(a). Further, the Regulations were not to be subject to sections 201 to 205 of the Commonwealth Documents Law, Act of July 31, 1968, P.L. 769, *as amended*, 45 P.S. §§1201–1205; the Regulatory Review Act, Act of June 25, 1982, P.L. 633, *as amended*, 71 P.S. §745.1–745.15; or sections 204(b) and 301(10) of the Commonwealth Attorneys Act, Act of October 15, 1980, P.L. 950, *as amended*, 71 P.S. §§732-204(b), 732-301(10); and 35 P.S. §1107(a). The Department allowed a period of time for interested parties to submit written comments, suggestions, or objections regarding the temporary regulations. Department of Health, Office of Medical Marijuana Bulletin No. 10-201, at 7631 (Issued Dec. 10, 2016).

and including the date of the submission of the application. The affidavit must include the amount and purpose of each payment made.

(4) A statement that the accredited medical school is currently accredited by the Liaison Committee of Medical Education or the Commission on Osteopathic College Accreditation.

(5) A statement that the acute care hospital designated by the accredited medical school under paragraph (2) holds a valid license from the Department.

(6) The State and Federal tax identification numbers of the accredited medical school.

(7) A statement that a false statement made by the accredited medical school submitting the application is punishable under the applicable provisions of 18 Pa.C.S. Chapter 49 (relating to falsification and intimidation).

(8) Any other information deemed necessary by the Department.

28 Pa. Code §1210.25(c) (emphasis added).

Further, the Regulations define "Approved clinical registrant" as

An entity that applied for and received the approval of the Department to do all of the following:

(i) Hold a permit as both a grower/processor and a dispensary

(ii) Enter into a research contract with a certified ACRC.

28 Pa. Code §1210.21. Section 1210.27 of the Regulations lists the contents required of a CR application:

> (a) An applicant shall file an application for approval of a [CR] with the Department on a form prescribed by the Department. The Department will publish a notice in the Pennsylvania Bulletin announcing the availability of applications and the time period during which the Department will accept applications.
>
> (b) An application for approval of a [CR] submitted under this section must include all of the following information:
>
> > (1) The legal name, address and telephone number of the applicant and the name, telephone number and professional e-mail address of an individual who will be the primary contact for the Department during the Department's review of the application.
> >
> > (2) The name of the certified ACRC under § 1210.25 (relating to certifying ACRCs).
> >
> > (3) The applicant's State and Federal tax identification numbers.
> >
> > (4) An affidavit, on a form prescribed by the Department, **disclosing any payments** made by the applicant, a principal or financial backer of the applicant to a certified ACRC or any affiliates of a certified ACRC, up to and including the date of the submission of the application. The affidavit must include the amount and purpose of each payment made.
> >
> > (5) The name of an institution of higher education, if any, that will be participating in an approved research project.
> >
> > (6) An affidavit and release under § 1210.24 (relating to capital requirements).

(7) Evidence that the applicant is responsible and capable of successfully operating as an approved [CR], including all of the following:

(i) **A copy of the research contract between the applicant and the certified ACRC.**

(ii) A description of the research projects the applicant and the certified ACRC intend to conduct.

(iii) A statement that the applicant may not engage in the business of selling, dispensing or offering to dispense medical marijuana products at an applicant's dispensary until the dispensary is ready, willing and able to dispense medical marijuana products.

(8) Except as provided in subsection (d), an application for a grower/processor permit under Chapters 1141 and 1151 (relating to general provisions; and growers/processors).

(9) Except as provided in subsection (d), an application for a dispensary permit under Chapter 1141 and Chapter 1161 (relating to dispensaries).

(10) A statement that a false statement made by the applicant is punishable under the applicable provisions of 18 Pa.C.S. Chapter 49 (relating to falsification and intimidation).

(11) Any other information deemed necessary by the Department.

(c) An applicant may only include one certified ACRC in its application for approval of a [CR].

> (d) Subject to the limitations in § 1210.23 (relating to limitation on permits), an applicant that already holds a grower/processor permit or a dispensary permit, or both, under sections 601-616 of the [A]ct (35 P.S. §§ 10231.601-10231.616), shall include in its application for approval of a [CR] a request for conversion of an existing permit under § 1210.28 (relating to request for conversion of an existing permit).
>
> (e) The following documents provided to the Department under this chapter are confidential and not subject to disclosure under the Right-to-Know Law (65 P.S. §§ 67.101-67.3104):
>
> (1) A research contract.
>
> (2) A description of a research project.
>
> (3) A certified ACRC's intellectual property.
>
> (4) An approved [CR]'s intellectual property.

28 Pa. Code §1210.27 (emphasis added).

As noted by the Honorable Katharine M. Watson in her amicus brief, pursuant to section 1210.28(b) of the Regulations, if an existing permittee under Chapter 6 becomes registered as a CR, the permittee must surrender its commercial permits, which are placed back into the pool of available commercial permits. 28 Pa. Code §1210.28(b).

Section 1210.31 of the Regulations addresses the requirements of an application for renewal of a CR permit. With regard to denial of a CR's renewal application, section 1210.31(c) states,

> The Department will **not renew an approval** for a [CR] under this section if the Department determines that **none** of the dispensary locations under the dispensary permit held by the approved [CR] are participating in an approved research project and the approved [CR] does not intend to commence

> any additional approved research projects within the first 6 months following the approval of its application for renewal.

28 Pa. Code §1210.31(c) (emphasis added).

Finally, section 1210.23 of the Regulations sets forth certain limitations on permits:

> (a) An approved [CR] may not hold more than one grower/processor permit and one dispensary permit.
>
> (b) A dispensary permit held by an approved [CR] for use under this chapter may be used to dispense medical marijuana products at no more than six separate locations as approved by the Department. An approved [CR] may dispense medical marijuana products to a patient or caregiver who presents a valid identification card to an employee who is authorized to dispense medical marijuana products at a dispensary location operated by an approved [CR] under this chapter.
>
> (c) An approved [CR] may not locate more than three of its approved dispensaries in the same medical marijuana region or in the same county.

28 Pa. Code §1210.23.

In March 2018, the Department announced that ACRC applications would be available on April 5, 2018, and must be filed as of May 3, 2018, and that CR applications would be available on May 24, 2018, and must be filed as of July 12, 2018. Department of Health, Office of Medical Marijuana Bulletin No. 18-461, at 1781 (Issued Mar. 24, 2018).

Facts and Procedural History

Petitioners are "medical marijuana organizations" as that term is defined by section 103 of the Act,[9] of which six are growers/processors, nine are dispensaries, and four are vertically integrated entities (holding permits as both grower/processors and dispensaries). Petitioners initiated this action on April 10, 2018, by filing a petition for review in this Court's original jurisdiction against Dr. Rachel Levine, Secretary of Health. Petitioners sought declaratory relief and a permanent injunction enjoining the Department from enacting the Regulations implementing Chapter 20 of the Act. Petitioners simultaneously filed the present application for special relief in the nature of a preliminary injunction, seeking to enjoin the Department from enforcing these Regulations.

Petitioners contend that, while the Act allows up to eight existing permittees to achieve CR status so as to grow and dispense medical marijuana solely for research purposes in conjunction with an ACRC, the Regulations permit any entity—even a previously denied permit applicant under Chapter 6—to acquire what Petitioners deem a "super-permit" to engage in "virtually unfettered trade in medical marijuana products in competition with Petitioners, at double the number of dispensaries Petitioners' permits allow, with only a minimal commitment to research." (Petition for review at 2.) Further, Petitioners contend that the Regulations impermissibly delegate CR approval decisions to ACRCs by requiring, as the primary requisite for applying for CR status, that the applicant already have a privately-negotiated contract with an ACRC. As such, Petitioners suggest that the Regulations

[9] Section 103 defines "Medical marijuana organization" as "[a] dispensary or a grower/processor. The term does not include a health care medical marijuana organization under Chapter 19." 35 P.S. §10231.103.

are inconsistent with the Act and violate the non-delegation doctrine of the Pennsylvania Constitution.[10]

The Department filed an answer to Petitioners' application for a preliminary injunction, denying that Petitioners were entitled to relief and raising as a new matter the assertion that section 2001's definition of a CR is not limited to an entity that *already* holds a grower/processor and dispensary permit and that section 2002 makes clear that the Act intended the eight CRs to be additional entities beyond the limits of section 616.

Petitioners filed a brief in support of their application, and the Department filed a brief in opposition. In the Department's brief, it raises for the first time the argument that Petitioners' case is not justiciable in that they lack standing, the matter is unripe, and they have failed to exhaust administrative remedies. Petitioners filed a reply brief arguing that the case is justiciable. On May 2, 2018, the Court heard argument on Petitioners' application for a preliminary injunction.[11]

Discussion

A. Justiciability

Since standing is a threshold issue, the Court must first address whether the matter is justiciable.

1. Standing

[10] Article 2, section 1 states: "The legislative power of this Commonwealth shall be vested in a General Assembly, which shall consist of a Senate and a House of Representatives." PA. COST. art. 2, §1.

[11] During the hearing on May 2, 2018, the Court also heard argument on the application of a prospective CR, MLH Explorations, LLC, for leave to intervene, which it ultimately denied.

The Department alleges that Petitioners lack standing because, although they have the opportunity to submit applications to become CRs, Petitioners' interest in this lawsuit is in operating free of competition, which is insufficient for the purposes of standing. The Department asserts that Petitioners have not alleged facts indicating that they are aggrieved. Specifically, the Department argues they have not pleaded that the Regulations have caused or required them to invest money to ensure compliance with the Regulations, that there are or will be delays in the operations of their businesses because of the Regulations, that the Regulations impose operational uncertainties with regard to their permits, or that the Regulations have resulted in any loss of their property rights. The Department contends that Petitioners "wholly fail to allege how the [] [R]egulations even apply to them—and, indeed, unless they seek to have their permits converted to CR permits, the [] [R]egulations will not apply to them." (Department's brief at 13.)

In response, Petitioners assert that they do not seek to operate free of competition, nor as a monopoly. Instead, Petitioners contend that they have a "direct, immediate and substantial interest in 'operating free of competition from the CR "super-permittees" the Chapter 20 [R]egulations create.'" (Petitioners' Reply Brief at 2.) Petitioners assert that the testimony of Mr. Jonathon Goldrath, the CFO of a vertically integrated entity under Chapter 6, and Mr. Drew D. Mooney, a certified public accountant and consultant, during the May 2, 2018 hearing demonstrated that Petitioners are adversely impacted by the Regulations and that their harm is not abstract but real. More specifically, Petitioners cite the witnesses' testimony that the promulgation of the Regulations on March 17, 2018, immediately lowered the market value of Petitioners' businesses because it signaled to investors that the Department would treat the Act's statutory limit on permits as a suggestion rather than a mandate. This, Petitioners contend, made it certain that existing permit holders will lose market share as soon as the super-permittees are operational because the Regulations expanded Chapter 20's research purpose to allow for commercial use as well. Petitioners argue that this was contrary to the permissible scope of Chapter 20 and was not known to Petitioners at the time of their application to become Chapter 6 permittees. Petitioners assert that, although the deterioration of their market share will not occur until CRs are awarded permits, their witnesses' testimony showed that the dilution effect is "inevitable." *Id.* at 3.

Petitioners further assert that pre-enforcement challenges are not limited to the facts of *Arsenal Coal Co. v. Department of Environmental Resources*, 477 A.2d 1333, 1339-40 (Pa. 1984), in which the Pennsylvania Supreme Court determined pre-enforcement was appropriate where 55 coal mine operators and producers were challenging regulations that directly and immediately affected the anthracite industry by, *inter alia*, requiring the expenditure of substantial sums to comply, and where the lengthy process to challenge the regulations' validity would have resulted in ongoing uncertainty in the industry's business operators. Petitioners assert the "core concept" of *Arsenal Coal* was that pre-enforcement challenges are permitted where "the effect of the challenged regulations upon the industry regulated is direct and immediate" such that the "hardship thus presented suffices to establish the justiciability of the challenge in advance of enforcement." (Petitioners' Reply Brief at 4) (citing *Arsenal Coal*, 447 A.2d at 1339).

Our Supreme Court has stated that in order to have standing, the individual initiating the action must be "aggrieved," which can be demonstrated by showing a "substantial, direct, and immediate interest in the outcome of the litigation." *Pittsburgh Palisades Park, LLC v. Commonwealth*, 888 A.2d 655, 659-60 (Pa. 2005).

> An interest is "substantial" if it is an interest in the resolution of the challenge which "surpasses the common interest of all

> citizens in procuring obedience to the law." Likewise, a "direct" interest mandates a showing that the matter complained of "caused harm to the party's interest," *i.e.*, a causal connection between the harm and the violation of law. Finally, an interest is "immediate" if the causal connection is not remote or speculative.

Id. at 660 (internal citations omitted).

Here, the Court finds that Petitioners have demonstrated standing to initiate this action. In *Arsenal Coal*, the Supreme Court addressed "whether a court of equity may properly exercise its jurisdiction to resolve [a] pre-enforcement challenge to the validity of a regulatory scheme grounded in a claim that the regulations were promulgated in excess of the statutory authority by which the regulatory agency is empowered to enact such regulations," and held that it could. 477 A.2d at 1338. Petitioners, like those in *Arsenal Coal*, assert that a set of regulations were promulgated in excess of the statutory authority by which the regulatory agency was empowered to enact them. Specifically, Petitioners allege that the Department's Regulations are inconsistent with the text and intent of the Act and, further, are unconstitutional to the extent that the CR application process would violate the non-delegation clause of Article 2, section 1 of the Pennsylvania Constitution.

Petitioners have demonstrated a substantial, direct, and immediate interest by establishing the following: their interest, as permittees under Chapter 6 of the Act, is unique from other citizens; their businesses lost value immediately upon the publication of the Regulations, testimony about which was presented during the hearing; and, finally, the deterioration of their market share is inevitable upon award of the CR permits, which was also addressed during testimony at the hearing.[12]

[12] As discussed below, the Court found this testimony credible.

Accordingly, the Court finds that Petitioners have sufficiently demonstrated standing to pursue their claims.

2. Ripeness

For the same reasons as with standing, the Department asserts that Petitioners' claims are not ripe and that post-enforcement review is sufficient. The Department relies on *Pennsylvania Dental Hygienists' Association, Inc. v. State Board of Dentistry*, 672 A.2d 414 (Pa. Cmwlth. 1996). In that case, the petitioners sought pre-enforcement review of newly-enacted regulations promulgated by the State Board of Dentistry, which the petitioners argued would have caused changes in their work schedules, reduction in services and income, possible unemployment, and uncertainty in the ongoing day-to-day operations. *Id.* at 418. Ultimately, this Court held that the petitioners' allegations were anticipatory and too remote to support a claim of direct and immediate harm. *Id.*

In response, Petitioners cite to *EQT Production Co. v. Department of Environmental Protection*, 130 A.3d 752, 753 (Pa. 2015), in which the Supreme Court held that "a company threatened by an administrative agency with ongoing, multi-million-dollar penalties per such agency's interpretation of a statutory regime has the right, immediately, to seek a judicial declaration that the agency's interpretation is erroneous." Petitioners assert that theirs is a substantial pre-enforcement challenge to the Regulations in which there is a real or actual controversy, that there are "no material factual dynamics involved in evaluating the validity" of the Department's interpretation of the Act, and that the Regulations will have a profound effect on Petitioners and Pennsylvania's entire medical marijuana industry. (Petitioners' Reply Brief at 5) (quoting *EQT Production Co.*, 130 A.3d at 759).

In *EQT Production Co.*, the Supreme Court outlined a history of its holdings with regard to pre-enforcement review:

> [I]n *Arsenal Coal*, a group of coal mine operators and producers were permitted to proceed with a pre-enforcement challenge to comprehensive regulatory requirements promulgated by the Environmental Quality Board, so as to clarify the operators' and producers' obligations under the law and avoid unnecessarily protracted proceedings. *See Arsenal Coal*, 477 A.2d at 1339–40. In *Bayada Nurses*[*v. Department of Labor and Industry*], 8 A.3d 866 (Pa. 2010), **a pre-enforcement challenge** advanced by a home health care provider was found to be **justiciable, since judicial review would eliminate substantial expense and uncertainty in the day-to-day operations of such providers and alleviate costly and inefficient piecemeal enforcement measures**. *See Bayada Nurses*, 8 A.3d at 876. In [*Commonwealth v.*] *Donahue*, [98 A.3d 1223 (Pa. 2014),] the Office of the Governor appropriately pursued declaratory relief in challenging the Office of Open Records' interpretation of statutory provisions governing the submission of open-records requests, in light of the adverse, direct, and immediate impact of that interpretation on Commonwealth agencies. *See Donahue*, 98 A.3d at 1230–31. And, in the present case, EPC will be permitted to pursue its substantial challenge to the Department's continuing-violation interpretation in the Commonwealth Court, given the company's potential exposure to potent, ongoing civil penalties for which DEP maintains the company is liable.

EQT Production Co., 130 A.3d at 758 (emphasis added).

Upon review, the Court agrees that the matter is sufficiently ripe in that there are no "material factual dynamics" involved in the evaluation of the validity of the Department's interpretation of the Act expounded in the Regulations and, thus, pre-enforcement review is appropriate in this case. Further, the Court agrees with Petitioners that it is prudent for the Court to resolve the issue of the validity of the Regulations prior to their implementation "since judicial review would eliminate substantial expense and uncertainty in the day-to-day operations" of potential CRs and Petitioners alike. Moreover, should the Court ultimately deem the Regulations invalid, pre-enforcement review prior to the Department's grant of CR permits will eliminate the need for CRs to rescind or invalidate contracts they negotiated based upon the invalid Regulations.[13] Thus, the Court agrees that, in this instance, it is preferable to stay the implementation of the Regulations pending their review, rather than to allow interested parties to attempt to "unwind" the Regulations after they have already been implemented. (Petitioners' Reply Brief at 8.)

3. Exhaustion of Administrative Remedies

Finally, the Department argues that the Court lacks subject matter jurisdiction over this action because Petitioners failed to exhaust their administrative remedies. Although the Act contains no provision that requires or permits Petitioners to seek redress, the Department asserts that Petitioners could have sought review of the Regulations under section 35.9 of the General Rules of Administrative Practice and Procedure (GRAPP), which states that a party "complaining of anything done or omitted to be done by a person subject to the jurisdiction of an agency, in violation of a statute or regulation administered or issued by the agency may file a complaint with the agency." 1 Pa. Code §35.9. The Department further asserts that Petitioners could have filed a formal petition for a declaratory order with the Department under section 35.19 of GRAPP, which states,

[13] During argument on MLH's application to intervene, counsel for MLH stated that it had already located and negotiated leases for its dispensary operations; however, under questioning by the Court, MLH's counsel acknowledged that its "real estate deals" and "equipment purchase orders and the like" were *contingent upon* the Department's approval of its CR application. (Notes of Testimony (N.T.), 5/2/18, at 19.)

> Petitions for the issuance, in the discretion of an agency, of a declaratory order to terminate a controversy or remove uncertainty, shall state clearly and concisely the controversy or uncertainty which is the subject of the petition, shall cite the statutory provision or other authority involved, shall include a complete statement of the facts and grounds prompting the petition, together with a full disclosure of the interest of the petitioner.

1 Pa. Code §35.19.

In response, Petitioners argue that they lack an adequate statutory or administrative remedy. Citing *Fletcher v. Pennsylvania Property and Casualty Insurance Guarantee Association*, 985 A.2d 678, 692 (Pa. 2009), Petitioners state that litigants are only required to exhaust administrative remedies where such remedies are capable of providing the relief sought and note that, where there is no adequate statutory procedure, there is no basis for a claim of failure to exhaust.

With regard to this issue, "[t]he courts of this Commonwealth have long held that a party challenging administrative decision-making must first exhaust administrative remedies before seeking judicial review; where such remedies exist, courts lack jurisdiction. This doctrine is not inflexible, and it is not applied where administrative remedies are not available or are not adequate." *Pennsylvania Pharmacists Association v. Department of Public Welfare*, 733 A.2d 666, 672 (Pa. Cmwlth. 1999) (internal citations omitted) (holding that the petitioners, who sought a declaration that certain rates implemented under a managed care program were invalid and who had already commenced the administrative process under 1 Pa. Code §35.9, had failed to exhaust their administrative remedy). Further, "[c]ourts should not lightly assume the futility of a party's pursuing an administrative remedy; instead, it is to be assumed that the administrative process, if given the opportunity, will discover and correct its errors." *Pennsylvania Pharmacists Association*, 733 A.2d at 673.

However, courts have also noted,

> A remedy is not adequate if it does not allow for adjudication of the issue raised or if it permits irreparable harm to occur to the plaintiffs during the pursuit of the statutory remedy. In addition, exhaustion has not been required in some cases where a complaint stated a direct constitutional attack upon a statute, such that administrative proceedings would contribute little to the ultimate adjudication, or where pursuit of an existing remedy would be futile.

Id. at 672 (internal citations omitted).

Here, unlike in *Pennsylvania Pharmacists Association*, Petitioners have not already commenced administrative proceedings under section 35.9 of GRAPP. Further, Petitioners are not challenging the Department's decision making, but instead challenge the validity of certain portions of the Regulations. Finally, Petitioners have also alleged a constitutional challenge to the Regulations. *Pennsylvania Pharmacists Association*, 733 A.2d at 672. Thus, in this case Petitioners' recourse necessarily lies with the courts.

B. Preliminary Injunction

We turn now to the merits of Petitioners' application for a preliminary injunction. A party seeking a preliminary injunction must show that each of the following essential elements are met:

> (1) an injunction is necessary to prevent immediate and irreparable harm that cannot be adequately compensated by damages; (2) greater injury would result from refusing an injunction than from granting it, and, concomitantly, that issuance of an injunction will not substantially harm other interested parties in the proceedings; (3) a preliminary injunction will properly restore the parties to their status as it existed immediately prior to the alleged wrongful conduct; (4) the activity sought to be restrained is actionable, that the right to relief is clear, and that the wrong is manifest, or, in

> other words, must show that it is likely to prevail on the merits; (5) the injunction is reasonably suited to abate the offending activity; and (6) a preliminary injunction will not adversely affect the public interest.

Summit Towne Centre, Inc. v. Shoe Show of Rocky Mount, Inc., 828 A.2d 995, 1001 (Pa. 2003). "A preliminary injunction may only be granted if each element is fully and completely established." *McClusky v. Washington Township*, 700 A.2d 573, 576 (Pa. Cmwlth. 1997).

Furthermore, a preliminary injunction is intended to preserve the *status quo* and prevent imminent and irreparable harm that might occur before the merits of the case can be heard and determined. After a preliminary injunction is awarded or denied, the case proceeds for a final hearing on the merits. *Soja v. Factoryville Sportsmen's Club*, 522 A.2d 1129, 1131 (Pa. Super. 1987). The preliminary injunction proceeding is distinct from the final hearing on the merits. *Kee v. Pennsylvania Turnpike Commission*, 743 A.2d 546, 549 (Pa. Cmwlth. 1999). Indeed,
it is well established that separate standards govern a request for a preliminary injunction and a request for permanent injunctive relief: a preliminary injunction looks for the presence of imminent, irreparable harm, whereas a permanent injunction is warranted if no adequate remedy at law exists for a legal wrong.[14] *City of Chester v. Chester Redevelopment Authority*, 686 A.2d 30, 35 (Pa. Cmwlth. 1996). Consequently, this Court has held that it is inappropriate for a court to treat a hearing for a preliminary injunction as a final hearing and as a basis for a permanent injunction, unless the parties stipulate to the contrary. *Kee*, 743 A.2d at 549; *Berger by and Through Berger v. West Jefferson Hill School District*, 669 A.2d 1084 (Pa. Cmwlth. 1995).

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[14] A court's final disposition of a request for permanent injunctive relief is independent of its determination relating to preliminary injunctive relief and the denial of the latter does not foreclose an order for a permanent injunction. *Soja*, 522 A.2d at 1131.

The Court will address each of these requisites for a preliminary injunction in turn, but will begin with Petitioners' argument regarding a clear right to relief.

1. Clear Right to Relief

Petitioners state that they have a clear right to relief because the Regulations are contrary to the Act's prescribed structure for CR/ACRC authorizations in four key respects and because the Regulations, as interpretative regulations, fail to track the meaning of the Act, are unwise, and are violative of legislative intent.

Petitioners begin by highlighting that one of the Act's central legislative goals is to "**[p]romote high quality research** into the effectiveness and utility of medical marijuana." 35 P.S. §10231.102(3)(iii) (emphasis added). To that end, Petitioners assert that the legislature implemented Chapter 20 of the Act to accomplish that particular goal.

With regard to alleged discrepancies between the Act and the Regulations, Petitioners first argue that the Regulations allow entities that are not existing permit holders to apply for CR status in violation of the plain language of the Act. Petitioners note that under section 2001, a CR is defined as one who "(1) holds a permit as both a grower/processor and a dispensary" (First Requirement), and "(2) has a contractual relationship with an [ACRC] under which the [ACRC] or its affiliate provides advice to the entity, regarding, among other areas, patient health and safety, medical applications and dispensing and management of controlled substances" (Second Requirement). 35 P.S. §10231.2001. Petitioners state that, despite these two items being prerequisites to applying for CR status under the Act, section 1210.27 of the Regulations does not treat the First Requirement as a prerequisite. As noted above this section, *inter alia,* requires the Applicant to provide the name of the ACRC with which it intends to partner, a copy of the contract with the ACRC, evidence that the applicant is capable of operating as a CR, and applications for grower/processor and dispensary permits. 28 Pa. Code §1210.27. Petitioners argue that the omission of the First Requirement as a prerequisite is contrary to the plain words of the Act and that the Department cannot "treat one as a pre-requisite [sic] but not the other." (Petitioners' Application for Preliminary Injunction at 13.)

Further on this point, Petitioners argue that the notion that the General Assembly intended only existing permittees to be able to apply for CR status is supported by the fact that it strictly limited the number of grower/processor and dispensary permits, which created competition and resulted in a rigorous application process and the selection of the best applicants. Petitioners state that it would be "an absurd result" for the General Assembly to make high quality medical marijuana research the goal of the Act, only to allow entities other than ones that "emerged victorious" from that competitive permitting process to partner with ACRCs to do the "high quality" research. *Id.*

Second, Petitioners argue that the Regulations create a CR/ACRC structure that violates the Act in numerous ways. Petitioners assert that the Regulations' requirement that the applicant have a contractual relationship with an ACRC as a prerequisite creates a situation in which the ACRC, not the Department, vets and chooses medical marijuana permittees, in violation of the Act and Article 2, section 1 of the Pennsylvania Constitution, which requires governmental functions to be conducted by governmental bodies.[15] Specifically, Petitioners state that by making the Second Requirement a prerequisite for a CR application but not the First Requirement—that applicants hold a permit—the Regulations arbitrarily delegate to

[15] This section states: "The legislative power of this Commonwealth shall be vested in a General Assembly, which shall consist of a Senate and a House of Representatives." PA. COST. art. 2, §1.

each ACRC the Department's governmental duty to vet and approve medical marijuana grower/processor and dispensary applicants for permits, which is unconstitutional. Petitioners explain that, under the Regulations, the primary criterion for CR status is that the CR applicant have a contract with an ACRC, and note that the CR applicant need only include one ACRC in its application. 28 Pa. Code §1210.27.

Thus, Petitioners contend that the result is that the ACRC determines, by privately-negotiated contract, the single entity that may apply to be that ACRC's CR, and the CR applicant need not already be vetted and permitted by the Department as a grower/processor and dispensary. Petitioners observe that the Department has provided no criteria to evaluate the quality of a CR, which leaves that determination to the ACRCs and equates to an unconstitutional delegation of authority. Further, according to Petitioners, this would result in the Department being faced with a *fait accompli* with regard to CR applicants that are not existing grower/processor and dispensary permittees under Chapter 6—either accept the ACRC's choice or deny the CR's application—instead of the Department exercising its discretion to select the best applicant from a pool. Petitioners also assert that nothing in the Regulations allows the Department to reject a CR application based upon the conclusion that a CR is not fit to operate a grower/processor or dispensary facility.[16]

The third way in which Petitioners argue that the Regulations are inconsistent with the Act is that the Regulations permit CRs to engage in the

[16] Petitioners contend that the only reason listed in the Regulations for rejecting a CR applicant is under section 1210.30(b), which permits the Department to deny a CR application for failure to comply with the Department's measures designed to eliminate "pay to play" concerns—specifically, according to Petitioners, the concern that an applicant or its affiliates would circumvent the application process by "buying" its way into permits via direct or indirect financial payments to ACRCs in order to secure the prerequisite ACRC contract. *See* 28 Pa. Code §1210.30.

unrestricted sale of medical marijuana products, whereas the Act limits a CR to growing and dispensing medical marijuana for research purposes only. Petitioners argue, "**Titles matter in statutory construction**, 1 Pa. C.S. § 1924, and the title the General Assembly chose for **Chapter 20** speaks volumes: '**Academic Clinical Research Centers.**'" (Petitioners' Brief at 24) (emphasis added). Petitioners contend that 28 Pa. Code §1210.23(b),[17] which permits CRs to dispense medical marijuana products to those presenting a valid identification card, violates the text and intent of the Act because section 2002 does not state that a CR is permitted to provide medical marijuana for non-research purposes. In this instance, Petitioners state that it is just as important to "listen attentively to what [the Act] does not say." (Petitioners' Brief at 25) (quoting *Hanaway v. Parkesburg Group, LP*, 168 A.3d 146, 154 (Pa. 2017)).

Petitioners observe that section 2003 of the Act "expressly acknowledges and reserves" to the CR and ACRC the confidentiality and value of intellectual property acquired through research authorized under the Regulations, thereby recognizing that the economic value of intellectual property that can be acquired through research is sufficient to justify the investment required for a medical marijuana grower/processor

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[17] This portion of the Regulations states:

> A dispensary permit held by an approved clinical registrant for use under this chapter may be used to dispense medical marijuana products at no more than six separate locations as approved by the Department. **An approved clinical registrant may dispense medical marijuana products to a patient or caregiver who presents a valid identification card** to an employee who is authorized to dispense medical marijuana products at a dispensary location operated by an approved clinical registrant under this chapter.

28 Pa. Code §1210.23(b) (emphasis added).

facility dedicated solely to research. (Petitioners' Application for Preliminary Injunction at 16.) Here, Petitioners cite to a fiscal note by the House Appropriations Committee accompanying the passage of the Act on April 13, 2016, which states, in pertinent part, "A clinical registrant is an entity registered as a grower/processor and a dispensary that has a contractual relationship with a hospital/medical school. The clinical registrant, upon approval the of rhw Department, may dispense medical marijuana to the hospital/medical school in order to conduct research projects." Ann Bertolino, House Committee on Appropriations Fiscal Note, available at http://www .legis.state.pa.us/WU01/LI/BI/FN/2015/0/SB0003P1690.pdf.[18]

Finally, Petitioners argue that the Regulations[19] ignore the text and intent of the Act by impermissibly expanding the Act's limited permission for CRs to "exchange . . . medical marijuana seed" amongst themselves for "the conduct of research" by permitting unrestricted commerce unrelated to research in all medical marijuana products, including immature plants, mature plants, and medical marijuana products, between and amongst CRs and other medical marijuana growers and dispensaries. 35 P.S. §10231.2003(3). Petitioners argue that the Act is "unequivocal" in limiting these exchanges to seed only, noting that the only reference to a CR's sales outside of the confines of the CR relates exclusively to research, and the Regulations directly flout that restriction. (Petitioners' Application for Preliminary Injunction at 17.)

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[18] It is unclear, however, what precedential value the fiscal note has with regard to this Court's interpretation of the Act.

[19] 28 Pa. Code §1210.36 allows the grower/processor of an approved CR to sell or exchange seeds, immature and mature marijuana plants, and medical marijuana products with other grower/processors of approved CRs for the purposes of conducting research.

In sum, Petitioners argue that the first reason they are likely to succeed on the merits is because the Act created CRs as research laboratories, which would recoup their investments by creating valuable intellectual property; however, Petitioners state that the Regulations "turn CRs into super-permittees chosen by ACRCs in privately-negotiated contracts that compete directly with Petitioners and other existing permittees to produce and sell medical marijuana products to patients." (*Id.* at 5.) Thus, Petitioners conclude that the Regulations have "little relation" to the language or intent of the Act. (Petitioners' Brief at 27.)

With regard to Petitioners' second argument regarding likelihood of success on the merits, Petitioners argue that the Regulations fail to track the meaning of the Act, are unwise, and are violative of legislative intent. Petitioners contend that the Regulations, as interpretative regulations rather than legislative, are entitled to less deference, and in this case, are entitled to no deference at all because of their inconsistency with the Act under which they were promulgated.

Petitioners also argue that the manner in which the Department promulgated the Regulations is likewise troubling. Petitioners assert that, although section 1107 of the Act provided that the Department may promulgate temporary regulations without regard to the Commonwealth Documents Law, the Regulatory Review Act, and the Commonwealth Attorneys Act, the Department could have utilized the process required under those laws and "arrived at the same point with regulations adopted using the appropriate procedural requirements." (Petitioners' Brief at 30.)

The Court concludes that, at this preliminary point in the proceedings, Petitioners have presented sufficient evidence demonstrating a reasonable likelihood of success on the merits in at least two aspects. First, based upon the arguments advanced by Petitioners, the Regulations appear to be inconsistent with the legislative intent of Chapter 20, which was to permit distribution of medical marijuana for purposes of and in conjunction with research studies conducted jointly with ACRCs. This is supported by the titles the legislature chose for Chapter 20, "Academic Clinical Research Centers," and for section 2003, "Research study." Further section 2003 specifically states, "[T]he [D]epartment may, upon application, **approve the dispensing of medical marijuana by a [CR] to the [ACRC] for the purpose of conducting a research study**." 35 P.S. §10231.2003 (emphasis added). Nothing in Chapter 20 of the Act appears to contemplate the sanctioning of commercial distribution of medical marijuana on a level that surpasses that which is permitted under Chapter 6.

It is of note that under Chapter 6, permittees are limited to dispensing at a maximum of **three separate locations**, with a restriction of no more than two grower/processor permits in each of the medical marijuana regions, whereas, under the Regulations, Chapter 20 permittees are permitted to distribute medical marijuana at up to **six locations**, with no more than three of its dispensaries to be located in the same medical marijuana region or county. *Compare* 28 Pa. Code §1141.23 (limitations on permits under Chapter 6), *and* Department of Health, Office of Medical Marijuana Bulletin No. 17-21, at 73 (Issued Jan. 7, 2017) (announcing Phase I), *with* 28 Pa. Code §1210.23(c) (limitations on permits under Chapter 20).

The Court also notes Petitioners' observation that, despite Chapter 20's apparent goal of research, the Regulations appear to require only a minimal commitment to research in order for a CR to obtain and retain a permit. Specifically, with regard to its plan for research, a CR applicant need only include a copy of its contract with a certified ACRC and a "description of the research projects the applicant and the certified ACRC intend to conduct." 28 Pa. Code §1210.27(7)(i)-(ii).

Moreover, under section 1210.31 of the Regulations, the only instance listed in which the Department will not renew a CR's approval is

> if the Department determines that **none** of the dispensary locations under the dispensary permit held by the approved [CR] are participating in an approved research project and the approved [CR] does not intend to commence any additional approved research projects within the first 6 months following the approval of its application for renewal.

28 Pa. Code §1210.31 (emphasis added). As Petitioners note in their application for a preliminary injunction, "[s]tated differently, the Chapter 20 Regulations as adopted required a CR to focus only 8% of its efforts on research (that is, during a one-year operating horizon, it must state that it 'intends' to conduct research over a 6-month period at 16% of its dispensary locations)." (Petitioners' Application for Preliminary Injunction at 11.)

Additionally, the legislature's choice to include a specific provision in section 2003(1)(v) of the Act regarding the reservation of intellectual property rights further supports the notion that Chapter 20 permittees were designed as research facilities and were not intended to engage in commercial distribution. Section 2003(1)(v) states that "the department may not require disclosure of any information that would infringe upon the [ACRC]'s exclusive right to intellectual property or legal obligations for patient confidentiality." 35 P.S. §10231.2003(1)(v). The Court finds meritorious Petitioners' argument that this section could be construed as the legislature's recognition that "the economic value of intellectual property that can be acquired through medical marijuana research studies and clinical trials is sufficient to justify the investment required for a medical marijuana grower/processor facility and related dispensaries dedicated solely to research, without any additional income stream from the commercial sale of medical marijuana products outside of research studies and clinical trials." (Petitioners' Application for Preliminary Injunction at 16.)

In sum, it appears to the Court that the legislature did intend for CRs to exist exclusively for research purposes, since, otherwise, Chapter 20 would serve no purpose. If the legislature desired to simply increase the number of grower/processor and dispensary permits in urban areas, as Mr. John J. Collins, Director of the Office of Medical Marijuana testified, it could have done so by adding such a provision with specific geographical restrictions in Chapter 6. Likewise, if, as the Department contends, the legislature intended for some commercial medical marijuana entities to *also* conduct research, it could have added such a provision in Chapter 6. However, as Petitioners observe, since the legislature did neither of these things and instead chose to create a separate Chapter 20, this would suggest that it desired for these organizations to perform a function separate and unlike that of the organizations set forth in Chapter 6—namely, research, as the title of the chapter suggests. This interpretation is corroborated by the remarks of representatives of the General Assembly during floor debate. *See* Pa. Legislative Journal, Session of 2016, 200th of the General Assembly, No. 12, at 370 (Mar. 16, 2016) (Representative Joseph A. Petrarca) ("[The Act] creates a serious research component as has been asked for by many."); Pa. Legislative Journal, Session of 2016, 200th of the General Assembly, No. 23, at 636 (Apr. 13, 2016) (Representative Ron Marsico) ("**[The Senate's amendments did not change] the robust research component, one run by the Department of Health and the other by medical schools and hospitals.**" (emphasis added)). The two types of research programs Representative Marsico referred to are those set forth in Chapters 19 and 20, as outlined above.

In her amicus brief in support of the Department, Representative Watson makes several points, including that Chapter 20 was passed with two important goals in mind:

> First, to build an unprecedented collaboration between the most important research institutions in the Commonwealth and medical cannabis organizations with a research-based, clinically-oriented focus. Second, to make Pennsylvania a pioneer by mandating the development and execution of meaningful research on the efficacy of medical marijuana, the measurement of public health outcomes and patient quality of life.

(Rep. Watson's amicus brief at 2.) Representative Watson also states that the requirement that CRs have a minimum of $15,000,000 in capital is evidence "that the General Assembly meant to promote a separate pool of applicants for CRs with sufficient resources to invest in state-of-the art [sic] facilities and mechanisms to provide research." *Id.* at 8. These arguments, however, provide further support for the notion that the Department exceeded the scope of the Act by permitting CRs, *which were designed to conduct research*, to commercially sell medical marijuana on a scale that exceeds that which is authorized under Chapter 6.

Representative Watson observes that the Regulations require an entity possessing commercial permits under Chapter 6 that desires to become registered as a CR under Chapter 20 to surrender its permits, which are then placed back into the pool of available commercial permits. 28 Pa. Code §1210.28. However, this would suggest that CRs are not to conduct "commercial" activity and supports the point that CRs were designed to make their profits from intellectual property rather than commercial sales.

Representative Watson goes on to address Chapter 19 of the Act, stating, "In contrast [to Chapter 20], Chapter 19 establishes a medical marijuana research program for commercial permittees to engage in research if desired." (Rep. Watson's amicus brief at 12.) She states that Chapter 19 directs the Department to develop the research program "to study the impact of medical marijuana on the treatment and symptom management of serious medical conditions," but notes that the program "shall not include a [CR] or [ACRC] under Chapter 20." *Id.* (quoting 35 P.S. §10231.1902). Representative Watson then cites to a February 13, 2018 letter to Mr. Collins that she authored along with Senator Mike Folmer, the "prime sponsor of Senate Bill 3":

> [C]linical registrants are medical marijuana organizations and are therefore allowed to sell medical marijuana products to any dispensary. This is because clinical registrants hold both a permit as a grower/processor and as a dispensary and because the exception to the definition of "medical marijuana organization" only includes a health care medical marijuana organization under Chapter 19. Under the act, a dispensary may obtain medical marijuana products from any grower/processor.

(Rep. Watson's amicus brief at 13.)[20] She contends that, had it been the legislature's intent, it could have included a provision limiting the ability of a CR to dispense medical marijuana, similar to that in Chapter 19, which excepts CRs and ACRCs from that research program.

Representative Watson is correct that Chapter 6 of the Act provides that both grower/processors and dispensaries "shall be authorized to receive a permit to operate as a medical marijuana organization to grow, process or dispense medical marijuana." 35 P.S. §10231.601. However, Representative Watson's point that the Act implicitly designates CRs as medical marijuana organizations authorized to commercially dispense medical marijuana is not supported by the Act. Only section

[20] Notably, this letter does not constitute legislative history and it is unclear what precedential value the letter has, if any, upon this Court.

1210.30(d) of the Regulations raises this issue, where it states that CRs shall have the same rights and obligations as "medical marijuana organizations." 28 Pa. Code §1210.30(d).[21] The Act does not make reference to nor designate CRs as medical marijuana organizations, which is simply further evidence that the Regulations do not track the language of the Act.

Thus, for the foregoing reasons, the Court cannot agree with the Department that, at this juncture, Petitioners have not demonstrated any likelihood of success on the merits because the "[R]egulations at issue in this case merely mirror the requirements of the [Act]." (Department's Brief at 18.)

Petitioners have also demonstrated a reasonable likelihood of success on their argument that the Regulations, by delegating the choice of CRs to ACRCs, may run afoul of Article 2, section 1 of the Pennsylvania Constitution. Pursuant to Article II, section 1 of the Pennsylvania Constitution, legislative power rests solely with the legislature. "Legislative power is the power to make a law and, thus, the General Assembly 'cannot constitutionally delegate the power to make law to any . . . other body or authority.'" *Washington v. Department of Public Welfare*, 71 A.3d 1070, 1087 (Pa. Cmwlth. 2013) (quoting *Blackwell v. State Ethics Commission*, 567 A.2d 630, 636 (Pa. 1989)).

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[21] This section states:

> An approved clinical registrant shall have the same rights and obligations as a medical marijuana organization that holds a grower/processor permit or a dispensary permit under sections 601-616 of the [A]ct (35 P.S. §§ 10231.601-10231.616) and Chapters 1141, 1151 and 1161 (relating to general provisions; growers/processors; and dispensaries), as applicable, subject to any modifications or limitations in sections 2001-2003 of the [A]ct (35 P.S. §§ 10231.2001-10231.2003) and this chapter.

28 Pa. Code §1210.30(d).

> Nevertheless, the legislature can make a law to delegate a power to determine some fact or state of things upon which the law makes, or intends to make, its own action depend. The legislature must make the basic policy choices, but it can impose upon others the duty to carry out the declared legislative policy in accordance with the general provisions of the statute. In that situation, it is the legislature which has legislated and not the administrative body.

Washington, 71 A.3d at 1088 (internal citations and quotation marks omitted). However, when the legislature delegates such power, it "must surround such authority with definite standards, policies and limitations to which such administrative officers, boards or commissions, must strictly adhere and by which they are strictly governed. If the legislature fails . . . to prescribe with reasonable clarity the limits of the power delegated or if those limits are too broad its attempt to delegate is a nullity." *Bell Telephone Co. of Pennsylvania v. Driscoll*, 21 A.2d 912, 915-16 (Pa. 1941).

In her amicus brief, Representative Watson argues that the Regulations do not delegate to ACRCs the authority to approve CRs and emphasizes that the requirement for a CR to have a contractual relationship with an ACRC is "one of *many* requirements imposed on the CR for registration under the Act." (Rep. Watson's amicus brief at 10.) However, the Court observes that, under the current Regulations, ACRCs apply for and receive approval *prior* to CRs. Within its application, an ACRC must list any payments it received from the CR with which it intends to partner. 28 Pa. Code §1210.25(c)(3). Moreover, under the Regulations, a CR applicant must produce a copy of its contract with the ACRC in conjunction with its application form. As Petitioners note, this may raise constitutional concerns in that it creates the appearance that the Department has delegated its duty to regulate the medical marijuana program by allowing ACRCs, at the very least, to narrow the field of CR applicants, given that ACRCs must already have selected the CR with which they intend to partner by the time they submit their applications. Prospective CRs who have not, at that point, partnered with an ACRC seem to be *per se* disqualified from obtaining CR approval.[22] This is of particular concern in light of the fact that, during the hearing, the Court heard testimony that some of the potential CRs with which ACRCs have partnered were previously rejected by Department under Phase I.[23] Accordingly, for the these reasons, the Court concludes that Petitioners have demonstrated a reasonable likelihood of success on the merits.

2. Immediate and Irreparable Harm

Petitioners argue they will be irreparably harmed if the Regulations remain in effect pending resolution of this litigation because, by permitting non-permit winners to apply for CR status based solely upon the ability to secure a contract with an ACRC, the Regulations "rob Petitioners, who are existing permit winners, of significant value that will be lost forever" if the Regulations are implemented and the CR application process commences. (Petitioners' Application for Preliminary

[22] In their applications, a potential CR must list the name of the certified ACRC with which it intends to partner, any payments made by the applicant to the ACRC, and a copy of its research contract with a certified ACRC, as well as a description of the research projects it intends to conduct with the certified ACRC. 28 Pa. Code. §1210.27(b)(2), (4), (7)(i), 7(ii). Thus, if a CR applicant is unable to form a partnership with an ACRC, it would not be able to include those required sections in its application and, as such, would presumably be denied approval. *See* 28 Pa. Code §1210.27(b) (stating that "[a]n application for approval of a [CR] submitted under this section **must** include" all of the listed items (emphasis added)).

[23] The Court is specifically referencing the testimony of Mr. Goldrath, who testified that Palliatech PA LLC, a company that applied for and was rejected during Phase I having been ranked 105 out of 177 applicants, has partnered with an ACRC. *See also* PENNSYLVANIA DEPARTMENT OF HEALTH, "Phase 1 Grower/Processor Applicant Evaluation Category Score Cards," at 9, http://www.health.pa.gov/My%20Health/Diseases%20and%20Conditions/M-P/MedicalMarijuana/Documents/PA%20DOH%20Phase%201%20Grower-Processor%20Evaluation%20Category%20Score%20Cards.pdf. The Court found Mr. Goldrath's testimony credible in its entirety.

Injunction at 4.) Additionally, Petitioners state that expanding the universe of potential CR applicants beyond existing permittees to include entities that have not already been approved as "worthy permit holders" by the Department—including entities who sought and were denied permits—dilutes Petitioners' hard-won rights as permittees and diminishes the value of their permits and, further, violates section 2001 of the Act, which defines a CR as an entity possessing both a grower/processor and dispensary permit. *Id.*

Petitioners further argue that the Regulations will cause immediate and irreparable harm to Petitioners because the "super-permits" they create will allow what the Act intended as research-only CR assets to be used to flood the commercial market for medical marijuana with products from up to 8 additional grower/processors and 48 additional dispensary locations. *Id.* Additionally, Petitioners state that, if non-permit holders are permitted to compete with Petitioners for CR status, Petitioners will be irreparably harmed because the pool of potential CR applicants will increase dramatically and their chances of securing CR status will decrease—a scenario, Petitioners state, they were not aware of when they invested in the permit process under Chapter 6 of the Act. Finally, Petitioners state that the CR process the Regulations initiate, once underway, will not be easily halted, reversed, or unwound even with a future ruling on the merits that invalidates the Regulations.

In response, the Department asserts that increased competition in a free market and potential lost profits due to that increased competition does not equate to irreparable harm. The Department cites *County of Luzerne v. Luzerne County Retirement Board*, 882 A.2d 531, 535 (Pa. Cmwlth. 2005), in which this Court held that the county did not demonstrate immediate and irreparable harm because the payment of current and prospective legal fees would not have impaired the actuarial soundness of a retirement fund.

The Department is correct that courts have held that there is no immediate and irreparable harm where a solely monetary injury is able to be adequately compensated by money damages, *id.*, or where the nature of the irreparable harm is speculative, *Novak v. Commonwealth*, 523 A.2d 318, 320 (Pa. 1987). However, courts have also held that, "[w]ith respect to equitable relief, the impending loss of a business opportunity is considered to be irreparable harm. An irreparable injury causes damage which can be estimated only by conjecture and not by an accurate pecuniary standard." *Carlini v. Highmark*, 756 A.2d 1182, 1188 (Pa. Cmwlth. 2000) (internal citations and quotation marks omitted).

Here, Petitioners have alleged an immediate loss of business value when the Regulations were implemented, as well as an imminent erosion of their market share when the permits are granted. Given that neither of these types of losses appear to lend themselves to precise valuation by an accurate pecuniary standard, Petitioners' imminent harm is fairly classified as immediate and irreparable.[24]

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[24] Here, the Court relies on Mr. Mooney's testimony during the hearing that Petitioners' "[m]arket share is going to go down relative to what it would be absent [the increase in supply of medical marijuana created by the Regulations]. So while we can't quantify that necessarily, it is . . . going to happen." (N.T., 5/3/18, at 93-94.) Mr. Mooney further testified,

> [Petitioners] would not [be able to realize the return that they originally anticipated] because, again, the volume of sales which all flows into the model of returns and [] value of a company, that all feeds the profits that investors value companies off of. That volume of sales will decrease and it will never come back. And these companies have not been able to establish themselves in the market to the level where they know, I've achieved this level of sales and then I know what it's going to drop to. That is—this is a new market, again. It's unknown what their sales record is going to be. They just started.

Id. at 94. The Court found Mr. Mooney's testimony, which establishes that it is not possible at this stage to assign an economic value to Petitioners' impending loss, credible in full.

Furthermore, courts of this Commonwealth have held that irreparable harm is demonstrated where a party credibly alleges violation of a statute and/or the Pennsylvania Constitution. *See SEIU Healthcare Pennsylvania v. Commonwealth*, 104 A.3d 495 (Pa. 2014) (reversing this Court's denial of a preliminary injunction holding that irreparable harm was demonstrated where the offending conduct was alleged to have violated both state statute and the Pennsylvania Constitution); *Milk Marketing Board v. United Dairy Farmers Co-op Association*, 299 A.2d 191 (Pa. 1973) (plurality) (affirming a finding of irreparable harm where the petitioners violated a state statute by selling milk below the minimum prices mandated by state law); *Pennsylvania Public Utility Commission v. Israel*, 52 A.2d 317 (Pa. 1947) (affirming the issuance of a preliminary injunction where the petitioners violated a state statute requiring taxicabs to have a certificate of public convenience); *Commonwealth ex rel Corbett v. Snyder*, 977 A.2d 28 (Pa. Cmwlth. 2009) (affirming the issuance of a preliminary injunction and a finding that irreparable harm is presumed where there was a credible violation of the consumer protection law).

Here, the Court finds that Petitioners have also sufficiently demonstrated immediate and irreparable harm where they have credibly alleged that the Department has adopted Regulations that violate the Act under which they were promulgated and violate the Pennsylvania Constitution. Accordingly, the Court concludes that Petitioners have met the immediate and irreparable harm requisite.

3. Greater Harm from Refusing Injunction

Petitioners contend that the harm they will suffer if refused a preliminary injunction is greater than the harm that would result for the Department or any other party if the injunction were granted. Specifically, Petitioners allege that neither the Department, nor potential CR applicants, will suffer harm if the process is put on hold until the disparity between the Act's research-only intent for CRs and the Regulations' permit implementation is resolved. Petitioners state that if the CR/ACRC process is put on hold pending resolution of the fundamental CR/ACRC issues Petitioners raise, the only effect will be to delay implementation of the Regulations' "watered-down" research program while the Court considers whether the Act requires, as Petitioners contend, a much more robust research-only CR program to be conducted by permittees that the Department has already found to be most qualified. (Petitioners' Application for Preliminary Injunction at 20.)

Further, Petitioners state that a stay of the Regulations will provide existing permittees that desire CR status clarity on the issue of whether CR status is research-only, which may have a determinative effect on their decision to seek CR status at all. Likewise, Petitioners argue that entities seeking CR status that are not existing permittees will benefit from that determination. Thus, overall, Petitioners urge that the balancing of harms weighs heavily in favor of granting a preliminary injunction.

The Department responds by arguing that "[a]ny delay in implementation of the research provisions of the Act will result in grave harm to the public, which will face a delay in receiving the fruits of that research." (Department's Brief at 28.)

The Court takes particular note of the testimony of Mr. Collins at the hearing that it will take the Office of Medical Marijuana "a considerable amount of time" to review the CR applications, which are due July 12, 2018, and that, based upon what the Department observed during Phase I of the Chapter 6 process, it will take approximately one year from receipt of a permit for a CR to be able to release medical marijuana product and to "hav[e] it available for sale." (N.T., 5/2/18, at 124-25.) Mr. Collins' testimony was that the grant of a preliminary injunction in this case would be "quite simply, horrific" in that it would be "extremely disruptive to the patients that are suffering in Pennsylvania." *Id.* at 125.[25] However, Mr. Collins' testimony overlooks the fact that Chapter 6 permittees already are currently dispensing medical marijuana to patients in Pennsylvania with a valid identification card. Moreover, notwithstanding Mr. Collins' testimony, nothing in the Act provides that CRs are permitted to dispense directly to patients or to "have it available for sale." Rather, they are permitted under section 2003 to dispense to ACRCs. 35 P.S. §10231.2003.

Thus, the Court finds Petitioners have satisfied this requisite because the potential harm Petitioners would suffer from the denial of a preliminary injunction is greater than that of the Department should the preliminary injunction be granted.

4. Restoration of *Status Quo*

The Court must also inquire as to whether a preliminary injunction will properly restore the parties to their status as it existed immediately prior to the alleged wrongful conduct. *Summit Towne Center, Inc.*, 828 A.2d at 1001. Petitioners assert that a preliminary injunction will restore all interested parties to the *status quo* that existed prior to the Regulations' implementation, noting that (1) the Regulations were implemented on March 17, 2018; (2) ACRC applications were available on April 5, 2018, and filed as of May 3, 2018; and (3) CR applications will be made available on May 24, 2018, and filed as of July 12, 2018. The Court agrees with Petitioners that a preliminary injunction issued now, enjoining the Department from applying the

[25] Relatedly, in her amicus brief, Representative Watson acknowledges that "like the *entirety* of Chapter 19, the provisions contained in Section 2003 (relating to research study) are not yet operative. This section only becomes operative when [the Department] approves the dispensing of medical marijuana by a CR to an ACRC." (Rep. Watson's Amicus Brief at 12) (emphasis in original). This point reinforces that there is no public harm in granting a preliminary injunction, given that the harm the Department contends the public will suffer—lack of research and commercial availability of medical marijuana under Chapter 20—is *already* occurring in that section 2003 is *not presently* operative and, according to Mr. Collins' testimony, is not likely to be for approximately one year, even under the best of circumstances.

Regulations, will leave all parties as they were until the underlying issues are resolved. As such, the Court concludes that Petitioners have satisfied this requisite.

5. Reasonably Suited to Abate Offending Activity

The Court must also determine whether the preliminary injunction Petitioners seek is "reasonably suited to abate the offending activity." *Id.* Here, the issuance of a preliminary injunction enjoining the Department from applying the Regulations is reasonably suited to abate the Department's offending conduct because it will prohibit the Department from awarding permits under the alleged unconstitutional Regulations.

6. Not Contrary to Public Interest

Finally, the Court must determine whether Petitioners have demonstrated that a preliminary injunction will not adversely affect the public interest. *Id.* Petitioners argue that it is in the public's interest to foster "high quality" research in medical marijuana and its uses. 35 P.S. §10231.102(3)(iii). However, Petitioners contend that the Regulations, as promulgated, "will do little to advance that goal" because they impose only a *de minimis* obligation on CRs to undertake research, despite Chapter 20's exclusive focus on research and intention to authorize the production and dispensing of medical marijuana for use only in clinical trials and other research purposes. (Petitioners' Application for Preliminary Injunction at 5.) Petitioners contend that the public's interest lies in "taking the time to get it right" before the Regulations go into effect and the CR application process commences because the short wait that will be occasioned by a preliminary injunction will be worth the properly-structured formal CR/ACRC program. *Id.* at 6.

The Court finds that Petitioners have satisfied this final requisite for a preliminary injunction. As noted above, should it be determined that the Regulations are in violation of either the Act or the Constitution, their application is *per se* injurious to the public. As such, maintenance of the *status quo* will protect, rather than harm, the public.

C. Bond and Automatic Supersedeas

Finally, Petitioners request that the bond required by Pa.R.C.P. No. 1531[26] be set at the nominal amount of $100.00, arguing that no entity will sustain reasonably foreseeable damages in the event that it is later determined that the requested preliminary injunction was wrongfully issued. Further, Petitioners request relief from an automatic supersedeas pursuant to Pa.R.A.P. 1736(b),[27] given that the standards for

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[26] Rule 1531(b) provides,

> Except when the plaintiff is the Commonwealth of Pennsylvania, a political subdivision or a department, board, commission, instrumentality or officer of the Commonwealth or of a political subdivision, a preliminary or special injunction shall be granted only if
>
> > (1) the plaintiff files a bond in an amount fixed and with security approved by the court, naming the Commonwealth as obligee, conditioned that if the injunction is dissolved because improperly granted or for failure to hold a hearing, the plaintiff shall pay to any person injured all damages sustained by reason of granting the injunction and all legally taxable costs and fees, or
> >
> > (2) the plaintiff deposits with the prothonotary legal tender of the United States in an amount fixed by the court to be held by the prothonotary upon the same condition as provided for the injunction bond.

Pa. R.C.P. No. 1531(b).

[27] This rule provides:

vacating an automatic supersedeas are substantially similar to those required for granting a preliminary injunction.

In order for the Court to vacate automatic supersedeas under Pa.R.A.P. 1736, Petitioners "must make a substantive case on the merits, demonstrating the stay will prevent [P]etitioner[s] from suffering irreparable injury, and establishing other parties will not be harmed and the grant of the stay is not against the public interest." *Department of Environmental Resources v. Jubelirer*, 614 A.2d 199, 203 (Pa. 1989). Petitioners have met this standard for the reasons set forth in the preceding analysis regarding the application for preliminary injunction, and Petitioners' request to vacate the automatic supersedeas, should the Department appeal this order, is hereby granted. Likewise, the Court grants Petitioners' request to set the bond at the nominal amount of $100.00, as no party is likely to be monetarily harmed in the event it is later determined that the preliminary injunction was improperly granted.

Conclusion

In conclusion, this matter is justiciable because Petitioners have standing, the matter is sufficiently ripe, Petitioners' remedy lies with this Court, and pre-enforcement review is appropriate in this case given that Petitioners have alleged a constitutional violation, for which administrative proceedings would do little to resolve. Further, Petitioners have satisfied the stringent criteria for the grant of a preliminary injunction by sufficiently demonstrating at this stage of the proceedings a

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> Unless otherwise ordered pursuant to this chapter the taking of an appeal by any party specified in Subdivision (a) of this rule shall operate as a supersedeas in favor of such party, which supersedeas shall continue through any proceedings in the United States Supreme Court.

Pa.R.A.P. 1736.

likelihood to succeed on the merits in that the Regulations apparently fail to genuinely track the meaning of the Act or to uphold the legislature's intent to implement a robust research program and, instead, appear to authorize commercial activity not provided for in the Act. In addition to the above, the Regulations appear to unlawfully delegate the Department's duty to issue the CR permits instead to ACRCs by first requiring from the CR applicant a contract with an ACRC, in violation of the non-delegation clause of the Pennsylvania Constitution. PA. CONST. art. 1, §2. There is *per se* harm when the Regulations violate the Act and Article 2, section 1 of the Pennsylvania Constitution. The issuance of the preliminary injunction will restore the parties to their prior *status quo* and promote the public interest by allowing a determination on the merits of this claim as to whether the Chapter 20 Regulations are consistent with the General Assembly's expressed intent to create a "high quality research" program for Pennsylvania's residents as opposed to another commercial component. The preliminary injunction will not impact current dispensation under Chapter 6 of the Act, nor research conducted pursuant to Chapter 19.[28]

Accordingly, the Court hereby grants Petitioners' application for a preliminary injunction enjoining the Department from applying the Regulations set forth in 28 Pa. Code §§1210.21-1210.37.

Patricia A. McCullough

PATRICIA A. McCULLOUGH, Judge

[28] Mr. Collins testified that, as of the date of the hearing, there were approximately "34,500 patients [] registered [for patient identification cards]" and "almost 15,000 [patient identification] cardholders." (N.T., 5/2/18, at 127.) Mr. Collins further testified that "24,800 dispensing events have occurred since February 15th [2018]." *Id.*

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

AES Compassionate Care, LLC, BAY, LLC, Chamounix Ventures, LLC, Cresco Yeltrah, LLC, GTI Pennsylvania, LLC, GuadCo, LLC, Ilera Healthcare, LLC, Keystone Center of Integrative Wellness, LLC, Pennsylvania Medical Solutions, LLC, Standard Farms, LLC, and The Healing Center, LLC, Petitioners	:	
	:	No. 233 M.D. 2018
v.	:	
Rachel L. Levine, MD, Acting Secretary, Pennsylvania Department of Health, Respondent	:	

ORDER

AND NOW, this 22nd day of May, 2018, the Court hereby orders the following:

1. The application for special relief in the nature of a preliminary injunction enjoining the Pennsylvania Department of Health (Department) from applying its March 17, 2018 temporary regulations, 28 Pa. Code §§1210.21-1210.37 (Regulations), relating to implementation of the academic research provisions of Chapter 20 of the Medical Marijuana Act (Act), Act of April 17, 2016, P.L. 84, 35 P.S. §§10231.2001-10231.2003, filed by AES Compassionate Care, LLC, BAY, LLC, Chamounix Ventures, LLC, Cresco Yeltrah, LLC, GTI Pennsylvania, LLC, GuadCo, LLC, Ilera Healthcare, LLC, Keystone Center of Integrative Wellness, LLC, Pennsylvania Medical Solutions, LLC,

Standard Farms, LLC, and The Healing Center, LLC (Petitioners) is hereby granted.

2. Petitioners shall post a bond pursuant to Pa.R.C.P. No. 1531 in the amount of $100.00.

3. In the event that Dr. Rachel Levine, Acting Secretary of Health, appeals this order, such appeal shall not act as an automatic supersedeas pursuant to Pa.R.A.P. 1736(b).

Patricia A. McCullough

PATRICIA A. McCULLOUGH, Judge

Certified from the Record

MAY 22 2018

and Order Exit

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

PENNSYLVANIA PROFESSIONAL LIABILITY JOINT UNDERWRITING ASSOCIATION,	:	**CIVIL ACTION NO. 1:17-CV-2041**
	:	**(Chief Judge Conner)**
Plaintiff	:	
v.	:	
TOM WOLF, in his Official Capacity as Governor of the Commonwealth of Pennsylvania,	:	
Defendant	:	

MEMORANDUM

On October 30, 2017, defendant Tom Wolf, in his capacity as Governor of the Commonwealth of Pennsylvania, signed into law Act 44 of 2017, P.L. 725, No. 44 ("Act 44"). The Act, *inter alia*, mandates that the Pennsylvania Professional Liability Joint Underwriting Association ("Joint Underwriting Association" or "Association") transfer $200,000,000 of its "surplus" funds for deposit into the Commonwealth's General Fund by Friday, December 1, 2017. Act 44 includes a "sunset" provision purporting to abolish the Association should it fail to comply with its deadline. The Association seeks a declaration that Act 44 violates the United States Constitution.

I. <u>Factual Background & Procedural History</u>[1]

The Joint Underwriting Association is a nonprofit association organized under the laws of the Commonwealth of Pennsylvania. (<u>See</u> Doc. 60 ¶ 1; Doc. 72 ¶ 1; Doc. 74 ¶ 1). The General Assembly created the Association in 1975 in response to a "hard market"[2] for medical malpractice insurance in the Commonwealth. (<u>See</u> Doc. 63 ¶ 1; Doc. 65 ¶ 2). The Association was initially established and organized by the Pennsylvania Health Care Services Malpractice Act of 1975, P.L. 390, No. 111 ("Act 111"). The General Assembly repealed Act 111 on March 20, 2002, enacting in its place the Medical Care Availability and Reduction of Error Act ("MCARE Act"), 40 PA. STAT. & CONS. STAT. ANN. § 1303.101 *et seq.*

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[1] Local Rule 56.1 requires that a motion for summary judgment pursuant to Federal Rule of Civil Procedure 56 be supported "by a separate, short, and concise statement of the material facts, in numbered paragraphs, as to which the moving party contends there is no genuine issue to be tried." LOCAL RULE OF COURT 56.1. A party opposing a motion for summary judgment must file a separate statement of material facts, responding to the numbered paragraphs set forth in the moving party's statement and identifying genuine issues to be tried. <u>Id.</u> Unless otherwise noted, the factual background herein derives from the parties' Rule 56.1 statements of material facts. (<u>See</u> Docs. 60, 63, 65, 72, 74, 76, 77). To the extent the parties' statements are undisputed or supported by uncontroverted record evidence, the court cites directly to the statements of material facts.

[2] The cyclical nature of insurance markets is described in academic literature as follows: "Property/liability insurance markets alternate between hard and soft markets in a phenomenon known as the underwriting cycle. In soft markets, underwriting standards are relaxed, prices and profits are low, and the quantity of insurance increases. In hard markets, underwriting standards become restrictive, and prices and profits increase. There are many policy cancellations or non-renewals, and policy terms (deductibles and policy limits) are tightened as the quantity of insurance coverage generally decreases." Seungmook Choi *et al.*, *The Property/Liability Insurance Cycle: A Comparison of Alternative Methods*, 68 S. ECON. J. 530, 530 (2002).

A. The MCARE Act and the Joint Underwriting Association

The MCARE Act is a sweeping piece of legislation. The Act's overarching goal is to ensure a "comprehensive and high-quality health care system" for the citizens of the Commonwealth. Id. § 1303.102(1). In pursuit of this objective, the Act seeks to guarantee that medical professional liability insurance is "obtainable at an affordable and reasonable cost," to ensure prompt and fair resolution of medical negligence cases, and to reduce and eliminate medical errors. Id. § 1303.102(3)-(5). The Act includes patient safety rules and reporting obligations, see id. §§ 1303.301-.315, establishes requirements relating to reduction and prevention of health care associated infections, see id. §§ 1303.401-.411, and develops standards for medical professional liability litigation and compensation, see id. §§ 1303.501-.516.

The MCARE Act also establishes a Medical Care Availability and Reduction of Error Fund ("the MCARE Fund"). See id. §§ 1303.711-.716. The General Assembly designed the MCARE Fund as a "special fund" within the state treasury to be administered by the Insurance Department of Pennsylvania ("the Department"). Id. §§ 1303.712(a), -.713(a). The Fund provides a secondary layer of medical professional liability coverage for physicians, hospitals, and other health care providers in the Commonwealth. See id. § 1303.711(g). It is funded primarily by annual assessments ("MCARE assessments") on health care providers as a condition of practicing in the Commonwealth. See id. § 1303.712(d)(1).

Additionally, the MCARE Act continues operation of the Joint Underwriting Association. Id. § 1303.731(a). Unlike the MCARE Fund, the General Assembly did not establish the Association as a "special fund" or a traditional agency within the

Commonwealth's governmental structures. See id.; cf. id. §§ 1303.712(a), -.713(a). Instead, the General Assembly "established" the Association as "a nonprofit joint underwriting association to be known as the Pennsylvania Professional Liability Joint Underwriting Association." Id. § 1303.731(a). Like its predecessor, see Act 111, § 802, the MCARE Act mandates membership in the Association for insurers authorized to write medical professional liability insurance in the Commonwealth, 40 PA. STAT. & CONS. STAT. ANN. § 1303.731(a). Currently, the Association has 621 member insurance companies. (Doc. 60 ¶ 43).

The Association is charged by statute with offering medical professional liability insurance to health care providers and entities who "cannot conveniently obtain medical professional liability insurance through ordinary methods at rates not in excess of those applicable to [those] similarly situated." 40 PA. STAT. & CONS. STAT. ANN § 1303.732(a). The MCARE Act sets forth broad parameters for achieving this objective, to wit:

> The [Joint Underwriting Association] shall ensure that the medical professional liability insurance it offers does all of the following:
>
> (1) Is conveniently and expeditiously available to all health care providers required to be insured under section 711.
>
> (2) Is subject only to the payment or provisions for payment of the premium.
>
> (3) Provides reasonable means for the health care providers it insures to transfer to the ordinary insurance market.

> (4) Provides sufficient coverage for a health care provider to satisfy its insurance requirements under section 711 on reasonable and not unfairly discriminatory terms.
>
> (5) Permits a health care provider to finance its premium or allows installment payment of premiums subject to customary terms and conditions.

Id. § 1303.732(b)(1)-(5). The Association insures "all comers" who certify that they cannot obtain coverage at competitive rates. (P.I. Hr'g Tr. 11:3-13:8; Doc. 60 ¶ 42). According to the Association, its insureds generally fall into four categories: (1) providers with a history of malpractice occurrences, (2) providers practicing high-risk specialties, (3) providers who have gaps in coverage, or (4) providers reentering the medical profession after loss or suspension of license or voluntary withdrawal from practice. (Doc. 60 ¶ 42).

The Association, like other insurers in the Commonwealth, is "supervised" by the Department through the Insurance Commissioner ("Commissioner"). 40 PA. STAT. & CONS. STAT. ANN. § 1303.731(a); see, e.g., id. §§ 221.1-a to -.15-a, 1181-99. The MCARE Act prescribes four "duties" to the Association. Id. § 1303.731(b). It requires the Association to submit a plan of operations to the Commissioner for approval. Id. § 1303.731(b)(1). It tasks the Association to submit rates and any rate modifications for Department approval. Id. § 1303.731(b)(2) (incorporating 40 PA. STAT. & CONS. STAT. ANN. §§ 1181-99). It requires the Association to "[o]ffer medical professional liability insurance to health care providers" as described above. See id. § 1303.731(b)(3). And it directs the Association to file its schedule of occurrence rates with the Commissioner, which she uses to set a "prevailing primary premium" for calculating the annual MCARE assessments for all health care providers in the Commonwealth. Id. § 1303.731(b)(4) (incorporating 40 PA. STAT. & CONS. STAT. ANN. § 1303.712(f)). The Act insulates the Commonwealth from the Association's debts and liabilities. Id. § 1303.731(c).

The MCARE Act provides that all "powers and duties" of the Association "shall be vested in and exercised by a board of directors." Id. § 1303.731(a). The board's composition, and all of the Association's operative principles, are set forth in a plan of operations developed by the Association with Department assistance and approval. (Doc. 60 ¶ 44; Doc. 63 ¶¶ 13-16); see also 40 PA. STAT. & CONS. STAT. ANN. § 1303.731(b)(1). The plan establishes a 14-member board of directors, which consists of the current Association president; eight representatives of member companies chosen by member voting; one agent or broker elected by members; and four health care provider or general public representatives who may be nominated by anyone and are appointed by the Commissioner. (Doc. 60 ¶ 45). Under the plan, the Association may be dissolved (1) "by operation of law," or (2) at the request of its members, subject to Commissioner approval. (Id. ¶ 46). The plan provides that, "[u]pon dissolution, all assets of the Association, from whatever source, shall be distributed in such manner as the Board may determine subject to the approval of the Commissioner." (Id. ¶ 47).

The Joint Underwriting Association writes insurance policies directly to its insured health care providers. (See Doc. 63 ¶ 27; Doc. 65 ¶ 19). Policyholders pay premiums directly to the Association. (See Doc. 60 ¶ 65). The Association is funded exclusively by policyholder premiums and investment income. (Id. ¶ 54). It is not and has never been funded by the Commonwealth, and it holds all premiums and investment funds in private accounts in its own name. (Id. ¶¶ 51, 54, 65-69). The Association currently insures approximately 250 policyholders. (Doc. 63 ¶ 26; Doc. 65 ¶ 20). The typical medical professional liability policy issued by the Association covers a one-year period, with a limit of $500,000 per claim and aggregate limits of $1,500,000 for individuals and $2,500,000 for hospitals. (Doc. 63 ¶ 27).

The Association maintains contingency funds—its "reserves" and its "surplus"—which allow the Association to fulfill its insurance obligations in the event of greater-than-anticipated claims or losses. (See Doc. 60 ¶¶ 108-12). An insurer's "reserves" are the "best estimate of funds . . . need[ed] to pay for claims that have been incurred but not yet paid." (Id. ¶ 109). Its "surplus" represents "capital after all liabilities have been deducted from assets." (Id. ¶ 111). The surplus operates as a "backstop" to ensure that unforeseen events do not impede an insurer's ability to meet obligations to its insureds. (Id. ¶ 112). As of December 31, 2016, the Joint Underwriting Association maintained a surplus of approximately $268,124,500. (See id. ¶ 115; Doc. 63 ¶ 32; Doc. 65 ¶¶ 23, 30).

B. Act 85 of 2016

On July 13, 2016, Governor Wolf signed into law Act 85 of 2016, P.L. 664, No. 85 ("Act 85"). Act 85 is wide-ranging in scope, but its principal effect was to amend the General Appropriation Act of 2016 and balance the Commonwealth's budget. Act 85, § 1. Among other things, Act 85 provides for certain transfers to the Commonwealth's General Fund. See id. § 1(7). Pertinent *sub judice*, Section 18 of Act 85 amends the Commonwealth's Fiscal Code to require a $200,000,000 transfer to the General Fund from the Joint Underwriting Association. The relevant language states:

> Notwithstanding Subchapter C of Chapter 7 of [the MCARE Act], the sum of $200,000,000 shall be transferred from the unappropriated surplus of the Pennsylvania Professional Liability Joint Underwriting Association to the General Fund. The sum transferred under this section shall be repaid to the Pennsylvania Professional Liability Joint Underwriting Association over a five-year period commencing July 1, 2018. An annual payment amount shall be included in the budget submission required under Section 613 of the Act of April 9, 1929 (P.L. 177, No. 175), known as the Administrative Code of 1929.

Id. § 18 (codified prior to repeal at 72 PA. STAT. & CONS. STAT. ANN. § 1726-C).

The Association did not transfer funds to the Commonwealth pursuant to Act 85. (Doc. 60 ¶ 96). On May 18, 2017, the Association commenced a lawsuit—also pending before the undersigned—challenging the constitutionality of Act 85. See Pa. Prof'l Liab. Joint Underwriting Ass'n v. Albright, No. 1:17-CV-886, Doc. 1 (M.D. Pa.). The lawsuit names as the sole defendant Randy Albright in his capacity as the Commonwealth's Secretary of the Budget. Id., Doc. 12. Secretary Albright moved to dismiss the Association's complaint on August 22, 2017. Id., Doc. 14. That motion is held in abeyance pending resolution of the Association's claims herein.

C. Act 44 of 2017

Governor Wolf signed Act 44 into law on October 30, 2017, in another attempt to bring balance to the state budget. Act 44, § 1. Therein, the General Assembly expressly repeals Act 85. Id. § 13. Act 44, *inter alia*, amends the Fiscal

Code to include certain "findings" concerning the Joint Underwriting Association's relationship to the Commonwealth and the nature of its unappropriated surplus. Id. § 1.3. The General Assembly in Act 44 specifically "finds" as follows:

> (1) As a result of a decline in the need in this Commonwealth for the medical professional liability insurance policies offered by the joint underwriting association under Subchapter B of Chapter 7 of the MCARE Act, and a decline in the nature and amounts of claims paid out by the joint underwriting association under the policies, the joint underwriting association has money in excess of the amount reasonably required to fulfill its statutory mandate.
>
> (2) Funds under the control of the joint underwriting association consist of premiums paid on the policies issued under Subchapter B of Chapter 7 of the MCARE Act and income from investment. The funds do not belong to any of the members of the joint underwriting association nor any of the insureds covered by the policies issued.
>
> (3) The joint underwriting association is an instrumentality of the Commonwealth. Money under the control of the joint underwriting association belongs to the Commonwealth.
>
> (4) At a time when revenue receipts are down and the economy is still recovering, the Commonwealth is in need of revenue from all possible sources in order to continue to balance its budget and provide for the health, welfare and safety of the residents of this Commonwealth.
>
> (5) The payment of money to the Commonwealth required under this article is in the best interest of the residents of this Commonwealth.[3]

[3] Act 44 twice references Subchapter *B* of Chapter 7 of the MCARE Act in describing the Association's function. The court notes that it is Subchapter *C* of Chapter 7 of the MCARE Act that establishes and defines the Association and its mission. See 40 PA. STAT. & CONS. STAT. ANN. §§ 1303.731-.733.

Id. Following these findings, Act 44 mandates the monetary transfer at the heart of this litigation: "On or before December 1, 2017, the joint underwriting association shall pay the sum of $200,000,000 to the State Treasurer for deposit into the General Fund." Id. Per the Act, the funds shall be appropriated by the General Assembly to the Department of Human Services "for medical assistance payments for capitation plans." Id.

Act 44 contains two additional pertinent provisions. Its "no liability" clause purports to immunize the Association as well as its officers, board of directors, and employees from liability arising from the transfer mandated by Act 44. Id. It also contains a "sunset" clause which threatens to abolish the Association if it fails to meet the Act's demands. Id. Specifically, that clause states that if the Association fails to transfer the $200,000,000 by the Act's deadline, the provisions of the MCARE Act creating it will immediately expire, the Association will be abolished, and its assets will be transferred to the Insurance Commissioner for administration of the Association's functions. Id. Act 44 then directs the Insurance Commissioner to transfer the $200,000,000 for deposit into the Commonwealth's General Fund "as soon as practicable after receipt." Id.

D. Procedural History

The Association commenced the instant litigation on November 7, 2017, challenging the constitutionality of Act 44. In its verified complaint, the Association asserts that Act 44 violates the Substantive Due Process Clause, the Takings Clause, and the Contract Clause, as well as the doctrine of unconstitutional conditions. The Association seeks declaratory and injunctive relief pursuant to Section 1983 and the

Declaratory Judgment Act, 28 U.S.C. § 2201. The verified complaint names Tom Wolf, in his official capacity as Governor of the Commonwealth of Pennsylvania, as defendant. With the court's leave, the General Assembly of the Commonwealth of Pennsylvania joined this litigation as intervenor defendant.

The Joint Underwriting Association sought both a temporary restraining order and preliminary injunction. We denied the temporary restraining order but accelerated proceedings on the Association's request for a preliminary injunction. Following extensive briefing by the parties and *amicus*, an evidentiary hearing, and oral argument, we preliminarily enjoined enforcement of Act 44 pending full merits review of the Joint Underwriting Association's claims. Cross-motions for summary judgment by the Joint Underwriting Association, Governor Wolf, and the General Assembly are presently before the court and ripe for disposition.

II. Legal Standard

Through summary adjudication, the court may dispose of those claims that do not present a "genuine dispute as to any material fact" and for which a jury trial would be an empty and unnecessary formality. FED. R. CIV. P. 56(a). The burden of proof tasks the non-moving party to come forth with "affirmative evidence, beyond the allegations of the pleadings," in support of its right to relief. Pappas v. City of Lebanon, 331 F. Supp. 2d 311, 315 (M.D. Pa. 2004); see also Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986). This evidence must be adequate, as a matter of law, to sustain a judgment in favor of the non-moving party on the claims. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250-57 (1986); Matsushita Elec. Indus.

Co. v. Zenith Radio Corp., 475 U.S. 574, 587-89 (1986). Only if this threshold is met may the cause of action proceed. See Pappas, 331 F. Supp. 2d at 315.

Courts are permitted to resolve cross-motions for summary judgment concurrently. See Lawrence v. City of Phila., 527 F.3d 299, 310 (3d Cir. 2008); see also Johnson v. Fed. Express Corp., 996 F. Supp. 2d 302, 312 (M.D. Pa. 2014); 10A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 2720 (3d ed. 2015). When doing so, the court is bound to view the evidence in the light most favorable to the non-moving party with respect to each motion. FED. R. CIV. P. 56; Lawrence, 527 F.3d at 310 (quoting Rains v. Cascade Indus., Inc., 402 F.2d 241, 245 (3d Cir. 1968)).

III. Discussion

The Joint Underwriting Association levies a fourfold objection to Act 44 through the prism of Section 1983. It contends *first*, that Act 44 violates its right to substantive due process; *second*, that Act 44 is an unconstitutional taking of private property; *third*, that Act 44 substantially interferes with the Association's contracts with its insureds and its members; and *fourth*, that Act 44 impermissibly conditions the Association's exercise of constitutional rights. The Association asks the court to declare Act 44 unconstitutional and permanently enjoin its enforcement. Our analysis begins and ends with the Association's Takings Clause claim.

A. The Association's Takings Clause Claim

Section 1983 of Title 42 of the United States Code creates a private cause of action to redress constitutional wrongs committed by state officials. 42 U.S.C. § 1983. The statute is not a source of substantive rights, but serves as a mechanism for vindicating rights otherwise protected by federal law. Gonzaga Univ. v. Doe, 536 U.S. 273, 284-85 (2002); Kneipp v. Tedder, 95 F.3d 1199, 1204 (3d Cir. 1996). To state a Section 1983 claim, plaintiffs must show a deprivation of a "right secured by the Constitution and the laws of the United States . . . by a person acting under color of state law." Kneipp, 95 F.3d at 1204 (quoting Mark v. Borough of Hatboro, 51 F.3d 1137, 1141 (3d Cir. 1995)). Governor Wolf does not dispute that he is a state actor. We must thus assess whether Act 44 deprives the Association of rights secured by the Fifth Amendment to the United States Constitution.

The Fifth Amendment's Takings Clause prohibits the government from taking private property for public use without just compensation. U.S. CONST. amend. V. The Takings Clause is made applicable to the states by the Fourteenth Amendment. See U.S. CONST. amend. XIV; Murr v. Wisconsin, 582 U.S. __, 137 S. Ct. 1933, 1942 (2017) (citing Chi., B. & Q. R. Co. v. Chicago, 166 U.S. 266 (1897)). It applies not only to the taking of real property, but also to government efforts to take identified funds of money. See, e.g., Phillips v. Wash. Legal Found., 524 U.S. 156, 160, 164-65 (1998); Webb's Fabulous Pharms., Inc. v. Beckwith, 449 U.S. 155, 164-65 (1980). Takings claims generally fall into two categories—physical and regulatory. See Yee v. City of Escondido, 503 U.S. 519, 522-23 (1992). The Association's claim concerns an alleged physical taking, to wit: that Act 44 is an unlawful attempt to expropriate $200,000,000 from the Association's private coffers.[4]

Governor Wolf and the General Assembly rejoin that the Association is a creature of statute—a public entity having no constitutional rights against its creator. Defendants alternatively contend, assuming *arguendo* that we deem the Association and its funds to be private in nature, that the Association has no interest in its surplus and, therefore, no "just compensation" is due. Defendants further submit that even if the Association prevails on the merits, it is not entitled to permanent injunctive relief. We address defendants' arguments *seriatim*.

1. *Taking of "Private Property"*

Defendants collectively adjure that the Joint Underwriting Association is a state entity and thus cannot assert a takings claim against the Commonwealth. Their respective positions take several forms. The General Assembly invokes the political subdivision standing doctrine, which originated in Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819). Governor Wolf urges the court to look to principles governing state actor liability developed in Lebron v. National

[4] Because this case concerns a *per se* physical taking, defendants' reliance on the Third Circuit's decision in American Express Travel Related Services, Inc. v. Sidamon-Eristoff ("Amex"), 669 F.3d 359 (3d Cir. 2012), is misplaced. The court in Amex addressed a regulatory taking—a statutory amendment that retroactively reduced the presumptive abandonment period for unclaimed travelers checks from fifteen to three years. Id. at 364-66. The court opined that "[t]hose who do business in [a] regulated field" cannot claim that a later amendment to the relevant statutory framework "interferes with its investment-backed expectations" as required for a regulatory takings claim. Id. at 371 (quoting Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 227 (1986)). Act 44 is not a regulatory taking. It directly targets and endeavors to take money from the Joint Underwriting Association alone. See Act 44, § 1.3. Amex has no application under these circumstances.

Railroad Passenger Corp., 513 U.S. 374 (1995). Defendants then jointly remonstrate that, regardless of the doctrine applied, the Association—or at minimum its surplus funds—are public in nature. We begin with the General Assembly's argument.[5]

a. The Association as a "Political Subdivision"

Counties, municipalities, and other subdivisions owing their existence to the state generally cannot assert constitutional claims against their creator. Trs. of Dartmouth Coll., 17 U.S. (4 Wheat.) at 660-61. Such entities are creatures of the state, developed "for the better ordering of government." Williams v. Mayor of Balt., 289 U.S. 36, 40 (1933) (collecting cases). A political subdivision accordingly "has no privileges or immunities under the Federal Constitution which it may invoke in opposition to the will of its creator." Id. The doctrine applies equally to all of a state's "political subdivisions," barring any federal claim against the state thereby. Williams v. Corbett, 916 F. Supp. 2d 593, 598 (M.D. Pa. 2012) (citations

[5] Preliminarily, the General Assembly asserts that Act 44's *ipse dixit* statement that the Association is an "instrumentality" of the Commonwealth is enough to make it so. We rejected this argument in our preliminary injunction opinion, (see Doc. 41 at 22), and we reject it again now. The General Assembly's citation to Harristown Development Corp. v. Commonwealth, 614 A.2d 1128 (Pa. 1992), does not persuade us otherwise. The legislature invokes Harristown for the Pennsylvania Supreme Court's statement that an entity "is an agency if the General Assembly says it is." (Doc. 71 at 2-3 (quoting Harristown, 614 A.2d at 1131)). This selective quotation of Harristown divorces the decision from critical context. The plaintiff in Harristown sought declaratory judgment that the state could not apply open records and open meetings laws to it based solely on the volume of business it did with the state. Id. at 1129-31. The court determined that the General Assembly could define "agency"—"*as that term appears in the Sunshine Act and the Right to Know Law*"—as it saw fit. Id. (emphasis added). No court has extended the quoted passage from Harristown beyond its open records and open meetings context.

omitted), aff'd *sub nom.* Williams v. Gov. of Pa., 552 F. App'x 158 (3d Cir. 2014) (nonprecedential).

The General Assembly recognizes that the Joint Underwriting Association is not a political subdivision in the usual sense. (See Doc. 62 at 8-11; Doc. 71 at 12-14). It nonetheless maintains that the doctrine is "not *limited* to municipalities and subdivisions" and in fact extends to *any* state-created entity. (Doc. 62 at 9-10). The General Assembly is correct that, in appropriate circumstances, courts apply the doctrine to bar Section 1983 suits by entities similar in kind to traditional political subdivisions. See Pocono Mountain Charter Sch. v. Pocono Mountain Sch. Dist., 908 F. Supp. 2d 597, 606-14 (M.D. Pa. 2012); see also Palomar Pomerado Health Sys. v. Belshe, 180 F.3d 1104, 1107-08 (9th Cir. 1999).[6] None of these cases supports the General Assembly's suggestion that the Commonwealth is insulated from suit by *any* entity it creates.

The central inquiry in the cases cited by the General Assembly is whether a relationship between plaintiff and defendant is "sufficiently analogous" to that between a state and its municipalities. In Pocono Mountain, for example, the court held that the link between a public charter school and its chartering public school district was sufficiently similar to that between a municipality and the state for

[6] Both the General Assembly and Governor Wolf also identify the Eleventh Circuit's decision in United States v. State of Alabama, 791 F.2d 1450 (11th Cir. 1986), as a bar to the Association's lawsuit. In State of Alabama, the Eleventh Circuit Court of Appeals opined without analysis that the political subdivision standing doctrine applicable to cities and counties "extends logically to other creatures of the state such as state universities." Id. at 1456. This thin holding concerning an indisputably public university offers precious little insight to aid our analysis of a private nonprofit's relationship to the state.

purposes of barring the charter school's Section 1983 lawsuit against the district. Pocono Mountain, 908 F. Supp. 2d at 611. In addition to the formation component, the court noted the school district's narrow circumscription of the charter school's authority, highlighting the degree of control reserved by the district, as well as the charter school's inherently municipal function. Id. at 611-12. Courts consistently apply Pocono Mountain to foreclose charter schools' suits against their chartering school districts. See, e.g., I-Lead Charter Sch.-Reading v. Reading Sch. Dist., No. 16-2844, 2017 WL 2653722, at *3-4 (E.D. Pa. June 20, 2017), appeal filed, No. 17-2570 (3d. Cir.); Reach Acad. for Boys & Girls, Inc. v. Del. Dep't of Educ., 8 F. Supp. 3d 574, 578 (D. Del. 2014). But no case has extended Pocono Mountain beyond its charter school context.

The General Assembly's reliance on Palomar is farther afield. Indeed, Palomar supports the Association's position that the political subdivision standing doctrine should *not* apply to it. Palomar involved a health care district established by a California statute as a "public corporation." Palomar, 180 F.3d at 1107. The district was imbued by statute with distinctly governmental functions. See id. at 1107-08. For example, the state statutorily authorized the district to levy taxes and issue bonds. Id. at 1107. The state also granted to the health care district the power of eminent domain. Id. The Ninth Circuit Court of Appeals had no difficulty determining that the health care district was a political subdivision of the state. Id. at 1108.

The Joint Underwriting Association is neither a political subdivision nor "sufficiently analogous" to one for Section 1983 purposes. The Association is not empowered with governmental authority: it has no power, for example, to tax, to issue bonds, or to exercise eminent domain. Its mission, while beneficial to the public, is inherently nongovernmental. In the vernacular, it is an insurance business, possessing none of the traditional characteristics of a political subdivision. We are also cognizant that the Third Circuit has observed that support for the political subdivision doctrine "may be waning with time." Amato v. Wilentz, 952 F.2d 742, 755 (3d Cir. 1991). For all of these reasons, we decline the General Assembly's invitation to declare the nonprofit Joint Underwriting Association a "political subdivision" of the Commonwealth.

b. The Association as the "Government Itself"

Governor Wolf's reliance on Lebron fares no better. The Supreme Court in Lebron supplied "guideposts" for federal courts to assess whether a defendant is a government actor subject to Section 1983 liability. See Sprauve v. W. Indian Co., 799 F.3d 226, 229-30 (3d Cir. 2015) (citing Lebron, 513 U.S. 374). Lebron sued the National Railroad Passenger Corporation, widely known as "Amtrak," alleging that Amtrak's rejection of his political billboard display violated the First Amendment. See Lebron, 513 U.S. at 376-77. Tasked to decide whether Amtrak was a proper Section 1983 defendant, the Supreme Court bypassed traditional analyses concerning whether and when private action is attributable to the state and instead asked whether Amtrak was itself a "government entity," and thus a "state actor" for purposes of Section 1983. See id. at 378, 383, 394-400.

The Court jettisoned Amtrak's assertion that its enabling statute—which disclaimed it as a federal agency—was dispositive. Id. at 392-93. Concluding that Amtrak was in fact a government entity subject to Section 1983 liability, the Court underscored two factors: *first*, that Amtrak was "established by a special statute for the purpose of furthering governmental goals," and *second*, that Amtrak was subject to extensive governmental control. See Sprauve, 799 F.3d at 231 (citing Lebron, 513 U.S. at 397-98). The Court found an "important measure of control" to be the fact that "a majority of the governing body of the corporation was appointed by the federal or state government." See id. To find that Amtrak was not a state actor, the Court concluded, would be to allow the government "to evade the most solemn obligations imposed in the Constitution by simply resorting to the corporate form." Lebron, 513 U.S. at 397.

As a threshold matter, an essential aspect of Lebron—that the federal government "retain[ed] for itself permanent authority to appoint a majority of [Amtrak's] directors," Lebron, 513 U.S. at 400—is indisputably lacking *sub judice*. More importantly, application of Lebron to the Association would betray the Court's *ratio decidendi*. The Court sought to ensure that government could not shirk constitutional *liability* by delegating its legislative prerogatives to a private corporate entity. Governor Wolf rejoins that whether a party asserts or disclaims constitutional liability is "an empty distinction," (Doc. 82 at 3 n.3), but his claim is accompanied by no citation, and the court has separately found no support therefor. Indeed, the only authority exploring Governor Wolf's argument flatly refutes it. See Ill. Clean Energy Comm. Found. v. Filan, 392 F.3d 934, 938 (7th Cir. 2004) (rejecting state's reliance on Lebron to foreclose takings claim when state demanded that state-authorized trust turn $125 million over to state). Lebron has no application in this posture.[7]

c. The Association as a "Public Entity"

We thus come to the *essentia* of defendants' argument: that the Joint Underwriting Association is nonetheless a public "entity" or "instrumentality" and cannot state a constitutional claim against the Commonwealth. Fortunately, in resolving this question, we do not write upon a blank slate. The Association is not the only state-created insurer-of-last-resort. Nor is the Association the first state-affiliated insurer to resist state action impacting its constitutional rights. As is often the case, examples are our best teachers. See Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass'n, 531 U.S. 288, 296 (2001).

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[7] For the same reason, we reject the General Assembly's repeated reliance on Justice Ginsburg's majority opinion in Hess v. Port Authority Trans-Hudson Corp., 513 U.S. 30 (1994), and Justice Brennan's concurrence in Port Authority Trans-Hudson Corp. v. Feeney, 495 U.S. 299 (1990). This pair of cases concerns the amenability of the Port Authority Trans-Hudson Corporation ("PATH"), a bistate railway created under the Constitution's Compact Clause, to suit in federal court. Both opinions express the unremarkable maxim that "ultimate control of every state-created entity resides with the State, for the State may destroy or reshape any unit it creates." Hess, 513 U.S. at 47; see also Feeney, 495 U.S. at 313 (Brennan, J., concurring) (noting that "political subdivisions exist solely at the whim and behest of their State"). The Justices make this point, however, in the context of explaining that such ultimate authority—which is true of *any* state-created entity—renders state control nondispositive to an Eleventh Amendment inquiry. See Hess, 513 U.S. at 47-48; Feeney, 495 U.S. at 313 (Brennan, J., concurring) (observing that political subdivisions are too far removed from the state to receive Eleventh Amendment protection "*even though* these political subdivisions exist solely at the whim and behest of their State" (emphasis added)). The General Assembly's theory that state creation is determinative finds no support in Hess or Feeney.

i. The Jurisprudential Landscape and Characteristics Examined

Defendants insist that we need not look beyond the fact of state creation to define the Joint Underwriting Association's relationship with the state. But for all of the ink spilled on the issue, neither defendant identifies a single decision that turns *exclusively* on the fact that an association was created by statute. Our research reveals no support for this uncritical proposition. *Per contra*, at least two federal courts have rejected defendants' position.

The First Circuit Court of Appeals, for example, dismissed the Commonwealth of Puerto Rico's contention that Puerto Rico's joint underwriting association, being "a state-created entity," lacked standing to challenge actions taken by its creator. See Asociacion de Subscripcion Conjunta del Seguro de Responsibilidad Obligatorio v. Flores Galarza, 484 F.3d 1, 20 (1st Cir. 2007). The court in Asociacion relied on an earlier First Circuit decision that expounded the nature of the association's relationship with the government. Id. (citing Arroyo-Melicio v. Puerto Rican Am. Ins. Co., 398 F.3d 56, 62 (1st Cir. 2005)). The court underscored several factors, to wit: that the association's members, not the government, shared in its profits and losses; that the association, through its members, bore the risk of insuring Puerto Rico's high-risk drivers; that the association managed its own day-to-day affairs; that it had "general corporate powers" to sue and be sued, enter contracts, and hold property; and that it was designated by statute as "private in nature, for profit," and subject to Puerto Rico's insurance code. See Arroyo-Melicio, 398 F.3d at 61-63.

The court found that the association was not a public entity, even though it was "under some direction by the Commonwealth." Asociacion, 484 F.3d at 20 (quoting Arroyo-Melicio, 398 F.3d at 62). Indeed, the court acknowledged that the legislature created the association, dictated its form and purpose, offered tax exemptions to compensate for the association's assumption of public risks, and held approval power over the association's plan of operations. See Arroyo-Melicio, 398 F.3d at 61-63. On balance, the association and its funds were overwhelmingly "private in nature," id. at 62, and the association was held to be a proper Section 1983 plaintiff. See Asociacion, 484 F.3d at 20 (citing Arroyo-Melicio, 398 F.3d at 62).

The Fifth Circuit Court of Appeals reasoned similarly in finding that the Texas Catastrophe Property Insurance Association had standing to sue the state attorney general under Section 1983. Tex. Catastrophe Prop. Ins. Ass'n v. Morales, 975 F.2d 1178, 1181-83 (5th Cir. 1992). The state of Texas established the association as an assigned risk pool to write windstorm, hail, and fire insurance policies in parts of the state, and required all property insurers to join as a condition of operating in Texas. Id. at 1179. The association wrote its own policies and paid its own claims, which were funded first by policyholder premiums and, as needed, from member assessments. Id. The state subsidized the association's losses with tax credits. Id. Its plan of operations was adopted by the state's board of insurance with input from the association's board of directors, a majority of which was comprised of member company representatives. Id. The association's board was statutorily "responsible and accountable" to the state's board of insurance. Id.

The association hired its own legal counsel for decades. Id. at 1179-80. The legislature eventually amended the relevant statute to proclaim that the association "is a state agency" and to require the association to use the state's attorney general for legal representation. Id. at 1180. When the association brought suit claiming a violation of its right to counsel, the attorney general rejoined that the association, as a creature of statute, is necessarily "a state agency" with no constitutional rights as against its creator. Id. at 1180, 1181. The Fifth Circuit disagreed. It emphasized that the state government did not contribute to the association, nor did it share in the association's losses, which were borne by the association's members alone. Id. The association's monies, in sum, were wholly private—"private money directed to pay private claims." Id. at 1183. The court observed that although the state could deprive *itself* of any constitutional right it chooses, the association was not "truly a part of the state" for that purpose. Id.

The General Assembly directs the court to two cases that reached a contrary result. The first originates from the same medical malpractice insurance crisis from which the Joint Underwriting Association arose. See Med. Malpractice Ins. Ass'n v. Superintendent of Ins. of State of N.Y., 533 N.E.2d 1030, 1031 (N.Y. 1988) ("MMIA"), *cert.* denied, 490 U.S. 1080 (1989). New York state created the Medical Malpractice Insurance Association, a nonprofit unincorporated association, to offer insurance that was "no longer readily available in the voluntary market." Id. The association was governed by an exhaustive statutory framework dictating the composition of its board and its plan of operation and authorizing the superintendent of insurance to unilaterally order amendments to the plan. See MCKINNEY'S INSURANCE LAW

§§ 5503, 5508 (1988). When the superintendent set new rates that would require the association to operate at a loss, the association challenged the reasonableness of his approach. MMIA, 533 N.E.2d at 1032. Pertinent here, the association complained that the rate change effected a "confiscatory" taking in violation of the state and federal constitutions. See id. at 1032-33.

The New York Court of Appeals dismissed the association's argument in short order. The court stated that the association "is a creature of statute, and all of its rights, obligations and duties have been defined by the Legislature." Id. at 1036. It noted that the statute authorized the association to operate only during "fixed periods of time" as the superintendent deemed necessary. Id. And it emphasized that the association's operations were "subject to the [s]uperintendent's extensive and direct control." Id. The court further noted that the association was separate and distinct from its members and held and invested its funds separately from its members. Id. at 1037. The court accordingly rejected the association's claim that the superintendent's actions were confiscatory. Id. at 1036-37. In a later decision, the same court held that, based on its decision in MMIA, the state could order the association to transfer its reserve funds without implicating the Takings Clause. See Med. Malpractice Ins. Ass'n v. Cuomo, 541 N.E.2d 393, 393-94 (N.Y. 1989).

The General Assembly also identifies as support the Fifth Circuit's unpublished decision in Mississippi Surplus Lines Association v. Mississippi, 261 F. App'x 781 (5th Cir. 2008), aff'g 442 F. Supp. 2d 335 (S.D. Miss. 2006) ("MSLA"). Mississippi's insurance law required the state's insurance commissioner to regulate all insurance companies doing business in the state, including unlicensed "surplus lines insurers." Id. at 783. The commissioner was tasked to determine whether these insurers met various requirements of state law, to review applications and collect fees from agents seeking to place insurance with those insurers, to review biannual surplus lines premium reports, and to collect a premium tax on all surplus lines premiums received. Id.

The statute permitted the commissioner to delegate its surplus lines responsibilities to a "duly constituted association of surplus lines agents," and to allow the association to levy a one percent examination fee on the insurers for its services. Id. The commissioner did so, asking a group of "private individuals" to form a nonprofit to "assist him with his duties," and the Mississippi Surplus Lines Association was born. Id. at 784. The association collected the examination fees as authorized by statute and invested the surplus. See id. In response to budget shortfalls several years later, the legislature amended the statute and ordered the association to transfer $2 million of the fee surplus to the insurance department for eventual transfer to the state's budget fund. Id. The association sued, challenging the amendment as an unconstitutional taking. Id.

The Fifth Circuit panel looked to both the nature of the association and the nature of its funds before concluding that both were "public in nature." Id. at 785. The court acknowledged that the association had some private features—noting, for example, that the association hired its own employees and bore its own losses—but found that the association did not have "overwhelmingly private characteristics" sufficient to establish it as a private entity. Id. at 785-86. In particular, the court observed that the association's mission was "wholly to serve the state" and that it "operate[d] under conditions imposed by state law." Id. at 786. The court further concluded that the funds in question were public monies, having been accrued as a direct result of an explicit statutory provision authorizing collection of the fees and for the "sole purpose" of supporting the insurance commissioner's work. Id. at 786-87. The court contrasted the association's funds with those at issue in Morales, finding that the latter were appropriately deemed private funds where premiums paid into the risk pool "had a private end use—insuring businesses against risk and paying those businesses' claims." Id. at 787 (quoting Morales, 975 F.2d at 1183).

ii. Characteristics of the Joint Underwriting Association and Its Funds

The General Assembly posits that several features distinguish this case from Asociacion and Morales and align it with MMIA and MSLA. It contends that, in the former cases, the members' financial interests were implicated by the legislatures' actions, whereas the Joint Underwriting Association's members share neither in its profits nor its losses. (Doc. 71 at 9-10 & n.6). It also holds up as conclusive that the enabling statute for Puerto Rico's joint underwriting association explicitly identified the association as "private" and "for profit." (Id. at 9-10). We agree with the General Assembly's assertion that these facts differentiate the instant case from Asociacion and Morales. But we disagree with the General Assembly's assertion that these factual distinctions are dispositive.

No decision cited by the General Assembly supports its contention that an entity's public or private status turns on for-profit versus nonprofit nature or a statutory designation. Nor has any court suggested, as the state legislature intimates, that the fact of state creation (and the attendant possibility of state abolition) is alone determinative. Instead, all courts facing our present inquiry have holistically examined the entity's relationship with the state. See Asociacion, 484 F.3d at 20 (adopting Arroyo-Melicio, 398 F.3d at 60-63); Morales, 975 F.2d at 1181-83; MSLA, 261 F. App'x at 784-86; MMIA, 533 N.E.2d at 1031, 1036-37. These courts have considered a variety of factors, including the nature of the association's function, the degree of control reserved in the state (or the level of autonomy granted to the association), and the statutory treatment, if any, of the entity, in addition to the nature of the funds implicated. Viewed through this prism, we are compelled to find that the Joint Underwriting Association is a private entity as a matter of law.

The Association's function is inherently private. It is, at its core, an insurance company. The Association is comprised of private insurer members, governed by a private board, and supported by private employees. It is funded by privately-paid premiums and is tasked to provide medical malpractice coverage to private persons practicing medicine within the Commonwealth. It does not "exist wholly to serve the State," nor is it engaged in work otherwise tasked by statute to the state's insurance commissioner. Cf. MSLA, 261 F. App'x at 785-86. That the Association's private operations work an incidental public benefit does not render its function a public one.

The Association is subject to *de minimis* Commonwealth supervision, and its statutory treatment indicates that the Association is private rather than public. *In toto*, three statutory sections are dedicated to the Association. See 40 PA. STAT. & CONS. STAT. ANN. §§ 1303.731-.733. The first "establishe[s]" the Association as a nonprofit, sets forth "duties" largely applicable to all insurers, and defines its membership to include all insurers writing medical malpractice insurance within the state. Id. § 1303.731(a)-(b). It also disclaims Commonwealth responsibility for the Association's debts and liabilities. See id. § 1303.731(c). The second section describes the particular type of insurance to be offered—medical professional liability insurance for providers and entities otherwise unable to obtain coverage at reasonable rates. Id. § 1303.732(a). It sets forth broad-based policy objectives to that end, *i.e.*: that coverage be "conveniently and expeditiously available," and that the Association "provide[] sufficient coverage" on "reasonable and not unfairly discriminatory terms." Id. § 1303.732(b). Its third and final provision requires the Association's board to file any deficit with the Commissioner for approval before borrowing funds to satisfy the deficit. Id. § 1303.733.

Defendants' assertion that the statute subjects the Association to imperious control is belied by the statutory language and the record. The statute merely states that the Association is "supervised" by the Commissioner. Id. § 1303.731(a). But the Commissioner wields regulatory authority over all Commonwealth insurers, and the MCARE Act does not articulate a uniquely prescriptive role for the Commissioner in overseeing the Joint Underwriting Association. To the contrary, the Act grants nearly unfettered autonomy to the Association's board—all of its "powers and duties" are "vested in and [to be] exercised by a board of directors." Id. Importantly, the statute is silent as to the composition or operations of the board. Cf. MMIA, 533 N.E.2d at 1036-37. Board composition is instead defined by the Association's plan of operations, which provides for a board of directors comprised predominantly of representatives elected by the Association's members. See *supra* at p. 6; (see also Doc. 60 ¶ 45).

The General Assembly asserts that the MCARE Act ties the Association's hands with respect to a key function—setting its rates. The statute does require the Association to submit its rates and any rate modification to the Department for approval—in accordance with rate-setting provisions applicable equally to every insurer in the Commonwealth. 40 PA. STAT. & CONS. STAT. ANN. § 1303.731(b)(2) (incorporating 40 PA. STAT. & CONS. STAT. ANN. §§ 1181-99). The legislature also argues that the Commissioner holds "revisionary power" over the Association's rates and can "unilaterally 'adjust [the JUA's] prevailing primary premium.'" (Doc. 71 at 19 (quoting 40 PA. STAT. & CONS. STAT. ANN. § 1303.712(f))). This assertion is simply incorrect. The provision the legislature cites concerns the Commissioner's authority to determine the *MCARE assessment* levied on each health care provider in the state. 40 PA. STAT. & CONS. STAT. ANN. § 1303.712(d), (f). That assessment is calculated based upon the "prevailing primary premium" submitted for approval by the Association. Id. The statute permits the Commissioner to adjust the prevailing primary premium for the purpose of calculating MCARE assessments; it does not authorize the Commissioner to unilaterally reset the Association's rates. See id. § 1303.712(f).

Both defendants asseverate that the Association may be dissolved "by operation of law," positing that this "alone, establishes absolute governmental control." (Doc. 66 at 19-20; see also Doc. 62 at 7-9). Preliminarily, it is not the MCARE Act but the Association's own plan of operations, developed by the board with the Commissioner's approval, which sets procedures for dissolution. The Act's silence on this point hardly indicates legislative intent to retain control over the Association. Moreover, neither defendant identifies support for the claim that the state's ability to dissolve a nonprofit confers total control thereof to the state. Nor could they. *Any* nonprofit in the Commonwealth may be dissolved by operation of law. See 15 PA. CONS. STAT. § 9134(a)(5) ("A nonprofit association may be dissolved . . . under law other than this chapter."). The Commissioner also has the authority to dissolve private insurers in the Commonwealth under certain circumstances, and even private insurers must secure Commissioner approval to voluntarily dissolve. See 15 PA. STAT. & CONS. STAT. ANN. § 21205(a); 40 PA. STAT. & CONS. STAT. ANN. §§ 221.1-.52. Surely, these provisions do not divest all such entities of their constitutional rights anent the Commonwealth.

The MCARE Act meaningfully circumscribes the Association's authority in only two ways: by requiring it to file any deficit with the Commissioner for approval thereby to borrow funds, see id. § 1303.733, and by subjecting its plan of operations to Commissioner approval, see id. § 1303.731(b)(1). These provisions are similar in kind to those applicable to other insurers: all insurers in the Commonwealth, for example, are subject to some level of Department review in the event of severe financial impairment, see 40 PA. STAT. & CONS. STAT. ANN. §§ 221.6-a to -221.9-a, and all insurers must submit material amendments to their articles of incorporation, including proposed changes to the scope of their business, to the Department for approval, see 15 PA. STAT. & CONS. STAT. ANN. § 21204. With minor and immaterial exceptions, the Joint Underwriting Association is no more closely managed by the Commonwealth than any other private insurer authorized to write insurance in the state.

We must also consider the nature of the funds in dispute. See MSLA, 261 F. App'x at 785, 786-87. The General Assembly likens the Association's surplus to the fees collected on the commissioner's behalf in MSLA, positing that the surplus here, too, was "collected under the auspices of the state for the purpose of funding MSLA's operation on behalf of the state." (See Doc. 62 at 15 (quoting MSLA, 442 F. Supp. 2d at 344)). Beyond this selective quotation, the General Assembly finds no footing in MSLA. The court in MSLA distinguished the case before it—which concerned fees collected by a nonprofit association performing the commissioner's statutory duties—from Morales—where a nonprofit association offered catastrophe insurance at the direction of the legislature. MSLA, 261 F. App'x at 787 (citing Morales, 975 F.2d at 1179, 1183). The funds in the former case had a "public end use" and were not private property for Fifth Amendment purposes. Id. The latter, however, were indisputably private—"[i]t was private money directed to pay private claims," and thus "had a private end use—insuring businesses against risk and paying those businesses' claims." Id. So too is it here.

The Association has never received Commonwealth funding. The only provision of the MCARE Act that concerns the Association's finances *distances* the Commonwealth therefrom, expressly disclaiming state responsibility for the Association's debts and liabilities. 40 PA. STAT. & CONS. STAT. ANN. § 1303.731(c). The Association is funded exclusively by private premiums—paid by private parties in exchange for private insurance coverage—and any interest generated on those premiums. As a nonprofit association, Pennsylvania law authorizes the Association to "acquire, hold[,] or transfer . . . an interest in" the funds, see 15 PA. CONS. STAT. § 9115(a), and to "use[] or set aside" those funds "for the nonprofit purposes" of the Association, see id. § 9114(d). We find that the Association's surplus is the private property of the Association.

Defendants lastly contend that the surplus will inevitably escheat to the state. Specifically, the General Assembly avers that it could dissolve the Association by statute and order the Commissioner to refuse any proposed distribution of assets offered by the Association's board. (Doc. 62 at 17-18; see Doc. 73 at 19, 22 n.8). It submits that, in this scenario, the Association's assets would sit "unclaimed" until the funds escheat to the state by operation of law. (Doc. 62 at 17-18). This argument rests on several assumptions: *first*, that the General Assembly succeeds in passing a law to dissolve the Association, and, *second*, that the Commissioner rejects every proposed asset distribution submitted by the board. The General Assembly further assumes, without explanation, that the hierarchical statutory windup framework governing nonprofit dissolution "does not otherwise apply" to justify its invocation of the last-resort escheat alternative. (Id. at 17). We find no merit in this argument. Moreover, even if the legislature's hypothetical actualized in the future, it would not deprive the Association of its *present* possessory right in the surplus.

The Joint Underwriting Association is created by statute. But in the same legislation that created the Association, the General Assembly relinquished control thereof, for all material intents and purposes, to the Association's board of directors. The legislature had the option to tightly circumscribe the Association's operations and composition of its board, cf. MMIA, 533 N.E.2d at 1036-37 (citing MCKINNEY'S INSURANCE LAW § 5501 *et seq.*); to establish the Association as a special fund within the state's treasury, cf. 40 PA. STAT. & CONS. STAT. ANN. § 1303.712(a); or to retain meaningful control in any number of other ways. That the General Assembly chose to achieve a public health objective through a private association has a perceptible benefit: it assures availability of medical professional liability coverage throughout the Commonwealth at no public cost. By the same token, it also has a consequence: the General Assembly cannot claim *carte blanch* access to the Association's assets. We hold that the Joint Underwriting Association is a private entity, and its surplus funds are private property. The Commonwealth cannot take those funds without just compensation.

2. *For "Public Use" and Without "Just Compensation"*

We turn to the final two elements of the Joint Underwriting Association's takings claim: that the private property is taken "for public use" and "without just compensation." U.S. CONST. amend. V. The parties do not dispute that Act 44 seeks to repurpose the Association's surplus for public use. The General Assembly will utilize the funds to remedy the Commonwealth's budget deficits. See Act 44, § 1.3(4). Act 44 explains that the state "is in need of revenue from all possible sources in order to continue to balance its budget and provide for the health, welfare and safety of the residents of this Commonwealth." Id. In pursuit of this objective, the General Assembly earmarks the anticipated transfer "for medical assistance payments for capitation plans." Id. Act 44 thus purports to take the surplus funds for "public use."

There is also no genuine dispute that Act 44 fails to provide "just compensation" for its *per se* taking of the Association's funds. U.S. CONST. amend. V. In determining what compensation the Constitution requires, we examine not the value gained by the government but the loss to the property owner. See Brown v. Legal Found. of Wash., 538 U.S. 216, 235-36 (2003) (quoting Boston Chamber of Commerce v. Boston, 217 U.S. 189, 195 (1910)). For this reason, the Supreme Court has long held that "even if there was technically a taking" of private property, there can be no recovery under the Fifth Amendment when "nothing of value" is taken from the property owner. Marion & Rye Valley Ry. Co. v. United States, 270 U.S. 280, 254-55 (1926).

The General Assembly intimates that the Joint Underwriting Association cannot prevail on its takings claim because it will not "actually *feel* . . . pain" from the forced transfer of $200,000,000 of its surplus. (Doc. 71 at 20-21). It submits that the funds subject to Act 44 constitute "excess" surplus which is both unnecessary to preserve the Association's insurance function and is unable to be put to other use given the Association's narrow nonprofit purpose. (See id.) In other words, the General Assembly posits that because the Joint Underwriting Association has not identified a present need or intended use for the $200,000,000 subject to Act 44, the Fifth Amendment requires no compensation for the Act's proposed transfer thereof.

The parties dispute whether the $200,000,000 targeted by Act 44 is in fact "excess" surplus. Competing expert reports debate this question at length. This dispute, genuine though it may be, is ultimately immaterial. Even if the surplus funds are "excess" and unnecessary to maintain the Association's solvency in a forthcoming hard market, the funds remain the private property of the Association. Pennsylvania law firmly establishes that profits earned by a nonprofit association may "be used or set aside for the nonprofit purposes" thereof. See 15 PA. CONS. STAT. § 9114(d). Neither defendant identifies authority supporting their self-serving proposition that the Association's failure to identify a present purpose for the funds dilutes the value thereof to zero. Nor is there any support for Governor Wolf's view that, because the Association cannot articulate an immediate plan for divesting of its surplus, the General Assembly is free to take those funds for use toward what it deems a better purpose. (See Doc. 73 at 22-23). Accordingly, we reject defendants' claim that the $200,000,000 surplus targeted by Act 44 is "valueless."

There are no genuine disputes of material fact *sub judice*. The Rule 56 record leads inescapably to the following conclusions. The Joint Underwriting Association is a private entity, and monies in its possession are private property. Act 44 endeavors to take a substantial portion of these funds—$200,000,000—for the public purpose of remedying longstanding imbalances in the Commonwealth's budget. Act 44 not only fails to provide "just" compensation; it fails to provide *any* compensation whatsoever. We find Act 44 to be an unconstitutional taking of private property in contravention of the Fifth Amendment to the United States Constitution.

B. Permanent Injunctive Relief

Our inquiry does not end with a determination that the Joint Underwriting Association has prevailed on the merits of its Fifth Amendment claim. Before the court may grant permanent injunctive relief, the Association must prove: *first*, that it will suffer irreparable injury absent the requested injunction; *second*, that legal remedies are inadequate to compensate that injury; *third*, that balancing of the respective hardships between the parties warrants a remedy in equity; and *fourth*, that the public interest is not disserved by an injunction's issuance. See eBay, Inc. v. MercExchange, LLC, 547 U.S. 388, 391 (2006) (citations omitted).

We have already determined that the constitutional injury effected by Act 44 is irreparable. (See Doc. 41 at 25). Sovereign immunity forecloses an award of monetary damages against the Commonwealth in this litigation. See Edelman v. Jordan, 415 U.S. 651, 663 (1974); Christ the King Manor, Inc. v. Sec'y U.S. Dep't of Health & Human Servs., 730 F.3d 291, 319 (3d Cir. 2013). We reject the General

Assembly's eleventh hour suggestion that we allow the unconstitutional taking to occur and force the Association to try its luck in state court. (See Doc. 62 at 33-34). For the same reason, we find that there is no adequate legal remedy to compensate plaintiff's injury. The Third Circuit Court of Appeals has explicitly stated that "the Eleventh Amendment bar to an award of retroactive damages against the Commonwealth clearly establishes that any legal remedy is unavailable and that the only relief available is equitable in nature." Temple Univ. v. White, 941 F.2d 201, 214-15 (3d Cir. 1991). A combination of declaratory and injunctive relief is the only way to ensure that the Association does not suffer an irreparable injury.

The remainder of the factors also favor the Association's request. Act 44 effects a direct loss of $200,000,000 to the Association as well as the indirect loss of both the interest on those funds and the cost of liquidating its investment portfolio. It inflicts a considerable and irreparable constitutional injury which far surpasses the General Assembly's frustration in returning to the budgetary drawing board. As concerns the public interest, we do not doubt that the General Assembly's intention was as stated—to achieve the estimable goals of balancing the state's budget and providing "for the health, welfare and safety of the residents of this Commonwealth." Act 44, § 1.3. As we have already held, the General Assembly cannot achieve this legitimate end through illegitimate means. (See Doc. 41 at 26-27). The public interest is furthered—not disserved—by permanently enjoining enforcement of a plainly unconstitutional statute. See Jamal v. Kane, 105 F. Supp. 3d 448, 463 (M.D. Pa. 2015) (Conner, C.J.). We will grant the Association's request for permanent injunctive relief.

IV. Conclusion

Through Act 44, the General Assembly attempts to take by legislative requisition the private property of a private association to remedy its perpetual budgeting inefficacies. This it cannot do. Act 44 is plainly violative of the Takings Clause of the Fifth Amendment to the United States Constitution. We will grant summary judgment, declaratory judgment, and permanent injunctive relief to the Joint Underwriting Association. An appropriate order shall issue.

/S/ CHRISTOPHER C. CONNER
Christopher C. Conner, Chief Judge
United States District Court
Middle District of Pennsylvania

Dated: May 17, 2018

[J-133-2016 and J-134-2016]
IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

SAYLOR, C.J., BAER, TODD, DONOHUE, DOUGHERTY, WECHT, MUNDY, JJ.

SUGARHOUSE HSP GAMING, L.P., Petitioner v. PENNSYLVANIA GAMING CONTROL BOARD, Respondent STADIUM CASINO, LLC, Intervenor	:	No. 124 EM 2016 Appeal from the Supplemental Adjudication of the Pennsylvania Gaming Control Board in the matter of the Applications for the Category 2 Slot Machine License in the City of the First Class, Philadelphia, dated June 23, 2016 SUBMITTED: November 7, 2016
MARKET EAST ASSOCIATES, LP, Petitioner v. PENNSYLVANIA GAMING CONTROL BOARD, Respondent STADIUM CASINO, LLC, Intervenor	:	No. 125 EM 2016 Appeal from the Supplemental Adjudication of the Pennsylvania Gaming Control Board in the matter of the Applications for the Category 2 Slot Machine License in the City of the First Class, Philadelphia, dated June 23, 2016 SUBMITTED: November 7, 2016

OPINION

JUSTICE TODD **DECIDED: June 20, 2017**

These matters return to us following our prior decision on March 29, 2016, in which we affirmed in part, and vacated in part, the November 18, 2014 order of the Pennsylvania Gaming Control Board ("Board") — awarding the last remaining Category 2 slot machine license provided for by the Pennsylvania Race Horse Development and Gaming Act ("Gaming Act")[1] to applicant Stadium Casino, L.L.C ("Stadium") — and remanded this matter to the Board for the limited purpose of addressing two issues: (1) whether Watche Manoukian, an individual who is an affiliate of Stadium, was eligible to apply for a Category 1 slot machine license at the time of Stadium's application for the Category 2 license, in violation of Section 1304(a)(1) of the Gaming Act;[2] and (2) whether, after the issuance of the Category 2 license to Stadium, Manoukian will possess a financial interest in that entity greater than 33.3%, in violation of Section 1330 of the Gaming Act.[3] *See SugarHouse HSP Gaming, LP v. Pennsylvania Gaming Control Board*, 136 A.3d 457 (Pa. 2016) ("*SugarHouse I*").[4] The Board issued a "Supplemental Adjudication" on June 23, 2016, in which both issues were addressed.

SugarHouse HSP Gaming ("SugarHouse"), the present holder of a Category 2 slot machine license for a casino it operates in Philadelphia, and Market East Associates, L.P. ("Market East"), an unsuccessful applicant for the Category 2 license awarded to Stadium, have both filed petitions for review from that Supplemental Adjudication.[5] After careful consideration, we dismiss SugarHouse's petition for review, docketed at 124 EM 2016, finding it was not entitled to intervene in the proceedings on

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[1] 4 Pa.C.S. §§ 1101-1904.
[2] 4 Pa.C.S. § 1304.
[3] 4 Pa.C.S. § 1330.
[4] As we explained in that opinion, the Gaming Act establishes three separate categories of slot machine licenses, Category 1, Category 2, and Category 3, and it specifically provided that two Category 2 slot machine licenses were to be issued for the City of Philadelphia. *SugarHouse I*, 136 A.3d at 461; 4 Pa.C.S. § 1301-1305.
[5] We have consolidated these petitions for purposes of conducting our review.

remand. In Market East's petition for review, docketed at 125 EM 2016, we affirm the Board's determination that Manoukian was not eligible to apply for a Category 1 slot machine license at the time of Stadium's application for its Category 2 license, and, thus, that Section 1304(a)(1) would not be violated by the issuance of a Category 2 license to Stadium. However, we reverse the Board's determination of what constitutes a "financial interest" as that term is used in Section 1330, and we define that term herein. Because the Board has admitted that it has not determined the nature of the specific "equity infusion" Manoukian will supply post-licensure to the trust which has an ownership interest in Stadium, we presently cannot affirm the Board's conclusion that Manoukian will not be in violation of Section 1330's 33.3% limit on the possession of a financial interest in a Category 2 slot machine licensee by another slot machine licensee. Thus, we again remand for further proceedings consistent with this opinion.

I. Background

To briefly recap the factual history of this matter, a more detailed recitation of which may be found in *SugarHouse I*, in 2006, the Board awarded one of the two Category 2 licenses allotted under the Gaming Act for Philadelphia to SugarHouse, which, in 2010, opened an "interim" casino located on the eastern side of Philadelphia near the Delaware River. In 2014, SugarHouse commenced construction of an expansion of this facility at that location, which has since been completed and is currently in operation.

Initially, the Board awarded the second Category 2 license for Philadelphia to Foxwood Casino; however, in 2010, the Board revoked this license due to Foxwood's inability to raise the necessary money to build the facility, and the Board reopened the application process. Thereafter, four entities, including Stadium and Market East, filed applications with the Board seeking licensure, and the Board conducted background investigations of each of the applicants to determine whether they met the Gaming Act's eligibility and financial requirements for the issuance of a Category 2 license. After this process was complete, in 2013, the Board conducted a series of public suitability hearings to consider the merits of each application.

Before these hearings commenced, SugarHouse filed a petition with the Board to intervene, advancing three contentions relevant to this appeal as to why, in its view, the license should not be granted: (1) the granting of a second slot machine license would result in the alleged saturation of the Philadelphia area gaming market and cause SugarHouse economic harm through the dilution of its gaming revenues; (2) Stadium was precluded from being awarded a Category 2 license by Section 1304 of the Gaming Act because one of its affiliates already was the owner or operator of a facility which had a Category 1 slot machine license; and (3) that "affiliates, owners, or financial backers" of Stadium, Market East, and other applicants owned or had a financial interest in other existing licensed gaming facilities potentially greater than the 33.3% share permitted by Section 1330 of the Gaming Act, which would preclude those applicants from receiving a Category 2 license. SugarHouse Petition to Intervene, 12/16/13, at 11. The Board granted SugarHouse limited intervention, restricted to the issue of market saturation, but denied its intervention as to the remaining issues.

After reviewing all of the evidence which had been submitted to it, on November 18, 2014, the Board, at an open public hearing, voted 7-0 to award the Category 2 license to Stadium, and it issued an order to that effect on the same day. *See* Gaming Board Order, 11/18/14. This order incorporated, by reference, the reasons for the Board's approval which it set forth in a separate Adjudication, also issued on November 18, 2014. *Id.* In the Adjudication, the Board explained that it selected Stadium based on a variety of factors such as its proposed facility's accessibility, proximity to other casinos, impact on the surrounding community, traffic flow, past positive history of its management group in the gaming and entertainment industry, and the ability of Stadium's ownership group to self-finance the construction of the facility.

Both SugarHouse and Market East filed petitions for review with our Court from the Board's November 18, 2014 order, which we consolidated for disposition.[6] In its petition, SugarHouse raised four claims: (1) the Board erred as a matter of law or acted arbitrarily and capriciously in limiting SugarHouse's intervention in Board proceedings to the question of market saturation; (2) the award of the license to Stadium would result in undue economic concentration in violation of Section 1102(5)[7] of the Gaming Act and the Board's regulations; (3) the award of the license to Stadium would violate the provisions of Section 1304 of the Gaming Act barring dual ownership and control of a Category 1 and a Category 2 licensed facility; and (4) renewing its argument that the award of the license to Stadium would violate Section 1330 of the Gaming Act, because it would result in its affiliates, who already possessed a slot machine license, owning or controlling more than 33.3% of a second casino.

We rejected SugarHouse's challenge to the Board's limitation of its intervention.[8] We ruled that, because SugarHouse had a "substantial, direct, and immediate" interest

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[6] Our Court has exclusive appellate jurisdiction over appeals from "any final order, determination or decision of the board involving the approval, issuance, denial or conditioning of a slot machine license or the award, denial or conditioning of a table game operation certificate." 4 Pa.C.S. § 1204.

[7] 4 Pa.C.S. § 1102(5).

[8] Our standard of review in these matters requires our Court to

> affirm all final orders, determinations or decisions of the board involving the approval, issuance, denial or conditioning of a slot machine license or the award, denial or conditioning of a table game operation certificate unless it shall find that the board committed an error of law or that the order, determination or decision of the board was arbitrary and there was a capricious disregard of the evidence.

4 Pa.C.S. § 1204.

in the outcome of the licensing proceedings greater than that held by the general public at large — namely, suffering possible financial detriment from the improper granting of a license to a competitor if the Board did not adequately weigh the statutory requirement that it consider the prospect of market saturation in its award of the second license, and because none of the other parties were pursuing this issue before the Board — SugarHouse was properly granted intervention in the licensing proceedings by the Board under its regulations governing intervention. *See SugarHouse I*, 136 A.3d at 470; *see also* 58 Pa. Code § 441a.7(z)(2) ("A person may file a petition to intervene [in a licensing hearing for a slot machine license] if the person has an interest in the proceeding which is substantial, direct and immediate and if the interest is not adequately represented in a licensing hearing."). However, SugarHouse did not present any argument in its brief to our Court on that issue. *SugarHouse I*, 136 A.3d at 470.

By contrast, regarding SugarHouse's other issues, because they were raised and pursued by the other parties before the Board, and since the Board also received evidence on these questions from its own Bureau of Investigations and Office of Enforcement Counsel, we found no legal error, nor any arbitrary or capricious disregard of competent evidence by the Board, in denying SugarHouse's intervention as to these matters. We further noted that, in any event, Appellant Market East had raised the same challenges in its petition for review and continued to argue them in its appellate brief, rendering SugarHouse's arguments duplicative; hence, for all of these reasons, our Court did not address the other issues raised by SugarHouse.

Addressing the issues Market East raised on appeal, we first rejected its claim that the Board failed to consider and explicitly analyze certain evidentiary factors, which it averred established that the award of the license to Stadium would result in undue concentration of economic opportunities in violation of Section 1102(5). We, therefore, affirmed the Board's ruling on this issue. *Id.* at 474-75.

Our Court next considered the question of whether Stadium was eligible to apply for a Category 2 license under Section 1304 of the Gaming Act which provides, in relevant part: "A person may be eligible to apply for a Category 2 license if the applicant, its affiliate, intermediary, subsidiary or holding company is not otherwise eligible to apply for a Category 1 license." 4 Pa.C.S. § 1304(a)(1). Market East contended that Stadium was disqualified under this section because its affiliate, Manoukian, was, at the time of Stadium's application, "eligible to apply for a Category 1 license," due to the fact he had an 85% ownership interest in an entity known as Greenwood Racing ("Greenwood"), which is the parent company of Category 1 license holder Parx Casino.

The crux of Market East's argument in this regard was that, because a Category 1 license holder had to reapply for the renewal of that license prior to its expiration, both it, and any of its affiliates, must be deemed eligible to apply for the license as if they were applying for it the very first time. We rejected this claim based on the Gaming Act's differing requirements for the issuance of a slot license and the renewal of said license, as well as the Act's definition of applicant. *SugarHouse I*, 136 A.3d at 478 (citing 4 Pa.C.S. §§ 1103, 1325(a), 1326(a)). However, we noted that these statutory provisions did not establish the eligibility requirements to apply for a Category 1 license; rather, those requirements are set forth in Section 1302 of the Gaming Act.[9]

Noting that Section 1302, by its terms, does not disqualify a Category 1 licensee or any of its affiliates from applying for another Category 1 license for a separate racetrack facility, we recognized that Manoukian, even though an affiliate of a Category

[9] 4 Pa.C.S. § 1302, set forth in full *infra*.

1 license holder Parx Casino, was, nevertheless, potentially eligible to apply for another Category 1 license for another racetrack facility in the Commonwealth. Due to the fact that such eligibility would arguably trigger disqualification for the issuance of a Category 2 license under the prohibitory language of Section 1304(a)(1), and because we agreed with Market East's contention that the Board did not sufficiently explain its consideration of this statutory provision in its Adjudication, we remanded the matter to the Board to address, in the first instance, whether Manoukian was, in fact, eligible to apply for a Category 1 license at the time of Stadium's application. *SugarHouse I*, 136 A.3d at 478.

Our Court next examined Market East's contention that Stadium's proposed post-licensure ownership structure[10] violated Section 1330 of the Gaming Act, which states:

> No slot machine licensee, its affiliate, intermediary, subsidiary or holding company may possess an ownership or financial interest that is greater than 33.3% of another slot machine licensee or person eligible to apply for a Category 1 license, its affiliate, intermediary, subsidiary or holding company.
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> * * *
>
> No such slot machine license applicant shall be issued a slot machine license until the applicant has completely divested its ownership or financial interest that is in excess of 33.3% in another slot machine licensee or person eligible to apply for a Category 1 license, its affiliate, intermediary, subsidiary or holding company.

[10] Under this structure, described in *Sugarhouse I*, Stadium will be owned in equal shares by two limited liability corporations: Stadium Casino Investors and Stadium Casino Baltimore Investors. 66% of Stadium Casino Investors will, in turn, be owned by Greenwood and 34% by an entity known as the Sterling Investors Trust, an irrevocable trust created by Manoukian. Sterling Fiduciary Services, Inc. ("Sterling Fiduciary"), a limited liability corporation, is the trustee of Sterling Investors Trust. Post-licensure, Manoukian will own 28% of the shares of Sterling Fiduciary, with the other 72% of the shares held by other members of his family. *Sugarhouse I*, 136 A.3d at 464-65. Three of Manoukian's family members, their spouses, and their children are the designated beneficiaries of the Trust; however, Manoukian is not. Supplemental Adjudication, 6/23/16, at 10-11.

4 Pa.C.S. § 1330.

Market East argued that the Board engaged in no meaningful analysis in its Adjudication of whether Manoukian's interests in Stadium, through his interests in Sterling Fiduciary, violated the requirements of Section 1330. Market East took the position that, because Manoukian's family members held all of the ownership shares in Sterling Fiduciary not owned by Manoukian, Manoukian's business ally occupied all of the corporate officer positions of Sterling Fiduciary, and because Manoukian pledged an "equity infusion" of $34 million[11] to Sterling Investors Trust, which would be used as capital by Stadium, this raised the question of whether the trust was being used by Manoukian to evade the requirements of Section 1330 by making it appear that his total interest in Stadium through Sterling Fiduciary and Greenwood was below the 33.3% limit imposed by that Section. Because Section 1330 expressly permits a license applicant to divest any ownership or financial interest prior to the issuance of a license in order to comply with this statute, we agreed with the Board that the relevant ownership structure of a Category 2 license applicant was that which the applicant would have post-licensure.

Although our Court found no fault with the Board's calculation of Manoukian's ultimate *ownership* interests in Stadium through Sterling Financial under Section 1330, we noted that the language of this section additionally required the Board to examine the percentage of "*the financial interest* that an existing license holder will possess in a licensee after the license is issued." *SugarHouse I*, 136 A.3d at 481 (emphasis original and footnote omitted). Market East argued to our Court that the Board's Adjudication

[11] The Board describes this equity infusion as being "provided from Watche Manoukian's personal funds," but, as discussed *infra*, the Board does not specify how this money would be transferred from Manoukian to the trust, *e.g.*, by loan or gift. Supplemental Adjudication, 6/23/16, at 10.

did not sufficiently support its apparent conclusion that Manoukian's financial interest in Stadium was also within the 33.3% limit of Section 1330,[12] and Market East further highlighted in its confidential brief to our Court its concerns over the equity infusion pledged by Manoukian to Sterling Investors Trust, which will, in turn, be used by the trust to purchase an interest in Stadium. Because the Board's Adjudication did not address these matters, we remanded to the Board to explicate whether Manoukian, post-licensure, would possess a financial interest in Stadium which exceeds that section's 33.3% limit on financial interests. *SugarHouse I*, 136 A.3d at 481. Due to the fact that the definition of financial interest as used in Section 1330 was integral to the Board's consideration of this issue, we additionally directed the Board, as the administrative agency charged with interpreting the Gaming Act, to articulate how it defined that term. *Id.* at 481 n.30.

We, thus, affirmed in part, and vacated in part, the Board's order of November 18, 2014, and issued both a public remand order and a separate sealed version of that order to protect certain confidential personal information provided to the Board which is not a matter of public record. Both versions of the remand order directed the Board to conduct "further proceedings" to address the two matters discussed above.[13]

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[12] *See* Market East Brief (Public Version) in *SugarHouse I* at 17 ("[T]he Board offered no substantive support for its apparent conclusion that Manoukian's ownership *or financial interest* in Stadium passes muster under section 1330, instead mostly relegating the issue to footnotes to the Adjudication." (emphasis added)).

[13] The public order stated in full:

> **AND NOW,** this 29th day of March, 2016, for the reasons expressed in the accompanying Opinion, the Order of the Gaming Control Board Court is hereby **AFFIRMED** in part, **VACATED** in part, and the matter is **REMANDED** for further proceedings on the following issues. First, regarding the question of the eligibility of Stadium Casino, LLC ("Stadium") to apply for a Category 2 slot machine license under 4 Pa.C.S. § 1304(a), the Board is directed to consider whether Watche Manoukian, as an affiliate of Stadium, was eligible

(continued…)

On June 8, 2016, the certified record in this case was remanded to the Board. Thereafter, on June 23, 2016, the Board issued a Supplemental Adjudication in which it determined "that adequate factual basis exists within the record of the proceedings before it, as well as within official records of the Board, to address [the remanded] issues. As such, an additional hearing for the purpose of taking further evidence is not necessary." Supplemental Adjudication, 6/23/16, at 4-5. Based on the extensive evidentiary record, which had been previously developed during the licensing proceedings, its prior 2014 Adjudication, and its taking of judicial notice of matters published in the Pennsylvania Bulletin,[14] the Board first found that neither Manoukian, nor any other affiliate, intermediary, or holding company of Stadium was otherwise eligible to apply for a Category 1 slot machine license, and, consequently, that Section 1304 would not be violated by the issuance of a Category 2 license to Stadium. Second, the Board elucidated its definition of what it considered to be a financial interest under Section 1330, and found that, under that definition, Manoukian will not have a

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(...continued)

> to apply for a Category 1 slot machine license at the time Stadium applied for the Category 2 slot machine license which is the subject of this appeal. Second, the Board is directed to consider whether the financial interest, if any, Manoukian may have in Stadium due to certain financial transactions and commitments of financial support he made during the application process violates the prohibitions in 4 Pa.C.S. § 1330. Specifically, the Board should consider whether Manoukian, by virtue of his pledged commitment to {redacted} or through any other financial transaction, would possess, post-licensure, a financial interest in Stadium in excess of the 33.3% threshold established by Section 1330.

SugarHouse I, 136 A.3d 457 (Pa. 2016) (public order).

[14] *See Riverwalk Casino, LP v. Pennsylvania Gaming Control Board*, 926 A.2d 926, 935 (Pa. 2007) (observing that "the Gaming Board serves as a quasi-judicial body with fact-finding and deliberative responsibilities.").

financial interest in Stadium, post-licensure, greater than 33.3%.[15] The Board, thus concluded, based on its prior Adjudication, that its November 18, 2014 order awarding the Category 2 license to Stadium was "supported by the extensive evidentiary record and consistent with the relevant provisions of the Gaming Act." *Id.* at 23.

The same day the Board issued its Supplemental Adjudication, SugarHouse filed a petition to intervene with the Board, requesting that it be granted "full party status as an Intervener in the proceedings on remand." SugarHouse Petition to Intervene, 6/23/16, at 1. SugarHouse sought to "raise and present . . . matters" pertaining to the questions that we directed the Board to answer on remand. *Id.* at 4. As per the Board's rules of procedure, Sugarhouse's petition to intervene was referred to the Board's Office of Hearings and Appeals ("OHA"), to which, as explained more fully herein, the Board has assigned responsibility for the disposition of "all matters, except for hearings under § 441a.7 (relating to licensing hearings for slot machine licenses)." 58 Pa. Code § 491a.8.

On June 29, 2016, a Board hearing officer returned the petition by mail to counsel of record for SugarHouse, along with the accompanying explanatory letter:

> We are returning the *Petition* and marking the proceeding where it was docketed (OHA Docket No. 4745-2016) closed. Upon review of the *Petition*, it was determined that the relief sought ("the right to intervene and participate in the Proceedings on Remand") could not be granted because, in fact, the Board held no additional proceedings on remand as it relied upon the existing evidence of record.

Letter from Board Hearing Officer Kenneth Zielonis, 6/29/16 (emphasis original). Thereafter, on July 22, 2016, SugarHouse filed a petition for review in our Court,

[15] The specific rationale of the Board in arriving at these conclusions will be further elaborated, *infra*, in our discussion of the issues we are addressing in this appeal.

docketed at 124 EM 2016, and Market East subsequently filed a petition for review, docketed at 125 EM 2016, on July 27, 2016.

In response to SugarHouse's petition, the Board filed an application for relief with our Court, asserting that SugarHouse's petition should be "quashed and dismissed, inasmuch as our Court, in *SugarHouse I*, previously upheld the Board's limitation of SugarHouse's intervention in the licensing process to the subject of market saturation. Board Application for Relief, 8/12/16, at 1. After SugarHouse filed an answer to the application, our Court entered an order deferring action on the application and directing the parties to address this question in their respective briefs. *See SugarHouse HSP Gaming v. Pa. Gaming Control Board*, 124 EM 2016 (Pa. filed Sept, 13, 2016) (order).

II. Analysis

SugarHouse and Market East raise the following issues in their briefs:

Appeal of SugarHouse at 124 EM 2016, J-133-2016:[16]

> 1. Did the Board err as a matter of law, or at the very least act arbitrarily and with a capricious disregard of the evidence, when it failed to even consider, much less grant, SugarHouse's pending Petition to Intervene on Remand before issuing the Supplemental Adjudication?
>
> 2. Did the Board err as a matter of law, or at the very least act arbitrarily and with a capricious disregard of the evidence, when it denied SugarHouse due process by failing to give it notice and an opportunity to be heard before issuing the Supplemental Adjudication?
>
> 3 Did the Board err as a matter of law, or at the very least act arbitrarily and with a capricious disregard of the evidence, in issuing its Supplemental Adjudication when it failed to comply with this Court's March 29, 2016 Remand Order?

[16] These issues have been reordered for ease of consideration.

> 4. Did the Board err as a matter of law, or at the very least act arbitrarily and with a capricious disregard of the evidence, when it issued its Supplemental Adjudication in violation of the Pennsylvania Sunshine Act?

SugarHouse Brief (J-133-2016) (Public Version) at 5-6.

Appeal of MarketEast 125 EM 2016, J-134-2016:

> 1. Did the Board commit an error of law in confirming its award of the License to Stadium without actually conducting further proceedings as specifically directed by this Court's March 29, 2016 Order vacating in part the Board's original order granting the License to Stadium?
>
> 2. Did the Board commit an error of law in confirming its award of the License to Stadium because granting the license to Stadium violates Section 1330 of the Gaming Act, 4 Pa.C.S. § 1330, which prohibits a slot machine licensee, its affiliate, intermediary, subsidiary, or holding company from possessing an ownership or financial interest greater than 33.3% of another slot machine licensee or person eligible to apply for a Category 1 license, its affiliate, intermediary, subsidiary, or holding company, and by adopting an impermissibly narrow definition of what constitutes a "financial interest" under this section of the Gaming Act with respect to Watche Manoukian?
>
> 3. Did the Board commit an error of law in confirming its award of the License to Stadium even though granting the License to Stadium violates Section 1304(a)(1) of the Gaming Act, 4 Pa.C.S. § 1304(a)(1), which makes Stadium ineligible for a Category 2 license because an entity is only eligible to apply for a Category 2 license if the applicant, its affiliate, intermediary, subsidiary or holding company is not otherwise eligible to apply for a Category 1 license?

Market East Brief (J-134-2016) (Public Version) at 9-10.[17]

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[17] Stadium, as a party to the licensing proceedings below, has intervened in this appeal as a matter of right and has filed a brief in support of the Board's Supplemental Adjudication. *See* Pa.R.A.P. 1531 ("A party to a proceeding before a government unit that resulted in a quasijudicial order may intervene as of right in a proceeding under this chapter relating to such order by filing a notice of intervention (with proof of service on (continued…)

A. Appeal of SugarHouse at 124 EM 2016, J-133-2016

We first consider the contentions of the Board that SugarHouse's appeal should be quashed or dismissed, which we directed the parties to brief.

1. Waiver.

The Board first argues that SugarHouse has waived any right to appeal due to the fact that it failed to exhaust its administrative remedies before the Board prior to the filing its petition for review. The Board contends that, under the Administrative Code, which supplements the Board's regulations, whenever a subordinate to the agency head takes an action pursuant to his or her delegated authority, the affected party has 10 days to file a petition seeking review from the agency head. Because the OHA hearing officer returned the petition to intervene to SugarHouse, and as SugarHouse did not seek further review of this action with the Board, it has waived all of its appellate arguments in the current appeal.

SugarHouse responds by averring that the Board's argument "misses the mark." SugarHouse Reply Brief (J-133-2016) (Public Version) at 24. In SugarHouse's view, because the Hearing Officer did not address its intervention petition, but simply rejected and returned the petition, it was performing a mere "ministerial action" at the Board's direction in the capacity of a surrogate; hence, it posits that the act of the Hearing Officer is attributable to the Board and, thus, is required to be appealed directly to this Court. However, according to SugarHouse, if the Hearing Officer was acting of his own initiative and without authorization from the Board, then his purported rejection of the appeal is a nullity, and the Board's decision is immediately appealable.

(…continued)
all parties to the matter) with the prothonotary of the appellate court within 30 days after notice of the filing of the petition for review.").

A claim that appellate issues are waived for failing to raise them in the first instance with the Board involves a question of law, and, thus, our standard of review is *de novo*. *Pocono Manor Investors, LP v. Pennsylvania Gaming Control Board*, 927 A.2d 209, 216 (Pa. 2007). The Board's argument implicates the concept of "*Dilliplaine* waiver," a doctrine arising from our seminal case of *Dilliplaine Valley v. Lehigh County Trust*, 322 A.2d 114 (Pa. 1974), wherein our Court abrogated the prior and long-standing jurisprudential rule that an appellate court could consider claims of trial court error which are "basic and fundamental," even though no timely objection to the alleged error was made to the trial court. *Id.* at 216-17. Informing our decision to abrogate this rule, we identified two principal benefits of requiring objections to be preserved through initial presentation to a lower tribunal: (1) a timely objection made to the trial court gives that court the opportunity to take immediate corrective action, which promotes efficiency in the judicial process by allowing litigants to avoid incurring unnecessary expense and delay by being forced to resort to the appellate process; and (2) it offers a predictable and neutral standard for appellate review of claims of trial court error which is applicable to all cases, unlike the former standard which was inconsistently applied by appellate courts on a case by case basis. *Id.* at 117.

Thereafter, our Court applied the rationale of *Dilliplaine* to administrative proceedings and ruled that a claim could be waived for purposes of appellate review for failure to present it to the administrative tribunal which rendered a final decision in the matter:

> [T]he administrative law tribunal must be given the opportunity to correct its errors as early as possible; diligent preparation and effective advocacy before the tribunal must be encouraged by requiring the parties to develop complete records and advance all legal theories; and the finality of the lower tribunals' determinations must not be eroded by treating each determination as part of a sequence of piecemeal adjudications.

Wing v. Commonwealth Unemployment Compensation Board of Review, 436 A.2d 179, 181 (Pa. 1981). These precepts have been codified in Rule 1551 of the Pennsylvania Rules of Appellate Procedure governing petitions for review from administrative tribunals, which provides, in relevant part:

> **(a) Appellate jurisdiction petitions for review.** Review of quasijudicial orders shall be conducted by the court on the record made before the government unit. No question shall be heard or considered by the court which was not raised before the government unit except:
>
> (1) Questions involving the validity of a statute.
> (2) Questions involving the jurisdiction of the government unit over the subject matter of the adjudication.
> (3) Questions which the court is satisfied that the petitioner could not by the exercise of due diligence have raised before the government unit . . . .

Pa.R.A.P. 1551(a).

Subsequently, however, our Court specified that waiver of a particular issue for failure to raise it before an administrative tribunal is not *required* by *Dilliplaine* itself; rather, *Dilliplaine* merely *permits* an administrative agency to adopt an issue preservation requirement through its own rules of procedure. *Goods v. Pennsylvania Board of Probation and Parole*, 912 A.2d 226, 235-36 (Pa. 2006). As a result, only if a statute or an administrative tribunal's rules of procedure afford the opportunity for an issue to be presented to the tribunal so that it may render a decision on it, and also provide notice that an issue will be waived for failure to properly raise and preserve it in a manner specified by those rules, will waiver under *Dilliplaine* be appropriate. *Id.* at 236; *Pocono Manor*, 927 A.2d at 240.

Consistent with these principles, our Court has previously declined to find appellate waiver of issues for failure to raise them first with the Board, whenever the Board's rules of procedure did not provide a mechanism for those issues to be presented to it so that the Board could rule on the issues in the first instance, or assurances that the Board would consider the issue if a party undertook certain steps to present claims of error to the Board. *See Station Square Gaming v. Pennsylvania Gaming Control Board*, 927 A.2d 232 (Pa. 2007); *Pocono Manor*.

In the case *sub judice*, the Board's validly promulgated and adopted rules of procedure provided a mechanism by which SugarHouse could have raised with the Board all issues relating to the alleged impropriety of the Hearing Officer's denial of its petition to intervene.[18] Specifically, the Board has adopted a regulation specifying that "[u]nless the Board hears the matter directly, all matters, except for hearings under § 441a.7 (relating to licensing hearings for slot machine licenses), will be assigned to the OHA." 58 Pa. Code § 491a.8; 58 Pa. Code § 491a.2. (defining OHA as "[a] division of the Board charged with administrating and conducting hearings *or other matters as the Board may direct.*" (emphasis added)). In this case, the Board conducted no new licensing hearing in this matter on remand; rather, as indicated above, the Board prepared a Supplemental Adjudication, which was an explanatory opinion setting forth the Board's findings of fact and its rationale for portions of its November 18, 2014 order. Consequently, under 58 Pa. Code § 491a.8, SugarHouse's petition to intervene in the remand proceedings was properly referred to OHA for initial consideration.[19]

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[18] In this respect, we construe the hearing officer's letter to SugarHouse to constitute a denial of its petition to intervene. *See* Hearing Officer Letter, 6/29/16 (Appendix B to SugarHouse Brief (J-133-2016) (Public Version)) ("Upon review of the Petition, it was determined that the relief sought ('the right to intervene and participate in the Proceedings on Remand'*)* could not be granted because, in fact, the Board held no additional proceedings on remand as it relied upon the existing evidence of record . . . .").

[19] SugarHouse contends that its petition to intervene was a petition "to intervene in a licensing proceeding" governed by 58 Pa. Code § 441a.7(z)(2). SugarHouse Reply Brief (J-133-2016) (Public Version) at 24 n.12. However, that regulation is inapplicable since, by its plain terms, it governs only petitions to intervene in *licensing hearings*, and, as indicated, the Board did not conduct a licensing hearing in this matter on remand. (continued…)

Section 35.20 of the Administrative Code, which has not been superseded by any Board regulation, and is, thus, applicable to proceedings before the Board, delineates a specific course of action which may be taken after the adverse action of a hearing officer. *See* 1 Pa. Code § 35.20 (any action "taken by a subordinate officer under authority delegated by the agency head *may* be appealed to the agency head by filing a petition within 10 days after service of notice of the action." (emphasis added)). The Administrative Code further defines "agency head" as "[t]he secretary of a department, a quorum of an authority or departmental administrative board or commission or *independent board* or commission, or another officer or group of officers whose action with respect to a matter pending before the agency exhausts opportunity for administrative review within the agency and constitutes the action of the administrative agency for the purposes of Pa. Constitution. art. V, § 9." 1 Pa. Code § 31.3 (emphasis added). Thus, these regulatory provisions afforded a means for SugarHouse to request that the Board review the decision of its hearing officer.

However, critically, there is nothing in the Board's regulations or in the Administrative Code which provides notice to a litigant pursuing matters before the Board that it *must* follow these procedural steps and present all alleged claims of error by a hearing officer to the Board in order to preserve such claims for appeal. As discussed above, our Court indicated in *Goods* that notice of such waiver of appellate issues for failing to follow specified agency procedures governing presentation of the issue to the agency for consideration is a fundamental requirement which must be included in an agency's regulatory framework in order for waiver to be appropriate

(…continued)
See 58 Pa. Code § 441a.7(z) ("This subsection pertains exclusively to intervention in a licensing hearing for a slot machine license under this section and is not applicable to other hearings before the Board.").

under *Dilliplaine*. Thus, as the Board's regulations did not clearly inform a litigant in SugarHouse's position that failure to appeal an adverse decision of a hearing officer to the Board would result in waiver of its appellate challenges to that decision, we will not find its claims waived under these circumstances.[20]

2. Whether SugarHouse may intervene in this appeal.

The Board next argues that SugarHouse was properly denied the right to intervene in the proceedings on remand, and should not be permitted to intervene in this appeal, due to the fact that our Court previously upheld the Board's decision to limit SugarHouse's intervention to the question of market saturation, and because that issue was finally disposed of in *SugarHouse I*. The Board contends that the remand of a case does not start the case anew and give litigants the opportunity to relitigate issues which have been previously decided by the appellate court. Consequently, in the Board's view, because our Court affirmed the decision of the Board denying SugarHouse intervention on the issues which we remanded to the Board, SugarHouse had no right to intervene in the proceedings on remand or to appeal any portion of the Board's decision.

SugarHouse again claims that it was permitted to seek intervention under 58 Pa. Code § 441a.7(z)(2). SugarHouse does not contest that this Court in *SugarHouse I* upheld the Board's determination that it was not entitled to intervene on any issue other than market saturation; however, it contends that decision was not determinative of its right to intervene in the proceedings on remand. SugarHouse argues that the prior denial of its intervention was based on the fact that other parties and the Board's Office of Enforcement Counsel were representing its interests in proceedings before the

[20] We do not mean to suggest that the Board could not validly adopt such a regulation, merely that it has not done so at present.

Board. Presently, it maintains that no other party was representing its interests on remand since Market East did not participate in those proceedings, and there is no indication that the Office of Enforcement Counsel participated in those proceedings. According to SugarHouse, because it continues to have an interest in the outcome of the proceedings greater than that of the general public, due to its status as the other Category 2 license holder in the City of Philadelphia, and because there was no other party adequately representing its interests, or which would have presented the same arguments it would have made, the Board should have permitted it to intervene on remand, and, for the same reasons, it presently should be permitted to intervene in this appeal.

The question of whether a person or entity which is not a party to proceedings below may intervene in an appeal to our Court is a question of law, which we review *de novo*. *Society Hill Civic Association v. Pennsylvania Gaming Control Board*, 928 A.2d 175, 178 (Pa. 2007). First, we reject SugarHouse's argument that 58 Pa. Code § 441a.7(z)(2) governs the question of whether the Board should have permitted it to intervene on remand. As we have already discussed, the proceedings on remand were *not* a licensing hearing. *See supra* note 19. The licensing hearing in this matter was held November 18, 2014, at which the Board voted 7-0 to award the Category 2 license to Stadium. The Board conducted no new licensing hearing on remand.

Moreover, and importantly, when SugarHouse filed its *initial* petition to intervene prior to the Board's holding of suitability hearings for the various applicants, it specifically claimed that Stadium's affiliates such as Manoukian were ineligible to receive the Category 2 license under Sections 1304 and Section 1330 of the Gaming Act. The Board denied it intervention as to those claims. Because SugarHouse was not a party to the proceedings below, and because of our affirmance of the Board's denial of its intervention, we did not consider SugarHouse's arguments to our Court concerning whether the Board's grant of a license to Stadium violated Sections 1304 and 1330. *SugarHouse I*, 136 A.3d at 470. Our ruling, therefore, finally adjudicated the question of SugarHouse's right to intervene in this case on issues involving whether Manoukian was in compliance with these statutory provisions, and, thus, established the "law of the case" with respect thereto: SugarHouse has no right of intervention with respect to these matters. *Commonwealth v. Yarris*, 731 A.2d 581, 586 (Pa. 1999) (prior legal conclusion of our Court on issue becomes law of the case).[21]

Inasmuch as the remand proceedings before the Board were restricted to requiring the Board to further explain its rationale for its prior determination that the award of the license to Stadium comported with Sections 1304 and 1330, the Board was bound by our ruling, under the law of the case doctrine, to deny SugarHouse intervention on these matters. *Riccio v. American Republic Insurance Company*, 705 A.2d 422, 425 (Pa. 1997) (pursuant to the law of the case doctrine, "a court involved in the later phases of a litigated matter should not reopen questions decided by another judge of the same court or by a higher court in the earlier phases of the matter").[22] For

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[21] We have not applied this doctrine inflexibly, and so we will not apply it "in exceptional circumstances such as where there has been an intervening change in the controlling law, a substantial change in the facts or evidence giving rise to the dispute in the matter, or where the prior holding was clearly erroneous and would create a manifest injustice if followed." *Commonwealth v. Starr*, 664 A.2d 1326, 1332 (Pa. 1995). None of these circumstances are present in the instant matter.

[22] Although our Court has articulated the law of the case doctrine in the context of a parallel relationship between trial courts, or the hierarchal relationship between appellate and trial courts, given that an administrative tribunal performs similar adjudicative functions as trial courts, and is similarly bound to follow the directives of an appellate court on remand, we consider this doctrine to be equally applicable in administrative proceedings, as is already the practice in the federal court system. *See, e.g.*, *Wilder v. Apfel*, 153 F.3d 799 (7th Cir. 1998) ("The law of the case doctrine, which requires 'the trial court to conform any further proceeding on remand to the principles set forth in the appellate opinion unless there is a compelling reason to depart,' is (continued…)

that reason, we dismiss SugarHouse's petition for review with respect to its challenge to the Board's Supplemental Adjudication concerning Manoukian's compliance with Sections 1304 and 1330 of the Gaming Act.[23] [24]

(…continued)
applicable to judicial review of administrative decisions. It requires the administrative agency, on remand from a court, to conform its further proceedings in the case to the principles set forth in the judicial decision, unless there is a compelling reason to depart."(internal citations omitted)); *Grigsby v. Barnhart*, 294 F.3d 1215 (10th Cir. 2002) (same).

[23] We reject SugarHouse's argument that the denial of its renewed request for intervention somehow constitutes a denial of its due process rights. As our Court has previously emphasized, "[t]he applicability of the constitutional guarantee of procedural due process depends in the first instance on the presence of a legitimate 'property' or 'liberty' interest within the meaning of the Fifth or Fourteenth Amendment." *Sweeney v. Tucker*, 375 A.2d 698, 712 (Pa. 1977). There is unquestionably no liberty interest at stake here in these proceedings, and, as the Board argues, SugarHouse has no legitimate property interest at stake here which would trigger the procedural protections of the due process clause. SugarHouse has been awarded a Category 2 slot machine, and these proceedings do not call into question the viability of that license. Moreover, the Gaming Act did not vest in SugarHouse an exclusive right to be the only Category 2 license holder in Philadelphia. To the contrary, the Gaming Act specifically contemplates the award of an additional Category 2 license; thus, SugarHouse has no protected interest in being the sole license holder in the City of Philadelphia.

To the extent that SugarHouse claims a right to intervene at present based on our Court's recognition that it met the first criteria to establish its right to intervene in the previous licensing proceedings under 58 Pa. Code § 441a.7(z)(2), that claim is baseless. This regulation does not confer on SugarHouse the unqualified right to intervene, but rather clearly specifies that intervention is "within the sole *discretion* of the Board." *Id.* (emphasis added). The regulation also requires that SugarHouse demonstrate that its interests would not be "adequately represented in [the] licensing hearing." *Id.* The Board found that SugarHouse's interests were adequately represented by the Board and other licensing applicants who were parties to the proceeding, and our Court affirmed the Board's decision as a valid exercise of its discretion. Merely because SugarHouse received an adverse decision by the Board and our Court on this point does not mean it was denied due process.

Likewise, there is no denial of due process in our ruling that SugarHouse was not entitled to intervention in the remand proceedings under the application of the law of the case doctrine. SugarHouse had a full and fair opportunity in the prior proceedings to present its legal arguments, and any supporting factual evidence, to the Board to demonstrate that it was entitled to intervention on questions relating to Stadium's compliance with Sections 1304 and 1330. SugarHouse also had the full and fair opportunity to appeal the Board's decision to deny it intervention, and to argue to our (continued…)

B. Appeal of MarketEast at 125 EM 2016, J-134-2016

1. Board compliance with remand order.

We turn now to the issues raised by Market East. Market East first contends that the Board misinterpreted, or otherwise failed to comply with, the terms of our remand order, by issuing a Supplemental Adjudication rather than conducting a formal hearing after the matter was returned to it for further proceedings. Market East asserts that the Board's review of the existing evidentiary record and issuance of the Supplemental Adjudication did not constitute "further proceedings" within the meaning of those terms as used in our remand order. It proffers that the term "proceedings" should be strictly interpreted in accordance with one of its enumerated definitions in Black's Law Dictionary, namely as "[t]he business conducted by a court or other official body; a hearing." Market East Brief (J-134-2016) (Public Version) at 20. Thus, in its view, the Board was required by our Court's order to conduct a formal hearing and allow it to present new evidence and argument with respect to these matters.

Additionally, Market East claims that the Board also failed to comply with our Court's remand order by failing to address in its Supplemental Adjudication whether Manoukian acquired a financial interest in Stadium through specific transactions

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(…continued)
Court that the decision was in error. Application of the law of the case doctrine under these circumstances does not deny SugarHouse due process. *See, e.g.*, 16D C.J.S. Constitutional Law § 2004 ("The application of the law-of-the-case doctrine on remand does not violate due process if a party had an ample opportunity to raise factual issues earlier in the litigation."); *Federated Mutual Insurance Company v. Anderson*, 991 P.2d 915, 927 (Mont. 1999) (same), *abrogated on other grounds by Citizens Awareness Network v. Montana Board of Environmental Review*, 227 P.3d 583 (Mont. 2010).

[24] Given that we are dismissing SugarHouse's petition for review, we do not address its arguments regarding the Board's alleged non-compliance with our remand order. With respect to SugarHouse's claim that the Board violated the Sunshine Act, we find that this claim is not yet ripe for adjudication, since, as explained *infra*, we are again remanding this case to the Board for further proceedings. Any alleged violation of the Sunshine Act by the Board's conduct of those proceedings may be raised at that time.

enumerated in that remand order, i.e., his proposed equity infusion to Sterling Investors Trust and the financial arrangements by which his family members acquired their ownership interests in Sterling Fiduciary.

The Board responds by asserting that, while our remand order was limited in scope, in that it directed the Board to consider two narrow issues on remand because the Board's disposition of them was not adequately explained in its original Adjudication, the order nevertheless granted the Board broad discretion as to what type of proceeding it was to conduct after remand. The Board acknowledges that it was obligated to follow the specific directives in the remand order, but it points out there was no language in that order which directed it to use a particular means of compliance such as conducting an evidentiary hearing, or reopening the record to take additional evidence. The Board rejects the assertion that there should be a standard definition of these terms when used in a remand order from an appellate court, since every case in which a matter is remanded to the administrative agency presents unique circumstances, and it is within the discretion of the agency to choose what particular action on its part is needed to address the issues in accordance with the terms of the appellate court's order. Here, the Board contends that "[t]here simply was no need to take further evidence to resolve the two limited issues, as neither the law nor facts related to either issue had changed since the evidentiary record closed," Board Brief (J-133-2016) at 21, and that the Board did what the order required it to do by reviewing the extant evidentiary record, and issuing its Supplemental Adjudication to further explain its decision.

We begin by observing that, although Pa.R.A.P. 2591 requires the court or other government unit on remand to "proceed in accordance with the judgment or other order of the appellate court," it does not require the court or government unit to utilize any specific mode of compliance with a general remand order, such as a trial or evidentiary hearing. Consequently, when an appellate court remands for "further proceedings" there is no "one size fits all" talismanic definition for those terms which is applicable to all cases and situations. It is axiomatic that the facts and procedural history of each case as it developed in the lower court or administrative agency will be different when considered by an appellate tribunal, and, thus, if that tribunal determines that a remand for further proceedings is warranted, the nature of those proceedings will necessarily vary depending on the specific circumstances presented by each individual case. *See Newman Development Group of Pottstown, LLC v. Genuardi's Family Markets, Inc.*, 52 A.3d 1233, 1247 (Pa. 2012) (explaining that "remands may encompass a variety of proceedings" including remand for an opinion or explanation).

Thus, every remand order directing that further proceedings be conducted must necessarily be examined in conjunction with the opinion of the appellate tribunal and the particular facts, circumstances, and procedural history of the case in order to determine what the lower court or tribunal is required to do upon return of the case to it. It must be emphasized that, when a case is returned to a lower court or administrative agency with such a directive, those tribunals have usually already conducted some fact-finding or legal analysis in the case and, accordingly, this acquired familiarity with the already developed record allows the court or administrative agency considerable discretion to choose the specific type of proceedings it will conduct in order to fulfill the purposes for which the appellate court has ordered remand.

As recited above, when this matter was last before our Court, we considered a variety of legal challenges to the Board's November 18, 2014 order awarding the Category 2 slot machine license to Stadium. The Board's explanation of its reasons for entering that order, set forth in its Adjudication issued that same day, was sufficient for us to conduct appellate review of all but two of the appellate issues we were asked to decide: whether the award of the license violated Sections 1304(a)(1) or 1330 of the Gaming Act.

Because we agreed with Market East's contention in that appeal that the Board's Adjudication did not sufficiently articulate its rationale for determining that Stadium's post-licensure structure complied with these statutory sections, we remanded to the Board for it to conduct "further proceedings" with regard to these two questions so that we could engage in proper appellate review of its prior legal conclusion that the award of the license did not violate these statutory provisions. We left it to the Board's discretion as the finder and trier of fact to determine whether it could sufficiently explain its rationale for finding Stadium's post-licensure ownership structure compliant with Sections 1304(a)(1) and 1330 based on the extant record before it, or whether it needed to take additional evidence to complete its task. While the Board was certainly free under our remand order to conduct additional hearings and receive supplementary evidentiary submissions if it considered that course of action necessary to comply with our directive, there was nothing in our order which compelled it to do so. Therefore, we deem the particular proceedings which the Board undertook in response to our order — the preparation of a Supplemental Adjudication in which it explains, based on the evidentiary record already before it and matters of public record, the reasons supporting its prior determination that Stadium complied with these statutory provisions, and, correspondingly, why its order awarding Stadium the Category 2 license was supported — to be a suitable mode of compliance.

We also reject Market East's contention that the Board was required under our remand order to receive additional factual evidence or argument at a formal hearing in order to articulate its definition of the term "financial interest," as used in Section 1330. We directed the Board to explain how it interpreted the Gaming Act and its own regulations to define this term, which is a purely legal exercise reviewable *de novo* by this Court.[25] Accordingly, we reject Market East's contention that the Board failed to follow our remand order.

2. The Board's definition of "financial interest" under Section 1330.

Next, Market East contends that the Board erred by adopting an excessively restrictive definition of the term "financial interest" which is at odds with the commonly understood definition of that term. We first recount the Board's explanation in its Supplemental Adjudication of how it defines this term. The Board notes that this term is not defined in Section 1330; however, it acknowledges that there are two other places in the Gaming Act where the term is defined: (1) Section 1201, which establishes the membership, composition, and terms of the Board members, and places restrictions on the Board and its staff, defines "financial interest" as "[a]n ownership, property, leasehold or other beneficial interest in an entity," 4 Pa.C.S. § 1201; and (2) Section 1512, which restricts the financial interests of "an executive-level public employee, public official or party officer, or an immediate family member thereof," describes these terms as "[o]wning or holding, or being deemed to hold, debt or equity securities or other ownership interest or profits interest," *Id.* § 1512. The Board considered these definitions to be restricted to the statutory sections in which they appear and not to apply to the definition of financial interest used in Section 1330.

In formulating its definition of financial interest applicable to Section 1330, the Board recounted that it first examined the language of the sentence in which it was used, i.e., "may possess an ownership or financial interest that is greater than 33.3%."

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[25] Although we conclude that the Board complied with the directives in our remand order, that does not mean, as discussed below, that we agree with its ultimate legal conclusion regarding the definition of financial interest under Section 1330 and its use of that definition in its analysis of the questions we asked it to resolve.

Id. § 1330. The Board found that, because this sentence uses the disjunctive "or" to distinguish financial interest from ownership interest, this signifies the intent of the legislature to have financial interest be distinguishable in meaning from direct ownership. The Board next viewed the use of the "greater than 33.3%" language to convey the legislature's intent that a financial interest be restricted in meaning "to things that are quantifiable, on a percentage basis, up to 100% 'of a slot machine licensee.'" Supplemental Adjudication, 6/23/16, at 18. The Board noted that it has previously and consistently interpreted "financial interest" to include both "indirect ownership" of a casino through other entities and a "profits interest," as both are quantifiable up to 100%. Supplemental Adjudication, 6/23/16, at 19.

Consistent with what it perceives to be the General Assembly's intent to have some diversification of ownership and control of casinos, but not to preclude large lenders who finance the construction of such casinos, and owners of the real estate on which casinos are situated, from financing multiple casino construction projects, the Board rejected the more traditional and expansive definition of these terms to mean "an interest equated with money or its equivalent," which includes things such as "loan agreements, leases and security instruments." *Id.* at 19, n.18 (quoting Black's Law Dictionary, [631] [(6th Ed.)]). The Board considers such interests not to be easily quantifiable, and, thus does not consider them to be financial interests, "absent some unique factual circumstances." *Id.*

Although the Board explained what it did not consider to be a financial interest, the Board never articulated a definition *for* this term in the Supplemental Adjudication. Even so, the Board proceeded to a putative analysis of Manoukian's financial interests in Stadium. The Board first reminded that it had already determined that Manoukian had no indirect ownership interest in Stadium in excess of the statutory limit imposed by

Section 1330. *See SugarHouse I*, 136 A.3d at 481. The Board then proceeded to analyze how the profits from Stadium's operations would be divided under the terms of the various operating agreements between the entities which comprised its ownership structure. The Board determined that, "[i]dentical to ownership interests, all profits generated from the operation of Stadium will be split equally between the entities [Stadium Casino Investors] SCI and [Stadium Casino Baltimore Investors] SCBI." Supplemental Adjudication, 6/23/16, at 9.

The Board found that the profit division between the Sterling Investors Trust and SCI also paralleled the Sterling Investors Trust's ownership interest in SCI. Thus, as the Sterling Investors Trust owns 34% of SCI, under the Board's calculation, it would receive 34% of its profits. Because SCI, in turn, owns 50% of Stadium, the Sterling Investors Trust, by the Board's calculation, ultimately receives 17% of Stadium's profits.[26] The remaining percentage of Stadium's profits flow to Greenwood through its ownership interest in SCI. Because Greenwood owns 66% of SCI, which in turn owns 50% of Stadium, Greenwood receives 33% of Stadium's profits.[27]

The Board determined, without explanation, that not all of the profits which Greenwood receives from Stadium will be retained by Manoukian.[28] Nevertheless, the Board reasoned that, even if it attributed all of Greenwood's 33% profit interest in Stadium to Manoukian, there is no violation of Section 1330 because, by its estimation,

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[26] This computation is derived by multiplying these fractional profit interests together, (.34)(.50), to give Sterling Investors Trust an aggregate 17% (.17) profit interest in Stadium.

[27] This computation was arrived at by the Board in the following fashion: (.66)(.50) = (.33).

[28] The Board determined in its first Adjudication that Manoukian owned 85.84% of Greenwood. Adjudication, 11/18/14, at 80. Assuming, as the Board does, that Manoukian's profit interest follows his ownership interest, Manoukian's actual profit interest in Stadium through Greenwood would seemingly be only 28%: (.8584)(.66)(.50) = .28)

Manoukian will receive none of the profits realized by the Sterling Investors Trust. The Board found that, once Manoukian established the irrevocable trust, he relinquished all control over its assets, inasmuch as the complete control of those assets rested with the corporate trustee, Sterling Fiduciary, and Manoukian retained only a 28% minority interest in that corporation such that he did not control its appointment of officers, directors, and employees, nor could he control decisions regarding trust management. Additionally, the beneficiaries of the trust were Manoukian's children, and their spouses, Supplemental Adjudication, 6/23/16, at 10, and, as set forth above, Manoukian is not entitled under the terms of the trust document to receive any proceeds or distributions from the trust.

Market East argues that the Board erred in not utilizing the definition of financial interest contained in Sections 1201 and 1512, or the Board's regulation governing the financial interests of its members which describes financial interest as "[a]n ownership, property, leasehold or other beneficial interest in an entity." 58 Pa. Code § 403a.1. Market East proffers that, even though these definitions are broad, they are in accord with the common usage of these terms as reflected by the Black's Law Dictionary definition the Board recited in the Supplemental Adjudication. Further, in Market East's view, the more expansive definitions chosen by the General Assembly for financial interest in Sections 1201 and 1512 are evidence of its intent that the term financial interest be construed throughout the Gaming Act in accordance with the generally accepted meaning of these terms.

Market East assails the Board's reliance on the quantifiability of an interest as determinative, as, in its view, this disregards any financial interest that is not simple to calculate. Market East points out that the definition which the Board adopted included indirect ownership, even though the use of the disjunctive "or" in Section 1330 — i.e., ownership or financial interest — indicated that the legislature did not intend to subsume any ownership interest within the definition of financial interest. Market East contends that, in any event, other financial interests such as loans are quantifiable up to 100%, yet the Board offers no reason why those interests are not included in its definition.

Market East rejects the Board's conclusion that including loans within the definition of financial interest would encompass commercial lenders or holders of real estate on which casinos will be built, since Section 1330, by its terms, applies only to a "slot machine licensee, its affiliate, intermediary, subsidiary or holding company," which typical commercial lenders and holders of casino property would not be. To the contrary, according to Market East, Section 1330's restrictions were intended to encompass someone who already possesses a casino license from acquiring a financial interest in another casino greater than 33.3% so as to guard against monopolization and to promote competition. Market East contends that the Board's definition undermines this legislative objective.

Market East avers that the term financial interest must be given its plain meaning in analyzing Manoukian's planned financial contributions to Sterling Investors Trust. Market East asserts that the proposed equity infusion by Manoukian to the Sterling Investors Trust would establish his financial interest in that entity and, in turn, his financial interest in Stadium. This interest, it argues, when coupled with his financial interest in Stadium through Greenwood, would put Manoukian over the 33.3% limit permitted by Section 1330.

The Board responds by defending its derivation of its definition of financial interest under Section 1330 set forth in its Supplemental Adjudication, and it largely reiterates in its brief its reasoning set forth in that adjudication for choosing this particular definition. It notes, further, though, that our Court recognized in *SugarHouse*

I, consistent with prior rulings from our Court, that it, as the administrative agency tasked with interpreting and applying this statute, is best suited to furnish a definition of these terms.

Additionally, in support of its interpretation, the Board cites to a regulation it promulgated in 2007 to address the multiple slot machine license prohibitions of Section 1330 — 58 Pa. Code § 441a.17 — though it did not discuss this regulation in its Supplemental Adjudication. Specifically, the Board notes that paragraph (j) of this regulation states that "[n]othing in this section concerning ownership or financial interests applies to contractual interests including those in the nature of management contracts, options to purchase exercisable after a license has been issued or leases." 58 Pa. Code § 441a.17(j). The Board argues that a promissory note, which is a contract in support of a loan, would fall within this exclusion. The Board, however, admits that, at present, the precise nature of the equity infusion Manoukian will make to Sterling Fiduciary is undetermined. *See* Board Brief at 26 ("The one open issue which remains regarding the Sterling Investors Trust is how Manoukian will finance it, by gift or loan."). The Board contends that it is therefore "premature to say Stadium is precluded by Section 1330 from receiving a license." *Id.* at 28.[29]

Since the parties' contentions focus on the meaning of the term "financial interest" as used in Section 1330 of the Gaming Act, we are guided in our review by the principles of the Statutory Construction Act, 1 Pa.C.S. §§ 1501 *et seq.* ("SCA"). The paramount objective of our interpretative task under the SCA is to "ascertain and effectuate the intention of the General Assembly" in enacting the legislation under review. *Id.* § 1921(a). The polestar indication of the legislature's intent is the plain

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[29] Stadium, in its brief filed as Intervenor, aligns itself with the Board on these arguments.

language of the statute. *Department of Environmental Protection v. Cumberland Coal*, 102 A.3d 962, 975 (Pa. 2014). Accordingly, when interpreting statutory language, all "[w]ords and phrases shall be construed according to rules of grammar and according to their common and approved usage." 1 Pa.C.S. § 1903(a). The SCA mandates that, if the words of a statute are clear and unambiguous, their plain meaning should not be disregarded by a reviewing court "under the pretext of pursuing its spirit." *Id.* § 1921(b).

In addition to these principles, the SCA also furnishes certain presumptions of which a reviewing court is entitled to avail itself in order to ascertain the intent of our legislature, two of which are relevant in this instance: (1) "the General Assembly does not intend a result that is absurd, impossible of execution or unreasonable," and (2) "the General Assembly intends the entire statute to be effective and certain." *Id.* § 1922(1), (2). Further, since we are considering an administrative agency's interpretation of its governing statute, its interpretation will "be given controlling weight unless clearly erroneous." *Borough of Ellwood City v. Pennsylvania Labor Relations Board*, 998 A.2d 589, 594 (Pa. 2010). Thus, although we accord an administrative agency such as the Board substantial deference in construing the laws it is tasked with administering, "we need not defer uncritically, particularly if we find that the interpretation is imprudent or inconsistent with legislative intent." *500 James Hance Court v. Pennsylvania Prevailing Wage Board*, 33 A.3d 555, 573 (Pa. 2011).

Applying these foundational principles to the interpretation of the term "financial interest," we first note that the Board is correct that the legislature did not define this term as it did in Sections 1201 and 1512 of the Gaming Act. As the parties have discussed, those sections define financial interest in terms of an ownership, beneficial, or profits interest in another entity. *See* 4 Pa.C.S. § 1201 (defining "financial interest" as "[a]n ownership, property, leasehold or other beneficial interest in an entity"); *Id.* § 1512 (defining "financial interest" as "[o]wning or holding, or being deemed to hold, debt or equity securities or other ownership interest or profits interest."). Thus, the legislature's choice not to use these definitions for financial interest in Section 1330 suggests an intent to give this term a different meaning in this statutory section.[30] *See Fletcher v. Pennsylvania Property and Casualty Insurance Guarantee Association*, 985 A.2d 678, 684 (Pa. 2009) ("[W]here a section of a statute contains a given provision, the omission of such a provision from a similar section is significant to show a different legislative intent."). However, merely because the legislature did not incorporate the definitions from Sections 1201 and 1512 into Section 1330, it does not necessarily follow, as the Board has concluded, that the legislature intended to have this term construed in a circumscribed manner so as to exclude from the definition its ordinary meaning.[31] To the contrary, as detailed above, a proper interpretation of this term, which on its face is unambiguous, must necessarily consider its common and approved usage in the English language, which may be determined from its dictionary definition. *In re Beyer*, 115 A.3d 835, 839 (Pa. 2015).

Conventional dictionaries do not define the term "financial interest." Nevertheless, Webster's defines "financial" as "pertaining or relating to money matters;

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[30] Accordingly, we disagree with Justice Baer that we should import the definition of "financial interest" from either Section 1201 or 1512. Indeed, as the discussion in his concurrence makes plain, the definitions in those two sections, while similar, address different contexts, and contain distinct exclusions. *See* Concurring Opinion (Baer, J.) at 3-7. The legislature could have, but did not, include either of these definitions (or their related exclusions) in Section 1330.

[31] For this reason, we disapprove of the Board's incorporation of an indirect ownership interest into its definition of "financial interest," as an indirect ownership interest is encompassed within the term "ownership interest." Although we do not disagree that the term "financial interest" might naturally be defined as also including an ownership interest, as the concurrence also offers, *see* Concurring Opinion (Baer, J.) at 6-7, the legislature, through the use of the terms "ownership or financial interest" in the disjunctive context evidences, in our view, its intent for these terms to have separate meanings.

pecuniary." *Webster's Unabridged Dictionary of the English Language* 719 (2d. ed. 1998); "Pecuniary" is also understood to mean "[o]f or relating to money." *American Heritage Dictionary* 622 (4th ed. 2001). Further, "interest" is pertinently defined as "[a] right, claim or legal share in something." *Id.* at 445. Thus, a financial interest would be any monetary right, claim, or legal share. This is consistent with the Black's Law Dictionary definition referenced by the parties. *See* Black's Law Dictionary 1846 (10th ed. 2014) (defining "financial interest" as "[a]n interest involving money or its equivalent; esp., an interest in the nature of an investment — Also termed *pecuniary interest*" (emphasis original)). Consequently, applying these ordinary and commonly understood meanings to the term "financial interest" as used in Section 1330, we construe Section 1330 to prohibit a slot machine licensee, or its affiliate, from possessing a legally enforceable monetary right or claim against another slot machine licensee, or an investment in another slot machine licensee, which exceeds 33.3% of the value of that slot machine licensee's financial assets. This definition is therefore broad enough to encompass loans from one slot machine licensee to another since, in that situation, the licensee which is the lender acquires a monetary right or claim to repayment of the loan proceeds from the recipient licensee in accordance with the loan's terms. *See also* 4 Pa.C.S. § 1311 (defining financial interest of "agents, employees or persons" in slot machine license applicant to include "*debt* or equity securities" (emphasis added)).

This definition is consonant with the legislature's stated objective in the Gaming Act that it "be implemented in such a manner as to prevent possible monopolization by establishing reasonable restrictions on the control of multiple licensed gaming facilities in this Commonwealth." *Id.* § 1102(5). A licensee which is a significant lender or investor in multiple other licensees may conceivably acquire a proportional degree of influence over those licensees, undermining their ability to effectively compete, and fostering monopolistic forces which the legislature sought to avoid through Section 1330's strict caps on the proportional ownership and financial interest one licensee may possess in another licensee. We, therefore, cannot countenance the Board's narrow interpretation of financial interest to exclude these type of monetary arrangements.

We recognize, of course, that our interpretation is contrary to the Board's interpretation of the regulation which it promulgated to provide guidance as to the meaning of the term "financial interest," 58 Pa. Code § 441a.17(j), since the Board views that regulation as excluding contracts associated with a loan such as promissory notes. Respectfully, we must conclude that the Board's interpretation of this regulation is clearly erroneous, and, thus, we are not required to defer to it. This regulation provides: "Nothing in this section concerning ownership or other financial interests applies to contractual interests including those in the nature of management contracts, options to purchase exercisable after a license has been issued or leases." *Id.* By including promissory notes, which are contracts, within the scope of this regulation, despite its lack of explicit reference to such instruments, the Board has interpreted this regulation in a manner which could conceivably exclude from the definition of "financial interest" a wide variety of contracts entered into by a licensee, not just the limited type of specialized service, property rental, or purchase contracts enumerated in the regulation. Such an interpretation would absurdly exclude *any* contract establishing a monetary obligation of one slot machine licensee to another from the ambit of Section 1330. Thus, for instance, any operating agreements between licensees that assign gaming revenue from one licensee to another would be regarded as not creating a financial interest in the assignee, even if the contract required the obligor licensee to pay the assignee 100% of its revenues.

For all of these reasons, we must reverse the Board's determination of what constitutes a financial interest as that term is used in Section 1330 of the Gaming Act. Moreover, inasmuch as the Board, by its own admission, has not identified exactly what type of equity infusion Manoukian will be making to the Sterling Investors Trust, i.e., a loan or gift, nor has the Board identified the nature of the financial transaction by which he transferred his ownership interest in Sterling Fiduciary to his family members, we must again remand to the Board for it to conclusively determine these matters and to correspondingly determine whether either of these transactions will result in Manoukian having a financial interest, as we have defined those terms in this opinion, in Stadium post-licensing which is in violation of Section 1330.[32]

3. Manoukian's eligibility to apply for a Category 1 slot machine license during Stadium's application process.

Finally, we address Market East's argument that the Board erred in its determination that Manoukian was not eligible to apply for another additional Category 1 slot machine license in addition to the license he possessed as an affiliate of Parx Casino. The Board found that, in order for an individual to be eligible to apply for a Category 1 license, Section 1302 of the Gaming Act requires that the applicant have been previously issued a horse or harness racing license, and conducted horse or harness racing for at least two years at the location where the applicant wants to operate a Category 1 licensed facility. The Board noted that, in 2013, in the midst of Stadium's application process, there was one remaining Category 1 license available, and an entity known as Valley View, which held a harness racing license for a racetrack it was seeking to build in Lawrence County, filed an application for that Category 1

[32] Inasmuch as these matters are not of record, it would appear that the Board, on remand, must re-open the evidentiary record and develop evidence to answer these questions.

license. Valley View sold its interest in the racetrack project to Endeka Entertainment ("Endeka") in 2013, and Endeka received the harness racing license previously awarded to Valley View. The Board found, based on its previously conducted background investigation of Stadium and Manoukian, that neither they, nor any of their affiliates, were owners or financiers of, or otherwise involved with, Endeka or Valley View. The Board also examined the lists of slot machine and racetrack applicants published in the Pennsylvania Bulletin and determined that neither Stadium, nor Manoukian, received a new horse or harness racing license during the entirety of the time Stadium's application was pending, nor had either applied for such a license. Because neither Manoukian, nor Stadium, possessed a horse or harness racing license, the Board reasoned that neither was eligible to apply for a Category 1 license during this time period.

Market East argues that the Board is incorrect in its conclusion, because Manoukian was already a Category 1 license holder through Greenwood, and, thus, this fact indicated that it was presumptively eligible to apply for such a license again. Market East also contends that the Board's conclusion rested on the fact that Endeka had already applied for the last remaining Category 1 license, and, thus, no licenses were available. Nevertheless, Market East avers that the availability of a Category 1 license is irrelevant to an applicant's eligibility to apply for such a license.

The Board responds that the requirements of Section 1302 are clear — a person or entity must already possess a horse or harness racing license in order to apply for a Category 1 license — and the record indicates that, at the time Stadium applied for its Category 2 license, neither Manoukian, nor any other entity or person affiliated with Stadium, sought or was issued a new horse or harness racing license. The Board notes that Manoukian's current horse racing license is, as are all such licenses, location-specific for Greenwood's Parx Casino facility and may not be transferred to a new location, and thus, neither Manoukian, nor any other of Greenwood's affiliates, may use it to apply for a new Category 1 license.

Consistent with the intent of the legislature in structuring the Gaming Act to prevent control of multiple gaming facilities by one individual or entity, Section 1304(a)(1) of the Gaming Act excludes from eligibility to apply for a Category 2 license any individual or entity which is also "eligible to apply for a Category 1 license." 4 Pa.C.S. § 1304(a)(1). The eligibility requirements for an individual or entity to apply for a Category 1 license are set forth in Section 1302 of the Gaming Act, which provides:

> **(a) Eligibility.--**A person may be eligible to apply for a Category 1 license to place and operate slot machines at a licensed racetrack facility if the person:
>
> > (1) has been issued a license from either the State Horse Racing Commission or the State Harness Racing Commission to conduct thoroughbred or harness race meetings respectively with pari-mutuel wagering and has conducted live horse races for not less than two years immediately preceding the effective date of this part;
> >
> > (2) has been approved or issued a license from either the State Horse Racing Commission or the State Harness Racing Commission to conduct thoroughbred or harness race meetings respectively with pari-mutuel wagering within 18 months immediately preceding the effective date of this part and will successfully conduct live racing pursuant to the requirements of section 1303 (relating to additional Category 1 slot machine license requirements);
> >
> > (3) has been approved by the State Harness Racing Commission, after the effective date of this part, to conduct harness race meetings with pari-mutuel wagering and will conduct live

> racing pursuant to the requirements of section 1303; or
>
> (4) is a successor in interest to persons eligible under paragraph (1), (2) or (3) who comply with the requirements of section 1328 (relating to change in ownership or control of slot machine licensee) or is a successor in interest to persons otherwise eligible under paragraph (1), (2) or (3) but precluded from eligibility under the provisions of section 1330.
>
> Nothing in this part shall be construed to permit the approval or issuance of more than one slot machine license at a licensed racetrack facility.
>
> **(b) Location.--**A Category 1 license may only be issued to an eligible person authorizing slot machine operations at the particular licensed racetrack facility identified in the application. No Category 1 licensed facility shall be located within 20 linear miles of another Category 1 licensed facility.

Id. § 1302. (footnotes omitted).

We agree with the Board that, under the plain language of these statutory provisions, only an individual or entity which has been approved for, or issued a license by, the State Racing Commission or the State Harness Racing Commission for a particular location is eligible to apply for a Category 1 slot machine license. Having an approved or issued horse or harness racing license, is, thus, a necessary predicate condition for an individual to be eligible to apply for a Category 1 license. As the record supports the Board's determination that neither Manoukian, nor Stadium, nor any of their affiliates had been, during the time Stadium's Category 2 license application was pending, either approved for or issued a horse or harness racing license for a location other than the location covered by the Parx Casino license,[33] we must affirm the Board's finding that they were ineligible to apply for a Category 1 license under Section 1302.[34]

III. Conclusion

We grant the Board's motion to dismiss SugarHouse's petition for review at 124 EM 2016, as it was not entitled to intervene in the proceedings on remand.[35] In Market East's petition for review, at 125 EM 2016, we affirm the Board's adjudication to the extent that it determined that Manoukian was not eligible to apply for a Category 1 slot machine license at the time of Stadium's application for its Category 2 license. However, we reverse the Board's determination of what constitutes a financial interest as that term is used in Section 1330, and we remand to the Board for further proceedings consistent with this opinion. Specifically, the Board is to determine whether, after Stadium's licensure, Watche Manoukian will possess a financial interest in Stadium in excess of the 33.3% permitted by Section 1330, either through his planned equity infusion to Sterling Investors Trust, or via the transaction by which he conveyed his ownership interest in Sterling Fiduciary Services to his family members.

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[33] Although the mere fact that Manoukian affiliate Greenwood already possessed a harness racing license and Category 1 license for its Parx Casino facility did not automatically disqualify Manoukian from holding a Category 1 license for another location, conversely, this possession of a Category 1 license for the Parx Casino did not, in and of itself, make Manoukian automatically eligible to apply for another category 1 license for a different location. As the Board notes, harness racing licenses which have already been granted are restricted to the specific location for which they were issued. *See* 3 Pa.C.S. § 9314.

[34] In making its determination of whether Manoukian or any of Stadium's affiliates had been approved for, or been issued, a horse or harness racing license, the Board was entitled to take judicial notice of the proceedings of other administrative agencies as published in the Pennsylvania Bulletin. *See* 45 Pa.C.S. § 506 (specifying that the contents of the Pennsylvania Code and Pennsylvania Bulletin "shall be judicially noticed").

[35] Sugarhouse's Motions for Leave to File Under Seal the Confidential and Unredacted Versions of its Principal Brief, Reply Brief, and Reproduced Record are hereby granted.

The Board is directed to conduct all appropriate proceedings in order to receive evidence sufficient for it to make this determination, including but not limited to, reopening the evidentiary record and holding a public hearing. The Board is also directed to follow its normal procedures and issue an appropriate final order after it has made these determinations.

Jurisdiction relinquished.

Chief Justice Saylor and Justices Donohue, Dougherty, Wecht and Mundy join the opinion.

Chief Justice Saylor files a concurring opinion.

Justice Baer files a concurring opinion.

155 FERC ¶ 63,004
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Public Utilities Commission of the State of California Docket No. EL02-60-007

Complainant,

v.

Sellers of Long-Term Contracts to the California Department of Water Resources

Respondents.

California Electricity Oversight Board Docket No. EL02-62-006

Complainant, (consolidated)

v.

Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources

Respondents.

INITIAL DECISION

(Issued April 12, 2016)

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Steven A. Glazer, Presiding Administrative Law Judge.

TABLE OF CONTENTS

TABLE OF ABBREVIATIONS

ALJ	Administrative Law Judge
BEEP Stack	Balancing Energy and Ex Post Stack
CAISO	California Independent System Operator
CalPX	California Power Exchange
CCGT	combined cycle gas turbine
CDWR	California Department of Water Resources
CEC	California Energy Commission
CERS	California Energy Resources Scheduling Division of CDWR
CFTC	Commodity Futures Trading Commission
Commission	Federal Energy Regulatory Commission
Complainants	CPUC and EOB
CONE	cost of new entry
CPUC	Public Utilities Commission of the State of California
Crisis Period	May 1, 2000 – July 6, 2001
DAYZER	Day-Ahead Locational Market Clearing Prices Analyzer
EDRAM	Environmental-Dynamic Revenue Analysis Model
EOB	California Electricity Oversight Board
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
HHI	Herfindahl-Hirschman Index
Iberdrola	Iberdrola Renewables, LLC
Interim Period	October 2, 2000 – January 16, 2001
IOUs	investor-owned utilities
LOI	letter of intent
LRMC	long run marginal cost
MMCP	mitigated market clearing price
MMIP	Market Monitoring and Information Protocol
NCI	Navigant Consulting, Inc.
Negotiation Period	January 17, 2001 – July 6, 2001
NGI	Natural Gas Intelligence
NPV	net present value
OOM	out-of-market
PG&E	Pacific Gas & Electric Company
PPM	PacifiCorp Power Marketing, Inc.
Refund Period	October 2, 2000 – June 20, 2001
Respondents	Shell and Iberdrola

RFBs	requests for bids
ROE	return on equity
RPS	renewable portfolio standard
SCE	Southern California Edison Company
SDG&E	San Diego Gas & Electric Company
Shell	Shell Energy North America (US), L.P.
SRA	Summer Reliability Agreement
Summer Period	May 1, 2000 – October 1, 2000
Wildflower	Wildflower Energy, L.L.C.

I. Decision

1. The primary issue for decision in this case is whether the *Mobile-Sierra* doctrine, holding that a bilateral contract for electric power is presumed to be just and reasonable in accordance with the Federal Power Act unless it is contrary to the public interest, applies to long term contracts for power that the State of California executed with two sellers during the Western Energy Crisis of 2000-2001. The short answer is that it does not apply to either contract.

2. The secondary issue for decision in this case is whether one of those sellers was properly dismissed from this case by the Commission at an earlier stage of the proceeding because it signed its contract with the State of California after the Western Energy Crisis had passed. The short answer is that it was not.

II. Preliminary Statement

3. On February 25, 2002, the Public Utilities Commission of the State of California (CPUC) and the California Electricity Oversight Board (EOB) (collectively, Complainants)[1] each filed a complaint with the Federal Energy Regulatory Commission (FERC or Commission) pursuant to section 206 of the Federal Power Act (FPA)[2] to abrogate several long-term wholesale electricity contracts that the California Department of Water Resources (CDWR) had made with certain power marketers.[3] The contracts were entered into during 2001[4] amidst a period of market dysfunction in the western United States that has come to be known as the "Western Energy Crisis."[5] All of the power marketers have settled with Complainants but two—Shell Energy North America

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[1] The CPUC complaint was assigned Docket No. EL02-60 and the EOB complaint was assigned Docket No. EL02-62. The Commission consolidated the complaints. *Pub. Utils. Comm'n of the State of Cal. v. Sellers of Long-Term Contracts to the Cal. Dep't of Water Res.*, 99 FERC ¶ 61,087 (2002) (*CPUC v. Sellers of Long-Term Contracts*). The EOB was defunded in 2008 and is no longer an active party. *See CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 2 n.2 (2014) (Comm'n Order on Remand).

[2] 16 U.S.C. § 824e(a) (2012).

[3] *See CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 2 (2014) (Comm'n Order on Remand).

[4] *See* Ex. CAL-50 (Summary of Executed CDWR Power Contracts).

[5] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 1 (2014).

(US), L.P. (Shell)[6] and Iberdrola Renewables, LLC (Iberdrola)[7] (collectively, Respondents).

A. Relevant History of the Western Energy Crisis Proceedings

4. It is not necessary to recite here the history of the Western Energy Crisis. A comprehensive survey of the Crisis is found in the opinion of the U.S. Court of Appeals for the Ninth Circuit in *Public Utilities Comm'n of State of Cal. v. FERC*, 462 F.3d 1027, 1036-1045 (9th Cir. 2006). The many proceedings before FERC concerning this crisis were spawned by enormous electric utility rate hikes that began in San Diego in 2000,[8] one of which was a complaint filed with the Commission on August 2, 2000 by San Diego Gas & Electric Company (SDG&E) in Docket No. EL00-95.

5. In the *SDG&E* case, the Commission determined that the electric market structure and market rules for wholesale sales of electric energy in California were seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand, caused unjust and unreasonable rates during the period of the Crisis, October 2, 2000 through June 20, 2001.[9]

6. The Commission followed up on December 15, 2000 with an Order allowing California's three investor-owned utilities (IOUs), Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), and San Diego Gas & Electric Company (SDG&E), to enter into long-term contracts to purchase electricity. Doing so removed their restraint on purchasing their energy needs exclusively through the California Power Exchange (CalPX) and the California Independent System Operator (CAISO).[10] This early effort on the Commission's part failed to staunch the bleeding,

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[6] Shell was known during the relevant time period as Coral Power, L.L.C.

[7] Iberdrola was known during the relevant time period as PacifiCorp Power Marketing, Inc. and later as PPM Energy, Inc.

[8] Ex. CAL-247 at 4:22-16:11 (Florio Direct).

[9] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the Cal. Indep. Sys. Operator and the Cal. Power Exch.*, 93 FERC ¶ 61,121 (2000) (*SDG&E v. Sellers*); 101 FERC ¶ 63,026 at P 41 (2002) (ALJ Certification of Proposed Findings on California Refund Liability).

[10] *SDG&E v. Sellers*, 93 FERC ¶ 61,294 (2000). Originally, CalPX ran California's Day-Ahead and Hour-Ahead electricity markets, while CAISO ran its Real-Time and Ancillary Services markets. Ex. CAL-285 at 19:7-9 and 20:15-16 (Taylor Direct).

however. The CalPX collapsed and closed its doors on January 30, 2001, filing for bankruptcy on March 9, 2001.[11] On April 6, 2001, PG&E filed for bankruptcy; SCE and SDG&E were in similar financial straits, but avoided bankruptcy filings through arrangements with creditors.[12]

7. As a result, FERC tried a more aggressive approach. An order issued on June 19, 2001, that imposed price caps on the Western spot market from June 20, 2001 through September 30, 2002.[13] Following FERC's issuance of that order, spot market bid levels dropped significantly.[14]

8. In 2001, the Commission established a refund procedure by establishing a proceeding (the "Refund Proceeding"). The refund procedure required sellers operating in the CalPX and CAISO during the period from October 2, 2000 through June 20, 2001 (the "Refund Period") to disgorge revenues that they made on the energy prices that they had charged during that time in excess of a "proxy price." The "proxy price" was defined as "the price that would be paid in a competitive market, in which sellers have the incentive to bid their marginal costs."[15] This proxy price was called the "mitigated market clearing price" or "MMCP."[16] In 2003, the Commission approved the determination of Administrative Law Judge Bruce Birchman in the Refund Proceeding that $1.8 billion in refunds were due to the CalPX and CAISO from the sellers.[17]

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[11] *Public Utilities Comm'n of State of Cal. v. FERC*, 462 F.3d 1027, 1042 (9th Cir. 2006).

[12] *Id*. at 1042-1043.

[13] *SDG&E v. Sellers*, 95 FERC ¶ 61,418 (2001).

[14] *See* Ex. CAL-227 at 15-16 (Figure 7 shows significant growth of lower-level bids into BEEP Stack over high-level bids).

[15] *SDG&E v. Sellers*, 97 FERC ¶ 61,275, at 62,212 (2001).

[16] *SDG&E v. Sellers*, 93 FERC ¶ 61,121 (2000), *on reh'g and clarification*, 97 FERC ¶ 61,275 (2001).

[17] *SDG&E v. Sellers*, 101 FERC ¶ 63,026, at P 7 (2002) (ALJ Cert. of Proposed Findings), *aff'd*, 102 FERC ¶ 61,317, at P 5 (2003) (Comm'n Order on Proposed Findings).

9. Upon appeal and remand of that decision by the U.S. Court of Appeals for the Ninth Circuit in 2006,[18] the Commission expanded the Refund Proceeding to include spot market sales that occurred during that part of the Crisis Period that predated October 2, 2000, and certain other types of transactions.[19]

10. In the expanded Refund Proceeding, Administrative Law Judge Philip Baten determined in 2013 that forward market and energy exchange sellers collectively owed an additional $90.9 million in payments exceeding MMCP for the original Refund Period.[20] The ALJ was not instructed by the Commission to determine refunds for the period that preceded October 2, 2000 (that is, the period from May 1, 2000 to October 1, 2000, referred to as the "Summer Period"). He did find, however, that certain sellers, including Shell, "committed various tariff and other violations that affected the market clearing price in the California organized electric markets during the Summer Period."[21]

11. In 2014, the Commission affirmed the ALJ's findings in the expanded Refund Proceeding in *SDG&E*.[22] However, all respondents that engaged in energy exchange transactions, and all respondents that engaged in forward market transactions except Constellation, had already settled with the Complainants by that time. Consequently, the Commission ordered only Constellation to pay refunds for the Refund Period in the amount of $2,845,024.[23] As for the Summer Period, the Commission ordered the remaining respondents, including Shell, to disgorge their revenues in excess of MMCP and to submit compliance filings specifying the exact amount of their refund

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[18] *Public Utilities Comm'n of State of Cal. v. FERC*, 462 F.3d 1027, 1036-1045 (9th Cir. 2006).

[19] *Id*. at 1035, *on remand*, *SDG&E v. Sellers*, 129 FERC ¶ 61,147 (2009), *on reh'g*, 135 FERC ¶ 61,183 (2011).

[20] *SDG&E v. Sellers*, 142 FERC ¶ 63,011, at P 2 (2013) (Initial Decision).

[21] *Id*. P 1.

[22] *SDG&E v. Sellers*, 149 FERC ¶ 61,116 (2014) (Opinion No. 536), *aff'd on reh'g*, 153 FERC ¶ 61,114 (2015) (Order on Rehearing).

[23] *Id*. PP 24, 238.

obligations.[24] On January 16, 2015, Shell complied with that obligation, reporting a refund (under protest) of $5,345,489.47.[25]

12. Also in 2014, Commission Administrative Law Judge Bobbie McCartney issued an initial decision in the *Puget Sound Energy* case,[26] a parallel proceeding addressing the effects of the Crisis Period in the Pacific Northwest energy market. She determined that the complainants in that case (including the Complainants here) had made a *prima facie* showing that Shell had engaged in manipulative schemes known as "false export" in that market.[27] The Commission affirmed the initial decision in part and reversed it in part, and remanded the initial decision to revise certain unclear determinations. [28] Upon remand to Judge Baten after Judge McCartney's retirement, a revised partial initial decision issued in 2016, confirming that Shell had engaged in false exports in the Northwest market. [29]

13. The instant case has arisen out of the same set of facts as the foregoing proceedings. It originally concerned more than 30 long-term contracts that were entered into during 2001 between the CDWR and numerous energy sellers.[30] CDWR was tasked in 2001 by the State of California with purchasing the electric power needed to make up the shortfall, known as the "Net Short," that arose in the state during the Crisis when its

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[24] *Id*. PP 3, 209-213.

[25] Shell Energy North America (US), L.P. Compliance Filing, Docket No. EL00-95-248, at 4 (January 16, 2015).

[26] *Puget Sound Energy, Inc. v. All Jurisdictional Sellers of Energy and/or Capacity at Wholesale into Electric Energy and/or Capacity Markets in the Pacific Northwest, Including Parties to the Western Systems Power Pool Agreement*, 146 FERC ¶ 63,028 (2014) (McCartney, J.), *aff'd in part and rev'd in part*, 151 FERC ¶ 61,173 (2015) (Opinion No. 537), *reh'g denied*, 153 FERC ¶61,386 (2015), *on remand*, 154 FERC ¶ 63,004 (2016) (Baten, J.) (*Puget Sound Energy v. All Jurisd. Sellers*).

[27] *Puget Sound Energy v. All Jurisd. Sellers*, 146 FERC ¶ 63,028, at PP 1413-1414 (2014).

[28] *Puget Sound Energy v. All Jurisd. Sellers*, 151 FERC ¶ 61,173, at P 215 (2015) (Opinion No. 537).

[29] *Puget Sound Energy v. All Jurisd. Sellers*, 154 FERC ¶ 63,004, at PP 20-33 (2016) (Baten, J).

[30] *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087, at 61,377 (2002).

three IOUs no longer had the financial viability to purchase all of the electricity needed to meet their customers' needs.[31]

14. The Complainants ask the Commission to abrogate these contracts as unjust and unreasonable, or to reform the contracts to provide for just and reasonable rates, reduce their duration, and strike certain non-price terms and provisions from the contracts.[32] The Complainants allege that the Respondents exercised market power that forced CDWR to pay unjust and unreasonable prices and to agree to onerous, unjust and unreasonable non-price terms in order to secure the power necessary to ensure that the lights stayed on in California.[33]

B. Legal Developments of the *Mobile-Sierra-Morgan Stanley* Rule

15. The complaints call into play the Commission's authority under the FPA to alter and abrogate contracts for the wholesale purchase and sale of electric power. A public utility cannot charge a customer a rate for future purchases of wholesale electricity unless the Commission finds that rate to be "just and reasonable" under the FPA.[34] However, unlike tariff rates that are imposed unilaterally by public utilities on power purchasers, the Commission cannot break a bilateral power contract—that is, a wholesale contract between a public utility on the one hand and a buyer or seller of electricity on the other—unless it is in the "public interest" to do so. This doctrine, known as the "*Mobile-Sierra* Rule" after the Supreme Court precedents that spawned it,[35] takes the form of a legal presumption that the rate set by a bilateral power contract is "just and reasonable" unless it is found not to be in the "public interest" to deem it so.[36]

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[31] Ex. CAL-12 at 2:1-7 (Hart Direct); Ex. Cal-247 at 4:1-5 (Florio Direct).

[32] *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087 at 61,377.

[33] *Id*.

[34] 16 U.S.C. §§ 824d(a), 824e(a) (2013).

[35] *United Gas Pipe Line Co. v. Mobile Gas Service Corp.,* 350 U.S. 332 (1956); *Fed. Power Comm'n v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

[36] *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.*, 554 U.S. 527, 530 (2008) (*Morgan Stanley*) (FERC "must presume that the rate set out in a freely negotiated wholesale-energy contract meets the 'just and reasonable' requirement imposed by law. The presumption may be overcome only if FERC concludes that the contract seriously harms the public interest.").

16. The Commission, in a 2003 ruling in this case, held that it was not in the public interest under the *Mobile-Sierra* Rule to break the power marketing contracts that CDWR had entered into with wholesale power sellers, including the CDWR-Shell and CDWR-Iberdrola contracts.[37] Following several years on appeal before the U.S. Court of Appeals for the Ninth Circuit and the U.S. Supreme Court, the *Mobile-Sierra* Rule, as it was initially applied to bilateral contracts involved in the California Crisis, was re-cast from its early precedents into its current form in the Supreme Court's decision in *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.*[38] In light of that legal development, this case was remanded to the Commission in 2008 for further action.[39] It is now here in accordance with the Commission's Order on Remand for this case.[40]

17. The questions to be decided here focus on the *Mobile-Sierra* Rule as reinterpreted by *Morgan Stanley*.[41] Specifically, those questions first ask whether the *Mobile-Sierra-Morgan Stanley* presumption of the justness and reasonableness of each of the contracts at issue is "avoided" by reason of unlawful activity on the part of each wholesale marketer in making its contract with CDWR. Alternatively, the next question asks whether the *Mobile-Sierra-Morgan Stanley* presumption is "overcome" by reason of the contract's burden on consumers or other harm to the public interest.

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[37] *CPUC v. Sellers of Long-Term Contracts*, 103 FERC ¶ 61,354, at P 3 (2003).

[38] *Nev. Power Co. v. Enron Power Mktg., Inc.*, 103 FERC ¶ 61,353 (2003), *rev'd sub nom. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash. v. FERC*, 471 F.3d 1053 (9th Cir. 2006), *aff'd and remanded sub nom. Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.*, 554 U.S. 527 (2008), *remanded to FERC*, 547 F.3d 1081 (9th Cir. 2008).

[39] *CPUC v. Sellers of Long-Term Contracts,* 103 FERC ¶ 61,354 (2003), *reh'g denied*, 105 FERC ¶ 61,182 (2003), *rev'd sub nom. Pub.Utils. Comm'n of Cal. v. FERC*, 474 F.3d 587 (9th Cir. 2006), *vacated and remanded sub nom. Sempra Generation v. CPUC*, 554 U.S. 931 (2008), *remanded to FERC sub nom. Pub. Utils. Comm'n of Cal. v. FERC*, 550 F.3d 767 (9th Cir. 2008).

[40] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127 (2014) (Order on Remand).

[41] Henceforth, this presumption will be referred to generically as the "*Mobile-Sierra-Morgan Stanley*" rule or presumption.

C. Standard of Decision in This Administrative Proceeding

18. For the analysis to be done here, the Commission has directed this administrative proceeding to gather evidence on: (1) whether the sellers under a particular contract at issue engaged in unlawful market activity in the spot market; and, if so, (2) whether such activity had a direct effect on the negotiations of the contract at issue. Evidence is also to be gathered on: (3) the difference "down the line" between having the contracts at issue in effect and not having them in effect; and (4) whether that difference seriously harmed the public interest.[42] Issues (1) and (2) have generally been referred to as critical to "avoiding" the *Mobile-Sierra-Morgan Stanley* Rule, whereas issues (3) and (4) have been considered critical to "overcoming" the Rule.

19. Although the "avoiding" and "overcoming" elements of the *Mobile-Sierra Morgan Stanley* Rule are expressed in the alternative,[43] this Initial Decision will decide both elements, even if only one leads to a dispositive outcome, in order to reduce the need for a remand from the Commission.[44]

1. "Avoiding" the *Mobile-Sierra-Morgan Stanley* Rule As a Result of Unlawful Activity Affecting Contract

20. The Commission has directed in this case that a showing of unlawful activity in the spot market "must be determined based on the relevant laws, regulations, orders, and tariffs in effect at the time of the Western energy crisis."[45] It looks specifically to the CAISO and CalPX tariffs that were then in effect. These tariffs included a provision known as the Market Monitoring and Information Protocol or "MMIP."[46] The MMIP

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[42] *CPUC v. Sellers of Long-Term Contracts*, 150 FERC ¶ 61,079, at P 5 (2015) (Clarifying Order) (*citing* 149 FERC ¶ 61,127, at PP 22-23 (2014) (Order on Remand)).

[43] *See State of Cal. v. FERC*, 809 F.3d 491, 502 n.5 (9th Cir. 2015).

[44] *See Seaway Crude Pipeline Co. LLC*, 154 FERC ¶ 61,070, at P 34 (2016) ("When there are sufficient unanswered questions in the record, or outstanding issues that must be resolved before a proper decision can be made, remand is appropriate. Where instead the circumstances are that no useful purpose would be served by further administrative proceedings, or where the record has been fully developed, it is appropriate for the Commission to issue an order on initial decision.").

[45] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 24 (2014) (Order on Remand).

[46] *Id.*

barred all participants in the CAISO and CalPX markets from engaging in "gaming" or "anomalous behavior" in those markets.[47]

21. The Commission includes within the scope of relevant evidence of unlawful behavior "market practices and behaviors [that] constitute a violation of the then-current CAISO and CalPX and individual seller's tariffs, as well as Commission orders."[48] Complainants, when they allege unlawful spot market manipulation by the Respondents, are subject to a duty "to be specific when presenting their arguments and evidence on this issue; the Complainants are required to specify which tariff provision and/or portion of the tariff provision the Respondents' conduct violated."[49] Further, the Commission has specified that Complainants must demonstrate "a persistent reoccurrence of the same market activity in violation of the then-effective tariffs" that demonstrate a "pattern" of behavior.[50] Respondents, in turn, may counter with evidence that the activity in question was, in fact, legitimate business behavior.[51]

22. As to "whether such activity had a direct effect on the negotiations of the contract at issue," Complainants must show "a causal connection between an unlawful activity and the terms of the contracts."[52] More specifically, the Commission in this case requires "the Complainants, when presenting evidence of such a connection, [to] demonstrate that a particular seller engaged in unlawful manipulation in the spot market *and that such manipulation directly affected the particular contract to which the seller was a party*."[53] The direct effect must be one which "eliminates the premise on which the *Mobile-Sierra*

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[47] *Id.*

[48] *Id.* (citing *SDG&E v. Sellers*, 135 FERC ¶ 61,183, at P 31 (2011)).

[49] *Id*.

[50] *SDG&E v. Sellers*, 153 FERC ¶ 61,144, at P 30 (2015) (Order on Rehearing).

[51] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 25 (2014) (Order on Remand) (*citing Nevada Power Co. v. Enron Power Mktg, Inc.*, 125 FERC ¶ 61,312, at PP 26-27 (2008); *SDG&E v. Sellers*, 129 FERC ¶ 61,147, at PP 21-22 (2009)).

[52] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 23 (2014) (Order on Remand).

[53] *Id*. P 50.

presumption rests: that the contract rates are the product of fair, arms-length negotiations."[54]

23. "Arms-length negotiations" are considered to be ones in which the negotiating parties possess generally equivalent bargaining power relative to one another, in which case the results of negotiation may be viewed as the reasonable equivalent of what would emerge from a competitive market.[55] Hence, for a power seller's unlawful manipulation in the spot market to have "directly affected" its long term contract negotiation with CDWR to a degree that "eliminated" the premise of a "fair, arms-length negotiation," the unlawful activity must have upset the balance of bargaining power between CDWR and the seller.

24. "Direct effect" is difficult to demonstrate in the present case. This case differs significantly from previous California Energy Crisis cases that examined the impact of sellers' unlawful activities on spot market prices. In those, the unlawful activity involved spot pricing itself, and thus affected such prices directly.[56] In this case, by contrast, the impact on long term contract negotiations is attenuated – the unlawful activity directly affects spot market prices as in the earlier cases, but their ultimate impacts on long term contract negotiations may be either direct or indirect. Dysfunction in the spot market may have had direct impacts by inducing the parties to the contracts at issue to enter into long term deals improvidently, including by reason of fraud or duress. It may have had indirect effects whereby spot market prices influenced forward market prices to be unduly high, in turn prompting negotiators to agree to excessively high long term contract rates.[57]

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[54] *Morgan Stanley*, 554 U.S. at 554.

[55] *See Am. Soc. of Composers, Authors & Publishers v. Showtime/The Movie Channel, Inc*., 912 F.2d 563, 584-585 (2d Cir. 1990).

[56] *See SDG&E v. Sellers*, 142 FERC ¶ 63,011, at PP 34, 35, 37, 62, 65 (2013) (Initial Decision), *aff'd*, 149 FERC ¶ 61,116, at PP 97, 102, 132, 176, 193, 200 (2014) (Opinion No. 536).

[57] Ex. CAL-717 at 106:3-8, 123:10-18 (Taylor Rebuttal) ("I shall later discuss how Shell's spot pricing impacted the Shell Contract negotiations both directly as the near-term alternative to the Shell Contract and indirectly through the elevation for forward contract prices that were of key importance in establishing contract terms.").

2. **"Overcoming" the *Mobile-Sierra-Morgan Stanley* Rule As a Result of Burden on Consumers "Down the Line" or Serious Harm to the Public Interest**

25. In *Morgan Stanley*, the Supreme Court held that where the presumption of justness and reasonableness that is afforded to bilateral contracts is not "avoided" by a reason of a respondent's unlawful activity in forming the contract, it may nevertheless be "overcome" when "an excessive burden on consumers" is shown.[58] The Court rejected a test suggested by the Ninth Circuit that an "excessive burden" on consumers is shown when the contract rate exceeds a "zone of reasonableness."[59] Such a test, the Supreme Court said, would do away with *Mobile-Sierra* contract protection altogether simply when the rate exceeds the marginal cost of producing power.[60] "A presumption of validity that disappears when the rate is above marginal cost is no presumption of validity at all, but a reinstitution of cost-based rather than contract based regulation," the Supreme Court remarked.[61]

26. Instead, the Supreme Court held that the *Mobile-Sierra* presumption can only be overcome upon a finding of "unequivocal public necessity" or "extraordinary circumstances." "In no way can these descriptions be thought to refer to the mere exceeding of marginal cost," it held.[62] "[E]xtraordinary circumstances where the public will be severely harmed"[63] are shown, the Supreme Court pointed out, by "determining whether the contracts imposed an excessive burden on consumers 'down the line,' relative to the rates they could have obtained (but for the contracts) after elimination of the dysfunctional market."[64]

27. The Commission, in its November 17, 2014 Order on Remand in this case, cast somewhat more light on the Supreme Court's penumbral "excessive burden on

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[58] *Morgan Stanley*, 554 U.S. at 552-553.

[59] *Id*. at 549-550.

[60] *Id*.

[61] *Id.* at 550.

[62] *Id.* at 550-551 (citations omitted).

[63] *Id.* at 551.

[64] *Id.* at 552.

consumers/harm to the public interest" test.[65] It determined that the Supreme Court's use of the term "down the line" meant "measured based on the life of the contract since the contracts in question have already expired."[66] It also decided that "[a] relevant factor in the down-the-line analysis is the cost of substitute power in the absence of the contracts."[67] An appropriate measure of the cost of substitute power, the Commission determined, "may be the actual market prices available at that time for comparable long-term contracts," together with evidence on how to account for "negotiated non-rate terms" in establishing a market price.[68]

28. The Commission cautioned, however, that "while evidence of the difference between market prices and the contract price is important, it is not dispositive."[69] Complainants here were instructed to submit evidence on "(1) given the contract, what consumers' rates were; (2) what consumers' rates would have been down the line in the absence of the contract; and (3) how the difference imposes an excessive burden on consumers."[70] "The impact on consumers," the Commission further noted, "is a key element of this analysis."[70]

29. In its February 9, 2015 Order on Request for Rehearing or Clarification, the Commission further elucidated that "evidence of non-parties' conduct may be introduced" when relevant to show that the contracts at issue impose an excessive burden on consumers.[71] However, the Commission admonished Complainants "to be very specific in [their] claims and arguments involving non-parties."[72] The Commission

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[65] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at PP 20-22 (2014) (Order on Remand).

[66] *Id.* P 20.

[67] *Id.* P 21.

[68] *Id.*

[69] *Id.* P 22.

[70] *Id*.

[70] *Id*.

[71] *CPUC v. Sellers of Long-Term Contracts*, 150 FERC ¶ 61,079, at P 14 (2015) (Clarifying Order).

[72] *Id.*

warned that it will not accept "general allegations of market dysfunction or high prices in the California markets," or "re-litigation of issues arising from non-parties' actions," and "will focus only on specific conduct by specific parties to the contracts at issue." [73]

D. Dismissal of Iberdrola

30. This proceeding is also tasked with determining whether the Commission properly dismissed Iberdrola from this case.[74] In an order issued on April 25, 2002, the Commission dismissed Complainants' allegations as to the sole Iberdrola contract at issue here on the ground that it was entered into after June 20, 2001, the date on which the Commission's WECC-wide wholesale price mitigation strategy for solving the Western Energy Crisis went into effect and forward prices declined.[75]

31. The Ninth Circuit reversed the Iberdrola dismissal on the ground that "FERC did not consider . . . whether some market dysfunction may have lingered after that order took effect."[76] The Supreme Court, however, summarily vacated the Ninth Circuit's ruling,[77] thereby rejuvenating the Commission's dismissal of Iberdrola. Nonetheless, the Commission has seen fit on this remand to revisit "whether Iberdrola was in fact improperly dismissed." [78]

E. Burden of Proof

32. The burden of proof to be applied in the Western Energy Crisis cases like this one has been described by the Commission as follows:

> [A]s the parties seeking contract abrogation, California Parties bear the burden of proof. The party with the burden of proof bears the burden of production, or the need to provide sufficient evidence to establish a *prima*

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[73] *Id.*

[74] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at PP 3, 5, 12, 13, 19 (2014) (Order on Remand), *aff'd on rehg*, 150 FERC ¶ 61,079, at n.11 (2015) (Clarifying Order).

[75] *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087, at 61,383 (2002).

[76] *Pub. Utils. Comm'n of Cal. v. FERC*, 474 F.3d 587, 596-597 (9th Cir. 2006).

[77] *Sempra Generation v. CPUC*, 554 U.S. 931 (2008).

[78] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 19 (2014) (Order on Remand).

> *facie* case. Once it establishes a *prima facie* case, the burden of going forward shifts to the opposing party; although the ultimate burden of proof remains with the proponent. The party bearing the burden of proof will prevail only if, when the record is closed, the preponderance of evidence supports its position.[79]

33. The Commission has underscored that "[t]he burden of proof, in the sense of the ultimate burden that rests upon a party to establish the truth of a given proposition, never shifts during the course of the trial, but remains from the first to the last with the party on whom the law cast it at the beginning of the trial."[80] The Complainants play that role here, with one exception: the Commission has said that "the Respondents accused of unlawful manipulation in this proceeding may submit evidence that the activity in question was, in fact, legitimate business behavior."[81]

F. <u>Remedy</u>

34. As for what remedy to impose, the Supreme Court in *Morgan Stanley* held that "FERC may abrogate a valid contract" that fails the *Mobile-Sierra-Morgan Stanley* test.[82] The Court made clear that avoiding or overcoming the *Mobile-Sierra-Morgan Stanley* Rule occurs only in "extraordinary circumstances" involving "unequivocal public necessity" where the contract "seriously harms" the public interest or imposes "an excessive burden on consumers."[83] In exercising its remedial authority, "the Commission's discretion is at its zenith."[84]

35. It should be noted that a showing of a "burden on consumers," as discussed above, is not the same as a showing of a "remedy." Parties may present evidence of a "burden on consumers" in the form of some dollar quantity or other measure, but that is only one way to demonstrate the existence of "extraordinary circumstances" or "unequivocal

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[79] *Puget Sound Energy v. All Jurisd. Sellers*, 151 FERC ¶ 61,173, at P 98 (2015) (Opinion No. 537).

[80] *ANR Storage Co.*, 153 FERC ¶ 61,052, at P 47 (2015).

[81] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 25 (2014) (Order on Remand).

[82] *Morgan Stanley*, 554 U.S. at 548.

[83] *Id*. at 530, 534, 547, 549 n.4, 550.

[84] *See Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967).

public necessity," which are intangible qualities that justify lifting the *Mobile-Sierra Morgan Stanley* presumption. The remedy to impose upon abrogating or reforming the contracts at issue is a different matter. In past Western Energy Crisis cases, such remedies have taken the form of refunds of spot price charges in excess of MMCP, which is not defined as a measure of "burden on consumers."[85]

36. This Initial Decision is not tasked with determining the appropriate restitution that Respondents must make to Complainants if any of the contracts at issue fail the *Mobile-Sierra-Morgan Stanley* test. Unlike other cases involving the Western Energy Crisis,[86] this proceeding has only been directed by the Commission to reopen the remanded record, to "hold a trial-type, evidentiary hearing" to supplement that record, and to issue "factual determinations" on the remanded issues on the basis of which the Commission can then "determine what further steps must be taken."[87]

G. Additional Considerations

37. The time period that constitutes the full period of the Western Energy Crisis is from May 1, 2000 (when the earliest spike in California spot market electricity prices occurred) through July 6, 2001 (when the CDWR-Iberdrola contract was signed), and is referred to in this Initial Decision as the "Crisis Period." Various intervals within that time period have been the focus of earlier cases about the Crisis.[88] In this case, frequent references are made to the period from October 2, 2000 through June 20, 2001, known as the "Refund Period," at the end of which FERC imposed price caps throughout the West. References are also made to the period from May 1, 2000 through October 1, 2000, known as the "Summer Period," which occurred at the outset of the Crisis. References are also made to the period from January 17 through July 6, 2001, known as the

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[85] *See*, *e.g.*, *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 7 (2014) (Opinion No. 536).

[86] *See, e.g.*, *id*. PP 209 & 235 (restitution ordered).

[87] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at PP 1, 18, 19 (2014) (Order on Remand).

[88] *Puget Sound Energy v. All Jurisd. Sellers*, 151 FERC ¶ 61,173, at P 10 (2015) (Opinion No. 537) (covering bilateral wholesale energy contracts entered into in the Pacific Northwest spot market between December 25, 2000 and June 20, 2001); *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 1 (2014) (Opinion No. 536) (covering the CalPX and CAISO markets during May 1, 2000 through June 21, 2001); *SDG&E v. Sellers*, 102 FERC ¶ 61,317, at P 1 (2003) (covering the CalPX and CAISO markets during October 2, 2000 through June 20, 2001).

"Negotiation Period," for the time during and shortly after the Crisis in which Shell and Iberdrola negotiated their long term contracts with CDWR. There is also an occasional reference to an "Interim Period" from October 2, 2000 through January 16, 2001.

38. This Initial Decision views the entire Crisis Period as a whole. Complainants' theory of the case, which they have the burden to prove, is that there is a nexus between unlawful activities affecting spot market prices that, in turn, affect long term contract negotiations. This nexus, if proved, spans the entire time period. It is assumed, therefore, that unlawful activity that took place at any time within that period can be attributed to the contracts at issue, irrespective of whether it occurred inside or outside of any lesser interval of time during the Crisis Period.[89]

39. This administrative proceeding arises on remand from the Commission's original decision in consolidated Docket Nos. EL02-60 and EL02-62, which it reached on the basis of its review of an evidentiary record that was developed by Administrative Law Judge Bobbie McCartney.[90] Although the subsequent Ninth Circuit appeals and related Supreme Court decision called into question the Commission's ultimate ruling in that case,[91] they did not question the evidentiary record that Judge McCartney collected. Here, the Commission expressly directs this proceeding "to supplement" that record.[92] Accordingly, that evidentiary record is incorporated by reference into the record in this proceeding and bears upon the findings of fact and conclusions of law reached here.[93]

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[89] *See* Tr. 2636:8-25 (McKeon Closing Arg.); Tr. 2730:19-2732:19 (Watkiss Closing Arg.).

[90] *CPUC v. Sellers of Long-Term Contracts*, 103 FERC ¶ 61,354 (2003), *aff'g* Partial Initial Decision, 102 FERC ¶ 63,013 (2003).

[91] *CPUC v. Sellers of Long-Term Contracts,* 103 FERC ¶ 61,354 (2003), *reh'g denied*, 105 FERC ¶ 61,182 (2003), *rev'd sub nom. Pub. Utils. Comm'n of Cal. v. FERC*, 474 F.3d 587 (9th Cir. 2006), *vacated and remanded sub nom. Sempra Generation v. CPUC*, 554 U.S. 931 (2008), *remanded to FERC sub nom. Pub. Utils. Comm'n of Cal. v. FERC*, 550 F.3d 767 (9th Cir. 2008).

[92] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 1 (2014) (Order on Remand).

[93] Exhibits in the record that bear identifying numbers below 200 (*i.e.*, Ex. CAL-51) were admitted by Judge McCartney in the 2002 hearing. Exhibits starting with 200 (*i.e.*, Ex. SNA-200) have been admitted in the 2015 hearing.

40. The omission from this Initial Decision of any argument raised by the participants at the hearing or in their briefs does not mean that it has not been considered. Rather, it has been evaluated and found to either lack merit or significance such that inclusion would only tend to lengthen this Initial Decision without altering its substance or effect. Accordingly, all arguments made by the participants that have not been specifically discussed or adopted by this decision have been considered and are rejected.

III. Procedural History

41. On January 13, 2016, the proceeding participants submitted a Joint Procedural History. This Joint Procedural History, with some modifications, is adopted by this Initial Decision as included below.

42. This case is before the Commission on remand from the United States Court of Appeals for the Ninth Circuit.[94] CPUC and EOB alleged in each complaint that the prices, terms, and conditions of the contracts were unjust and unreasonable and not in the public interest.[95]

43. In its April 25, 2002 order,[96] the Commission dismissed the February 25, 2002 CPUC and EOB allegations as to the contracts that were entered into after June 20, 2001 (of which the Iberdrola contract was one), and set for hearing the issues regarding the contracts entered into before that date.[97] The Commission's order specified that the hearing was to address "whether the dysfunctional California spot markets adversely affected the long-term bilateral markets, and, if so, whether modification [was warranted] of any individual contract at issue."[98] The Commission also instructed then-presiding

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[94] *Pub. Utils. Comm'n of Cal. v. FERC*, 550 F.3d 767 (9th Cir. 2008).

[95] *See* CPUC Complaint, Docket No. EL02-60-000 (February 25, 2002) and EOB Complaint, Docket No. EL02-62-000 (February 25, 2002). The original complaints involved many more parties, but Shell and Iberdrola are the only remaining Respondents in the instant proceeding.

[96] *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087 (2002) (April 25, 2002 Order).

[97] All of those sellers have since settled, with the exception of Shell.

[98] April 25, 2002 Order, 99 FERC ¶ 61,087*,* at 61,384. In differentiating the hearing from a concurrent staff investigation (Final Report on Price Manipulation in Western Markets, Docket No. PA02-2-000), the Commission stated that the contracts were being set for hearing "based on the arguments that the dysfunctional spot markets in California caused long-term contracts not to be reasonable, whereas the investigation *(continued ...)*

Administrative Law Judge McCartney to determine the applicable standard of review for those contracts that did not contain explicit *Mobile-Sierra* language.[99]

44. Judge McCartney issued a partial initial decision on January 16, 2003, in which she held that "the *Mobile-Sierra* standard of review applie[d] to a negotiated contract unless the contract expressly state[d] otherwise . . . ."[100] On June 26, 2003, the Commission affirmed Judge McCartney's holding with regard to the "public interest" standard of review. Finding that the CPUC and EOB had not met their burden of proof under that standard to justify modification or abrogation of the contracts at issue, the Commission denied their complaints.[101] The CPUC and EOB sought rehearing, which the Commission denied.[102] The CPUC and EOB then appealed.

45. On appeal, the Ninth Circuit reversed and remanded the Commission's prior orders, finding that the Commission incorrectly applied the *Mobile-Sierra* precedent when it concluded that the challenged contracts were just and reasonable, and that the Commission erred in dismissing Iberdrola from the proceedings.[103]

46. The Respondent sellers petitioned the Supreme Court for *certiorari*. The Supreme Court did not initially grant *certiorari* in this proceeding, but did in *Morgan Stanley*, involving a companion case with similar facts, arguments, and parties.[104] The *Morgan*

[looked] at whether there was improper behavior by sellers that may have caused prices not to be reasonable." April 25, 2002 Order, 99 FERC ¶ 61,087, at 61,383 n.28.

[99] *Id.* at 61,384. *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), *Federal Power Comm'n v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956); *CPUC v. Sellers of Long-Term Contracts*, 102 FERC ¶ 61,025, at P 13 (2003) (contract rates for wholesale energy sales are presumed to be just and reasonable, but the presumption can be overcome if the contract seriously harms the public interest).

[100] *CPUC v. Sellers of Long-Term Contracts*, 102 FERC ¶ 63,013, at P 45 (2003).

[101] *CPUC v. Sellers of Long-Term Contracts*, 103 FERC ¶ 61,354, at P 3 (2003).

[102] *CPUC. v. Sellers of Long-Term Contracts*, 105 FERC ¶ 61,182 (2003).

[103] *Pub. Utils. Comm'n of Cal. v. FERC*, 474 F.3d 587 (9th Cir. 2006).

[104] *Morgan Stanley*, 544 U.S. 527. *Morgan Stanley* involved a petition for *certiorari* filed by Morgan Stanley Capital Group and other sellers of the referenced companion case, *Pub. Util. Dist. No. 1 of Snohomish County v. FERC,* 471 F.3d 1053 (9th Cir. 2006).

Stanley majority held that the just and reasonable standard applies in the case of rates set by contract,[105] but is avoided where "it is clear that one party to a contract engaged in such extensive unlawful market manipulation as to alter the field for contract negotiations . . . ."[106] The Supreme Court further explained that if the *Mobile-Sierra* presumption applies to a contract, the presumption may be overcome if the contracts imposed an excessive burden on consumers "'down the line,' relative to the rates they could have obtained (but for the contract) after elimination of the dysfunctional market,"[107] or otherwise seriously harmed the public interest.[108]

47. Immediately after the decision in *Morgan Stanley*, the Supreme Court granted the petitions for *certiorari* in this case and remanded back to the Ninth Circuit its decision that the Commission had mistakenly applied the *Mobile-Sierra* precedent here.[109] As a consequence, the Ninth Circuit vacated its decision in this proceeding and remanded back to the Commission "for proceedings consistent with the Supreme Court's rulings" in *Morgan Stanley*.[110] Subsequently, CPUC and most of the remaining suppliers in these proceedings entered into settlements, which the Commission has approved.[111] Shell and Iberdrola are the only remaining Respondents.

48. On remand, the Commission ordered "a trial-type evidentiary hearing" to supplement the existing record in this proceeding in light of the Supreme Court's decision in *Morgan Stanley.*[112] The Commission reopened the record for evidence on whether the *Mobile-Sierra* presumption of just and reasonableness was avoided or

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[105] *Morgan Stanley*, 554 U.S. at 545.

[106] *Id.* at 554.

[107] *Id.* at 552.

[108] *Id.* at 553.

[109] *See Sempra Generation v. CPUC*, 554 U.S. 931 (2008).

[110] *Pub. Utils. Comm'n of Cal. v. FERC*, 550 F.3d 767 (9th Cir. 2008).

[111] *See, e.g., CPUC v. Sellers of Long-Term Contracts*, 141 FERC ¶ 61,092 (2012) (approving settlement between certain Dynegy entities and CPUC); *CPUC v. Sellers of Long-Term Contracts*, 133 FERC ¶ 61,245 (2010) (approving settlement between Sempra Generation and CPUC and CDWR).

[112] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 1 (2014) (Order on Remand).

overcome with respect to the Shell and Iberdrola contracts and whether Iberdrola is a proper party in this proceeding.[113] The California Parties requested clarification or, in the alternative, rehearing of the Commission's Order on Remand regarding the scope of evidence permitted.[114] The Commission "provide[d] certain clarifications regarding the scope of the hearing" in its Clarifying Order.[115]

49. On December 5, 2014, the Chief Administrative Law Judge set this proceeding for hearing under Track II Procedural Time Standards and assigned the undersigned to preside.[116]

50. The Parties submitted a discovery plan and request for extension of the procedural schedule, which the Presiding Judge adopted on December 29, 2014.[117]

51. On February 24, 2015, the parties jointly submitted the Official 2002 Record of this proceeding to the Presiding Judge.

52. On March 12, 2015, oral argument was held on the California Parties' motion to compel[118] relating to audio recordings and request for extension of the procedural schedule. The Presiding Judge granted the California Parties' motion to compel and extended the procedural schedule on March 16, 2015, pursuant to which the hearing commencement date was postponed from September 8 to November 9, 2015.[119]

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[113] *Id.* PP 16, 19.

[114] California Parties Request for Clarification or Rehearing, Docket Nos. EL02-60, *et al.* (Dec. 17, 2014).

[115] *CPUC v. Sellers of Long-Term Contracts*, 150 FERC ¶ 61,079, at P 9 (2015) (Clarifying Order).

[116] Order of Chief Judge Designating Presiding Administrative Law Judge and Establishing Track II Procedural Time Standards, Docket Nos. EL02-60, *et al.* (Dec. 5, 2014).

[117] Order Adopting Discovery Plan, Docket Nos. EL02-60, *et al.* (Dec. 29, 2014); Order Adopting Procedural Schedule, Docket Nos. EL02-60, *et al.* (Dec. 29, 2014).

[118] California Parties' Motion (1) to Compel Shell to Expedite Production of Audio Recordings (2) for Modification of the Procedural Schedule, and (3) for Expedited Consideration, Docket Nos. EL02-60, *et al.* (Mar. 4, 2015).

[119] Order Compelling Discovery Responses and Adopting Amended Procedural Schedule, Docket Nos. EL02-60, *et al.* (Mar. 16, 2015).

53. On May 19, 2015, the California Parties filed Direct Testimony. On July 21, 2015, Shell and Iberdrola filed Answering Testimony. On September 4, 2015, Commission Trial Staff filed Answering Testimony. On October 6, 2015, the California Parties filed Rebuttal Testimony.

54. On October 22, 2015, the Presiding Judge issued a revised Order on Hearing Procedures implementing e-trial procedures.[120] On October 26, 2015, the parties submitted a joint statement of issues. The parties submitted prehearing briefs on November 2, 2015.

55. A conference to set up computer technology was held on November 6, 2015 pursuant to the previous October 22, 2015 order.

56. The hearing began on November 10, 2015, with oral argument concerning the California Parties' October 6, 2015 motion to compel and request for sanctions relating to missing audio recordings. The Presiding Judge granted the California Parties' request for sanctions against both Shell and Iberdrola and issued an order to that effect on November 13, 2015.[121] The evidentiary hearing commenced on the afternoon of November 13, 2015, and concluded on December 4, 2015.

57. On December 8, 2015, the Acting Chief Administrative Law Judge issued an order extending the briefing schedule.[122]

58. On December 11, 2015, the parties submitted the joint final exhibit list.

59. On December 15, 2015, the California Parties filed an unopposed motion to reopen the record to correct certain hearing exhibits, which the Presiding Judge granted on December 16, 2015.[123]

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[120] Revised Order Adopting Rules for the Conduct of the Hearing, Docket Nos. EL02-60, *et al.* (Oct. 22, 2015).

[121] Order Memorializing November 10, 2015 Bench Ruling on Motion to Compel Production of Audio Recordings and Request for Sanctions, Docket Nos. EL02-60, *et al.* (Nov. 13, 2015).

[122] Order of Chief Judge Extending Briefing and Initial Decision Deadline, Docket Nos. EL02-60, *et al.* (Dec. 8, 2015).

[123] Order Granting California Parties' Motion to Reopen the Record, Docket Nos. EL02-60, *et al.* (Dec. 16, 2015).

60. On January 13 and February 16, 2016, post-hearing initial and reply briefs were filed respectively. On March 3, 2016, the parties presented closing oral arguments to the Judge.

IV. Issue One: Whether Iberdrola Should Be a Party in this Proceeding?

61. In an order issued on April 25, 2002, the Commission set for hearing a number of complaints that the California Parties had lodged against several sellers, including Iberdrola, which was known at the time as PacifiCorp Power Marketing, Inc. (PPM).[124] PPM's contract with CDWR, however, was not included among the contracts that the Commission set for hearing in that Order because it had been negotiated before but executed after June 20, 2001, the date that the Commission's final price mitigation order went into effect.[125] According to the Commission, the California Parties had offered the Commission "no evidence showing that CDWR was bound to proceed with execution of the contracts after the West-wide mitigation went into effect. Contracts entered into after the date the West-wide mitigation went into effect are not set for hearing, since the effect of the West-wide mitigation was to stabilize prices."[126]

62. Upon review of the April 25, 2002 Commission Order, the U.S. Court of Appeals for the Ninth Circuit reversed and remanded the Commission's dismissal of PPM.[127] According to the Court, FERC's decision not to adjudicate contracts executed after June 20, 2001 did not consider "whether some market dysfunction may have lingered after that order took effect. . . . It is not at all clear that the forward markets had stabilized by the date when the parties entered the PPM contract."[128]

63. The Ninth Circuit's decision, in turn, was vacated and remanded by the U.S. Supreme Court on June 27, 2008, in light of its issuance of the *Morgan Stanley* decision.[129] The Ninth Circuit thereupon remanded the case back to FERC.[130] The Commission's Order on Remand instituting this proceeding followed.[131]

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[124] *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087, at 61,383 (2002).

[125] *SDG&E v. Sellers*, 95 FERC ¶ 61,418, at 62,548 (2001).

[126] *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087, at 61,383-61,384 (2002).

[127] *Pub. Utils. Comm'n of Cal. v. FERC*, 474 F.3d 587, 596-597 (9th Cir. 2006).

[128] *Id.* at 587, 597.

[129] *Sempra Generation v. CPUC*, 554 U.S. 931 (2008).

64. The Commission has decided to revisit its dismissal of PPM here. "While the Ninth Circuit's opinion was subsequently vacated by the Supreme Court," the Commission said in its Order instituting this proceeding, "that was due to errors in the court of appeals' interpretation of the operation of the *Mobile-Sierra* presumption. Accordingly, we believe that the Ninth Circuit's decision warrants a review of whether Iberdrola was in fact improperly dismissed. The Commission therefore will allow the parties to present evidence to address whether or not Iberdrola should be a party to this proceeding."[132]

65. Irrespective of any significance attributable to the Commission's initial dismissal of Iberdrola or the Supreme Court's subsequent vacatur, we are bound by the Commission's order that "the Ninth Circuit's decision warrants a review" here. [133] What must be addressed here, then, is whether the once-dysfunctional spot market no longer affected negotiations for the contract between CDWR and Iberdrola after the Commission's West-wide price mitigation went into effect on June 20, 2001, or if instead that dysfunction lingered after the Commission Order took effect and had an impact on those negotiations.

66. On June 20, 2001, the date that the Commission's West-wide price mitigation plan went into effect, the "non-reserve deficiency" price cap for spot market sales, which was also the maximum price for negotiated bilateral contracts imposed by the Commission's plan, stood at $91.87/MWh, and remained at that level through December 19, 2001.[134] This price cap represented 85 percent of the highest hourly Stage 1 "reserve deficiency" price declared on May 31, 2001 of $108/MWh, as declared by the Commission's plan.[135]

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[130] *Pub. Utils. Comm'n of Cal. v. FERC*, 550 F.3d 767 (9th Cir. 2008).

[131] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127 (2014) (Order on Remand).

[132] *Id.* P 19.

[133] *Seaway Crude Pipeline Co. LLC*, 154 FERC ¶ 61,070, at P 23 (2016) ("When the Commission calls on an ALJ, on remand, to accept the agency's reading of the applicable law, the ALJ is bound to follow that instruction.").

[134] Ex. CAL-227 at 16 (CAISO, *Third Annual Report on Market Issues and Performance* (January 2002)).

[135] *Id*. at 16 n.5.

67. Negotiations between Iberdrola and CDWR began on January 24, 2001 and ended with execution of the contract on July 6, 2001.[136] When they concluded, the final deal provided, *inter alia*, for Iberdrola to deliver to CDWR: (i) 150 MW of 7x24 firm energy (that is, delivered seven days per week, 24 hours per day) at $70/MWh from July 1, 2001 through June 30, 2002; and (ii) 200 MW at $70/MWh from July 1, 2002 through December 31, 2002.[137] As of the date of execution of the contract, forward prices in the CAISO SP-15 zone stood at approximately $50/MWh for 2002 and 2003 deliveries.[138] Spot electric prices in the SP-15 zone as of the execution date stood at approximately $97/MWh.[139]

68. Iberdrola was further required under the contract to deliver to CDWR 200 MW from January 1, 2003 through June 30, 2004 and 300 MW from July 1, 2004 through the end of the contract term on June 30, 2011, priced according to a "tolling" arrangement.[140] In a "tolling contract," the buyer has the option to dispatch a generation resource at any time, and to use that generation resource to convert a fuel supply into electricity at a guaranteed conversion rate (known as the "heat rate"). In exchange for this right, the buyer agrees to pay the seller a "capacity" payment that compensates the seller for providing the buyer the option to dispatch the plant. Thus, the product being sold in a tolling agreement is plant capacity, not energy.[141] In this instance, Iberdrola provided CDWR dispatching rights to its Klamath cogeneration facility.[142]

69. The CDWR-Iberdrola contract, as finally negotiated, achieved a price for power that was well below the Commission's then-existing West-wide mitigation cap of $91.87/MWh. There is no reason, therefore, why CDWR would not have been "bound to proceed with execution of the [Iberdrola contract] after the West-wide mitigation went into effect," as the Commission asserted was its reason for dismissing Iberdrola, because

[136] Ex. CAL-210 at 16:12-17:1 (Hart Direct); Ex. CAL-41 (Iberdrola Contract).

[137] Ex. IB-200 at 12:1-17 (Harlan Answering); Ex. CAL-210 at 18:10-15 (Hart Direct); Ex. CAL-41 (Iberdrola Contract).

[138] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

[139] *Id*.

[140] Ex. IB-200 at 12:1-17 (Harlan Answering); Ex. CAL-210 at 18:10-15 (Hart Direct); Ex. CAL-41 (Iberdrola Contract).

[141] Ex. IB-222 at 9:1-5 (Cavicchi Answering).

[142] Ex. IB-200 at 13:1-12 (Harlan Answering).

the cap did not override the contract rate.[143] The Commission's rationale, then, did not support dismissing Iberdrola from this case.

70. Moreover, the fact that the CDWR-Iberdrola contract price benefitted CDWR because it was below the West-wide mitigation cap does not justify dismissing Iberdrola either. In *Morgan Stanley*, the Supreme Court stated:

> [I]t is entirely possible that rates had increased so high during the energy crises because of dysfunction in the spot market that, even with the acknowledged decrease in rates [resulting from CDWR's negotiation of forward contracts], consumers still paid more under the forward contracts than they otherwise would have. If that is so, and if that increase is so great that, even taking into account the desirability of fostering market-stabilizing long term contracts, the rates impose an excessive burden on consumers or otherwise seriously harm the public interest, the rates must be disallowed.[144]

71. Immediately before the onset of the Western Energy Crisis, the wholesale spot electric price in California averaged $34/MWh, and after it was over, the spot price averaged $32/MWh.[145] Hence, the West-wide mitigation cap of $91.87/MWh and the price agreed by CDWR and Iberdrola of $70/MWh represented significant increases in price compared to what consumers paid before the dysfunction in the spot market began and after the dysfunction was over, even though they were below the peak prices that were paid during the Crisis.

72. As a result, it is possible, as the Ninth Circuit surmised, that the dysfunction in the spot market indeed "lingered" long enough to inflate prices and influence negotiations between Iberdrola and CDWR. The Supreme Court in *Morgan Stanley* did not expressly contravene the Ninth Circuit on this point.[146] Thus, Iberdrola should not have been

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[143] *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087, at 61,383-61,384 (2002).

[144] *Morgan Stanley*, 557 U.S. at 553 (internal punctuation and citations omitted).

[145] Ex. CAL-90 at 15:10-21 (Stoft Direct).

[146] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 19 ("While the Ninth Circuit's opinion was subsequently vacated by the Supreme Court, that was due to errors in the court of appeals' interpretation of the operation of the *Mobile-Sierra* presumption. Accordingly, we believe that the Ninth Circuit's decision warrants a review of whether Iberdrola was in fact improperly dismissed.").

dismissed from the case out of hand without first evaluating whether "that increase is so great that, even taking into account the desirability of fostering market-stabilizing long term contracts, the rates impose an excessive burden on consumers or otherwise seriously harm the public interest." [147]

73. Accordingly, the dismissal of Iberdrola was incorrect. Its contract with CDWR, then, will receive a full *Mobile-Sierra Morgan Stanley* analysis here.

V. Issue Two: Whether the *Mobile-Sierra-Morgan Stanley* Rule Applies to the Contracts at Issue?

A. Whether Respondent Sellers Engaged in Unlawful Market Activity That Had a Direct Effect on the Negotiations of the Contracts at Issue, Such That the *Mobile-Sierra-Morgan Stanley* Rule Is Avoided?

74. The Crisis began in earnest in late May 2000 and remained intense through late May of 2001, when it suddenly relented. Prior to its start, the spot price of electricity averaged \$34/MWh. After it was over, the spot price averaged \$32/MWh. During the Crisis year, however, the spot price averaged \$201/MWh.[148] The average wholesale price in the spot market in January 2001 reached \$320/MWh, with prices in on-peak hours frequently exceeding \$400/MWh, and at times exceeding \$1,000/MWh.[149]

75. The following chart shows starkly how wholesale electricity prices acted during the Crisis compared to the norm in the spot market both beforehand and afterward: [150]

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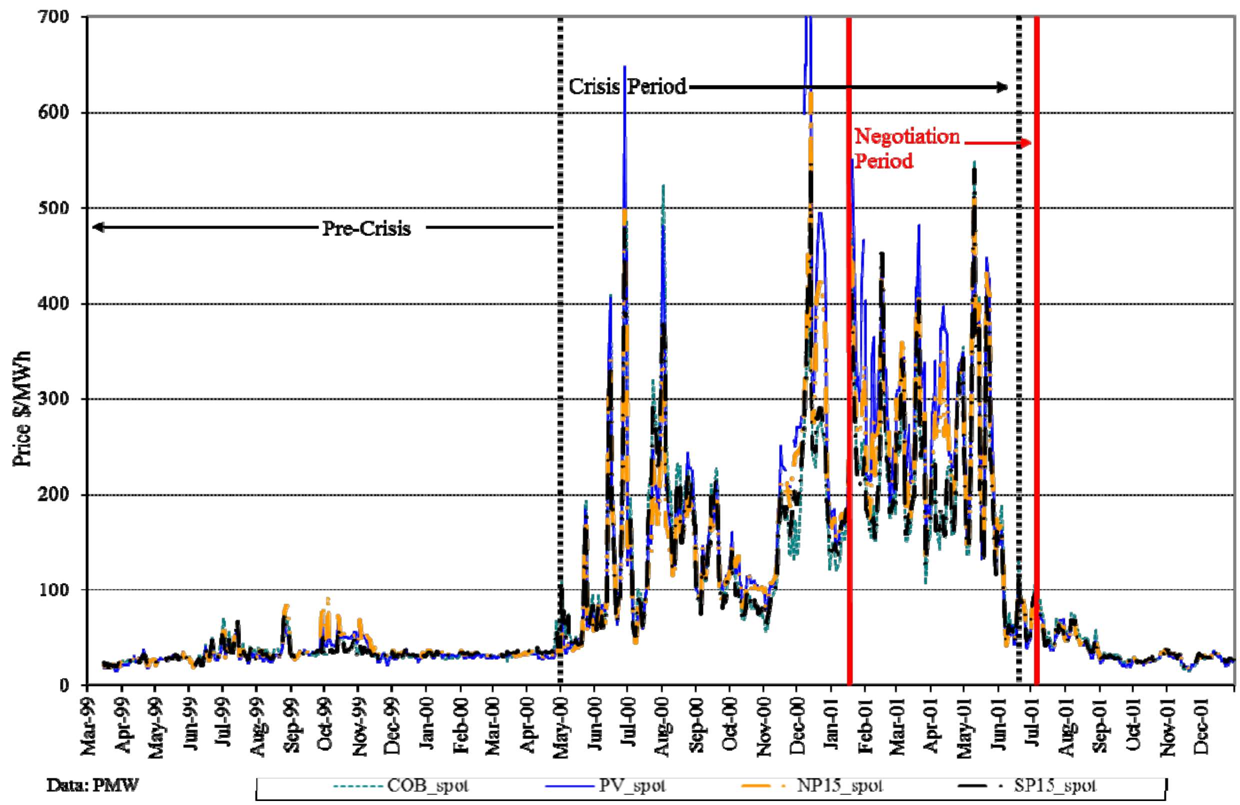
[147] *Morgan Stanley*, 557 U.S. at 553 (internal punctuation and citations omitted).

[148] Ex. CAL-90 at 15:10-21 (Stoft Direct); Ex. CAL-604 at 17, fig.1 (Goldberg Direct).

[149] Ex. CAL-200 at 5:5-8 (Nichols Direct).

[150] Ex. CAL-604 at 17, fig.1 (Goldberg Direct).

Spot Prices from March 1999 through December 2001



76. By 2002, evidence came to light about manipulative schemes that were carried on in the California spot markets during the Crisis Period by then-bankrupt marketer Enron, Inc.[151] It then came to light that these schemes were practiced by other marketers as well, including Shell. It is notable in this regard that Carey Morris, an Enron trader, moved to Shell's San Diego trading operation at the beginning of the Crisis and took on a supervisory role, guiding Shell traders in the same sort of schemes that Enron had perpetrated and bringing along Enron's former municipal utility partners, the cities of Glendale and Colton, California, to carry them out.[152]

77. These artifices violated several provisions of the CAISO Tariff that were set forth in its Market Monitoring and Information Protocol (MMIP).[153] The MMIP was the set of

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[151] Ex. CAL-302 at 2-22 (December 6, 2000 Enron Memos).

[152] Ex. CAL-285 at 35:16-20, 55:1-6 (Taylor Direct); Ex. CAL-319 at 25:1-6 (Taylor Direct).

[153] *Am. Elec. Power Serv. Corp.*, 103 FERC ¶ 61,345, at PP 35, 37-55 (2003), *reh'g denied*, 106 FERC ¶ 61,020 (2004).

rules that outlined the appropriate market behavior for participants in the organized auction market. The Commission has the authority to enforce these rules.[154]

1. Shell Contract

78. Since 2002, the Commission has recognized that the Enron-type manipulative activities that Shell and other marketers pursued in the California spot markets during the Crisis Period raised prices in those markets.[155] It comes as no surprise that more recent litigation on the Western Energy Crisis has focused blame for excessive prices on the pervasiveness of these unlawful practices in lieu of the systemic causes that were believed at an earlier time to be at fault.[156]

a. Unlawful Spot Market Activities

79. In order to prevail on the "avoidance" prong of the *Mobile-Sierra-Morgan Stanley* Rule, the Commission's Order on Remand requires Complainants to show that "the seller under a particular contract at issue in this proceeding engaged in unlawful market activity in the spot market."[157] Complainants, through the testimony of their expert witness, Gerald A. Taylor,[158] identify seven unlawful activities in the California spot market for

[154] *Id.* P 23 ("The MMIP puts market participants on notice regarding their rights and obligations in the marketplace. It serves as the rules of the road for market participants. It also contemplates that these rules will be enforced by the Market Surveillance Unit, in the form of monitoring and reporting, or by the appropriate body or bodies (including this Commission), in the form of corrective actions.").

[155] With regard to the impact of fuel costs, for example, FERC Staff, in its 2003 Report, realized that "the investigation has identified evidence of gas market dysfunction, speculative trading, and index misreporting. These factors, in addition to the linkage between gas and electric markets, resulted in artificially high gas prices." Ex. CAL-291 at 175 (FERC Staff, *Final Report on Price Manipulation in Western Markets*, Docket No. PA02-2-000 (March 2003)).

[156] Before the Enron disclosures, the Commission in the early stage of this proceeding had concluded that "there is nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation specific to the long-term contract negotiations resulting in prices and terms being challenged here." *CPUC v. Sellers*, 103 FERC ¶ 61,354, at P 61 (2003).

[157] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 23 (2014) (Order on Remand).

[158] Exs. CAL-285 and CAL-319 (Taylor Direct); Ex. CAL-717 (Taylor Rebuttal).

electricity that they claim were perpetrated by Shell and others during the Crisis Period. They are: (i) anomalous bidding; (ii) circular scheduling; (iii) phantom ancillary services; (iv) false export, abetted by illicit parking; (v) shorting generation; (vi) false load and load shift; and (vii) noncompliant quarterly reporting. Shell's expert witness, Dr. Craig Pirrong, an economist, challenges Taylor's findings.[159]

80. Of the seven unlawful Shell activities identified by Taylor, only three have ever been shown to have tangible effects on price levels in the electricity spot market during the Crisis Period. These are: (i) anomalous bidding of types 2 and 3; (ii) false export; and (iii) false load scheduling. They were shown in the *SDG&E* case to raise spot market-clearing prices.[160] No evidence was presented by Complainants in *SDG&E* or here of price effects for any of the other unlawful activities that Shell is alleged to have committed.

81. Complainants' theory of the case is that Respondents' unlawful activities raised spot market prices, and that those elevated prices in turn raised forward market prices.[161] If an unlawful activity has not been shown to have a price effect in the spot market, it follows that there can be no showing that it had an impact on prices in the forward market. Accordingly, it is only necessary to examine here the three unlawful Shell activities that Complainants have shown to have raised spot market-clearing prices.

82. Conversely, if a price effect for a particular unlawful activity is shown, its impact on the spot market is not necessarily limited to that one price spike. In a recent decision in the *SDG&E* case, the Commission clarified that a remedial refund from a particular seller was not limited to the hours during the Summer Period in which that seller committed tariff violations.[162] Instead, that seller must disgorge overcharges it received for *all* of its sales during *all* hours of the Summer Period during which the market prices were inflated by tariff violations committed by *any* of the Respondents.[163] The Commission noted that "price shocks in markets can be perpetuated by changing seller

[159] Ex. SNA-230 (Pirrong Answering).

[160] *SDG&E v. Sellers*, 149 FERC ¶ 63,011, at PP 14, 34, 35, 37, 58, 62, 63 (2013) (Baten, J.), *aff'd*, 149 FERC ¶ 61,116, at PP 57, 62, 97, 102, 120, 127, 174, 176 (2014) (Opinion No. 536); Tr. 2650:4-13 (McKeon Closing Arg.).

[161] Complainants Post-hearing Initial Br. at 54-62; Complainants Post-hearing Reply Br. at 5-9.

[162] *SDG&E v. Sellers*, 154 FERC ¶ 61,063, at PP 2-4 (2016).

[163] *Id.* P 8.

behavior," and that there can be "significant inter-temporal effects to the . . . tariff violations due to price persistence following tariff violations." [164] Sellers "were behaving as tacit colluders and adjusting their behavior in response to changes in supply offers," the Commission held.[165] Hence, such price spikes "were not isolated incidents."[166] Although this decision addressed the issue of remedy, an aspect of the long term contract case that is not before this administrative proceeding, [167] it suggests that even isolated price effects of particular unlawful activities can be sufficiently disruptive of spot market price levels to influence a wide range of forward prices as well.

83. Complainants also contend, through the testimony of their expert witness, economist Dr. Carolyn A. Berry,[168] that Shell unlawfully manipulated natural gas forward prices by falsifying reports of natural gas contracts that they provided to gas price index publishers during the Negotiation Period of the CDWR long term contract.[169] According to Berry, natural gas prices have a direct effect on electricity forward prices, and therefore Shell's manipulative activity, together with the same widespread practice of other sellers, distorted long term electricity contract negotiations with CDWR.[170] Shell's expert witness, Dr. Randal Heeb, an economist, questions Berry's findings.[171]

i. <u>Anomalous Bidding</u>

84. "Anomalous bidding" is a term that is used to describe strategies that were employed by traders in the CalPX and CAISO markets when submitting offers to furnish electricity. Several of the other strategies that are described below were used in

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[164] *Id.* P 10.

[165] *Id.*

[166] *Id.* P 11.

[167] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at PP 1, 18, 19 (2014) (Order on Remand).

[168] Ex. CAL-268 (Berry Direct); Ex. CAL-706 (Berry Rebuttal).

[169] Ex. CAL-268 at 3:5-4:4 (Berry Direct).

[170] Ex. CAL-268 at 5:17-6:10, 11:3-12:2, 13:10-17, 21:6-20 (Berry Direct).

[171] Ex. SNA-265 (Heeb Answering).

conjunction with anomalous bidding in order to manipulate market prices. Generally speaking, anomalous bids were bids that departed from normal competitive patterns.[172]

85. The CalPX and CAISO markets operated as single-price auctions. "No matter how low or how high a bid was for a bidding hour, the resulting market clearing price for a particular bidding hour was the price per MWh that all bidders received for their bids."[173] The market clearing price that they would receive was the highest bid in dollars per MWh accepted for that hour. "All bids were accumulated in a stack known as the Balancing Energy and Ex Post (BEEP) stack. The CAISO then dispatched the energy, which these bids represented, from the lowest price to highest price until all energy requirements for that hour were satisfied."[174]

86. Anomalous bidding strategies used by traders, including Shell, in these markets fell into three categories. "Type 1" anomalous bids featured a portion of a bid that was offered at an extremely high price that was well in excess of the marginal cost of producing the electricity that the seller was bidding into the market at the given hour. If accepted, such a bid had the effect of elevating the market clearing price for all sales made in the same bidding hour.[175]

87. "Type 2" anomalous bids were bids above marginal cost offered in conjunction with some other strategy, such as false export or false load. The purpose of such bids was to place energy into the real-time market on a "price-taker" basis. The real-time market structure would set the price that the seller must accept, hence the name "price-taker." However, by engaging in anomalous bidding of this type, the seller maneuvered the structure into elevating the price excessively. The seller effectively became a "price-maker" instead of a "price-taker."[176]

88. "Type 3" anomalous bids were bids that were priced far above marginal costs that the seller never expected to be accepted. These were actually a form of economic withholding of electric supply.[177]

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[172] Ex. CAL-285 at 37:10 (Taylor Direct).

[173] *SDG&E v. Sellers*, 142 FERC ¶ 63,011, at P 15 (2013) (Initial Decision).

[174] *Id*.

[175] Ex. CAL-285 at 38:3-6 (Taylor Direct).

[176] *Id*. at 38:7-15.

[177] *Id*. at 39:1-3.

89. The Commission found in the *SDG&E* case that type 1 anomalous bids violated sections 2.1.1 and 2.1.1.4 of the CAISO MMIP because they were consistently priced too high and were used to exploit shortages in supply in the CAISO real-time market.[178] MMIP sections 2.1.1, entitled "Anomalous Market Behavior," and subsection 2.1.1.4 provided in pertinent part**:**

> Anomalous market behavior . . . is defined as behavior that departs significantly from the normal behavior in competitive markets that do not require continuing regulation or as behavior leading to unusual or unexplained market outcomes. Evidence of such behavior may be derived from a number of circumstances, including:
> * * *
> pricing and bidding patterns that are inconsistent with prevailing supply and demand conditions, *e.g.,* prices and bids that appear consistently excessive for or otherwise inconsistent with such conditions . . . .[179]

90. The Commission also found that type 2 anomalous bids, in addition to violating MMIP sections 2.1.1 and 2.1.1.4, also violated section 2.1.3's prohibition on "gaming."[180] Gaming consisted of "taking unfair advantage of the rules and procedures [of CalPX and CAISO], or of transmission constraints in periods in which exist substantial Congestion, to the detriment of the efficiency of, and of consumers in, the [CA]ISO Markets." It also included "taking undue advantage of other conditions that may affect the availability of transmission and generation capacity, such as loop flow, facility outages, level of hydropower output or seasonal limits on energy imports from out-of-state, or actions or behaviors that may otherwise render the system and the [CA]ISO Markets vulnerable to price manipulation to the detriment of their efficiency."[181]

91. The Commission further held in *SDG&E* that type 3 anomalous bids violated MMIP sections 2.1.1.1 and 2.1.3 because economic withholding reduced the available supply to CAISO and increased the market-clearing price. In particular, section 2.1.1.1 prohibited the "withholding of generation capacity under circumstances in which it would normally be offered in a competitive market," and section 2.1.3 prohibited "behaviors

[178] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 58 (2014) (Opinion No. 536).

[179] *Id.* P 58 n.126.

[180] *Id.* P 61.

[181] *Id*. P 61 n.135.

that may render the system and the [CA]ISO Markets vulnerable to price manipulation to the detriment of efficiency."[182]

92. In the *SDG&E* case, Judge Baten found, and in Opinion No. 536 the Commission affirmed, that Shell had engaged in type 2 and type 3 anomalous bidding practices in the CalPX and CAISO markets during the relevant period in that case that had an impact on the market-clearing price.[183] Although the Commission also found that Shell engaged in type 1 anomalous bidding in those markets, it found no violation for those actions because the Complainants did not show that they had any effect on the market-clearing price.[184] In the *Puget Sound Energy* case, anomalous bidding was not an issue for the California Parties.[185]

93. Shell's expert witness, Pirrong, points out in his answering testimony that Complainants have not shown Shell to have engaged in anomalous bidding practices during the Interim or Negotiation Periods, nor have they submitted any evidence that this practice had any effect on spot market prices during those periods, nor have they submitted any evidence that anomalous bidding affected the rates agreed in, or negotiations for, the CDWR-Shell contract.[186]

94. As already stated earlier herein, the entire Crisis Period is viewed as a whole. Unlawful activities occurring during the Summer Period, for example, could have affected long term contract negotiations at the end of the Crisis Period. Accordingly, it is assumed that unlawful type 2 and type 3 anomalous bidding practices that took place at any time within the Crisis Period were potentially attributable to the contracts at issue, irrespective of whether they occurred inside or outside of any lesser interval of time within the Crisis Period.

ii. <u>False Export and Parking (a/k/a "Ricochet")</u>

95. The scheme of "false export," also known as "false import" and referred to by its Enron practitioners as "Ricochet" or "Megawatt Laundering," took advantage of the price

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[182] *Id.* P 63.

[183] *Id.* PP 3, 98, 101, 102.

[184] *Id.* P 93.

[185] *Puget Sound Energy v. All Jurisd. Sellers*, 151 FERC ¶ 61,173 (2015) (Opinion No. 537); 146 FERC ¶ 63,028 (2014) (McCartney, J.).

[186] Ex. SNA-230 at 48:23-49:11 (Pirrong Answering).

differentials that existed between the price-capped day-ahead or day-of markets and the non-capped out-of-market (OOM) prices in the real-time market. A market participant would make arrangements to export power purchased in the California day-ahead or day-of markets to an entity outside of the state and then repurchase that power from the out-of-state entity, for which the out-of-state entity would receive a fee. The "imported" power would then be sold to CDWR in the California real-time market at a price above the cap.[187] When power was parked under this practice, no power actually left the state of California.[188]

96. The "parking" aspect of this strategy had two components. The first part was a pre-scheduled (*e.g.*, day-ahead or hour-ahead) "sale" from the parking customer to the parking provider at a specific location and for certain specified operating hours (for example, a "delivery" from Shell to Glendale, arranged in the day-ahead market). The second part was a "repurchase" of the prescheduled power from the parking provider to the parking customer closer to the actual operating hour, in amounts that equaled the pre-scheduled volumes in each hour (that is, a "return" from Glendale to Shell, arranged in the real-time market). In some cases, the return leg also may have been arranged on a pre-scheduled (*e.g.*, day-ahead or hour-ahead) basis. Typically, the return was at the same location as the source of the sale.[189]

97. The day-ahead sale and the real-time repurchase gave the impression that a day-ahead transaction caused power to flow out of CAISO unrelated to a real-time flow back into CAISO in real-time, but this was not the case. The sale portion of the parking transaction would be scheduled a day early for "tomorrow," while the real-time repurchase would be scheduled that day for "today." The equal and simultaneous opposing flows out and back would effectively cancel each other out so that no power actually flowed at the intertie (*i.e.*, the fictitiously scheduled "export" and "import" point), or into or out of the parking provider's control area. Power scheduled from A (the supplier) to B (the parking provider) in the delivery leg and from B (the parking provider) to C (the ultimate purchaser) in the return leg actually just went from A (the supplier) to C (the ultimate purchaser). The parking provider, B, was merely a scheduling convenience that facilitated the deception.[190]

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[187] *Am. Elec. Power Serv. Corp.*, 103 FERC ¶ 61,345, at P 37 (2003); Ex. CAL-285 at 43:11-21 (Taylor Direct); Ex. CAL-680 at 18:15-19 (McIntosh Rebuttal); Ex. SNA-230 at 34:2-11 (Pirrong Answering).

[188] *Id.* P 38.

[189] Ex. CAL-285 at 48:5-14 (Taylor Direct).

[190] Ex. CAL-285 at 48:15-49:12 (Taylor Direct).

98. The reason for creating this fictional import was to take advantage of the fact that the CDWR would make OOM purchases that were not subject to the price cap during real-time whenever there was insufficient supply bid into its market. Resources outside CAISO could be bid into CAISO's ancillary services and real-time energy markets without the detailed information required of resources inside CAISO boundaries. Because they were supposed to be "backed up" by the control area on the other side of the interface, CAISO considered them to be reliable and did not require the same detailed information.[191] The success of this strategy required the seller to submit false information to CAISO, which violated the CAISO Tariff.[192]

99. The Commission determined in Opinion No. 536 of the *SDG&E* case that false export strategies violated the following provisions of the CAISO tariff:

> First, because False Export involved the submission of false information to CAISO, and therefore, subversion of export scheduling requirements, such transactions violated MMIP section 2.2.11.1,which provides that "[e]ach Preferred Schedule submitted by a Scheduling Coordinator…must include the name and identification number of each Eligible Customer for whom a Demand Bid or an Adjustment Bid is submitted." Sections 2.2.11.1.1-2 further specify that "For Load: the Location Code of the Take-Out Point," and "the aggregate quantity (in MWh) of Demand being served at each Take-Out Point" must also be included. The information submitted by the Respondents did not correspond to actual load. Second, we find that False Export violated CAISO MMIP section 2.1.1.5 prohibiting "unusual activity or circumstances relating to imports from or exports to other markets or exchanges." Third, we find that False Export violates the provisions within MMIP section 2.1.1.1, since the Respondents effectively withheld capacity from day-ahead markets to raise prices in the real-time markets.[193]

100. The Commission, in Opinion No. 536, affirmed Judge Baten's finding that Shell had engaged in false export transactions in the CAISO markets during the Summer Period. [194] Specifically, the Commission affirmed Judge Baten's determination that

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[191] Ex. CAL-285 at 45:1-6 (Taylor Direct).

[192] *Am. Elec. Power Serv. Corp.*, 103 FERC ¶ 61,345, at P 39 (2003); Ex. CAL-289 at 158 (CAISO Tariff, MMIP 2.1.3) (forbidding " '[g]aming,' or taking unfair advantage of the rules and procedures set forth in the PX or ISO Tariffs").

[193] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 120 (2014) (Opinion No. 536).

[194] *Id.* P 127.

"Shell engaged in such behavior during 110 hours of the Summer Period, and produced 1,657 MWh of falsely exported energy." [195]

101. In the *Puget Sound Energy* proceeding before Judge McCartney, 47 more instances of false export transactions on Shell's part in its sales to CDWR were shown to have taken place during the Negotiation Period from January 17 through July 6, 2001.[196] Judge McCartney did not rule conclusively that those instances constituted false exports.[197] Consequently, the Commission reversed and remanded her ID for further findings of fact.[198] On remand to Judge Baten, these false exports were confirmed.[199]

102. In response to Complainants' false export allegations, Pirrong points out that Shell's sales of energy to CDWR that it had simultaneously purchased from another seller at the same location, known as "back-to-back" or "B2B" transactions, were largely independent from its exports from the CAISO.[200] Each B2B-linked purchase and resale was at the same location and in the same hour, and was recorded with consecutive deal numbers in Shell's records. [201] Shell submitted into the record a listing of all of its B2B transactions with CDWR from January 17 through June 20, 2001.[202] According to Pirrong, Complainants do not demonstrate a dependent link between those transactions deemed to be "false exports" and Shell's B2B sales to CDWR.[203]

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[195] *Id*.

[196] Ex. CAL-319 at 85:16-86:12 (Taylor Direct).

[197] *Puget Sound Energy v. All Jurisd. Sellers*, 146 FERC ¶ 63,028, at P 1404 (2014) (Initial Decision).

[198] *Id*. P 1404, *rev'd in relevant part*, 151 FERC ¶ 61,173, at PP 97 & 100 (2015) (Opinion No. 537), *reh'g denied*, 153 FERC ¶ 61,386 (2015).

[199] *Puget Sound Energy v. All Jurisd. Sellers*, 154 FERC ¶ 63,004, at PP 20-33 (2016) (Revised Partial Initial Decision).

[200] Ex. SNA-230 at 36:3-4 (Pirrong Answering); Ex. SNA-200 at 12:18-22 (Bowman Answering).

[201] Ex. SNA-230 at 36:1-3 (Pirrong Answering); Ex. SNA-202.

[202] Ex. SNA-200 at 12:22 (Bowman Answering); Ex. SNA-202.

[203] Ex. SNA-230 at 35:20-36:7 (Pirrong Answering).

103. Complainants' evidence of Shell traders' e-mails, however, do establish a link between Shell's false exports and its B2B transactions. Shell trader Chris Giulini's January 26, 2001 transaction is readily found in Shell's list of B2B transactions as CDWR sale number 352, occurring on January 26, 2001 in HE 24, having deal number 40371, at the COB-MLNNW1 sale point, for 25 MW at a price of $625 per MWh. The B2B transaction behind it is a sale to Shell from PGE having deal number 40370, also at the COB-MLNNW1 sale point, for 25 MW at a price of $400 per MWh.[204] This is the transaction that Giulini described in his e-mail to Carey Morris, his boss, as "sending mw up the NOB line on Glen transmission and selling them to Portland for a $100 profit for Glendale … then having PGE launder the mw through their system and redeliver them to us at Malin where I am selling them at a $225 profit for [Shell] to CDWR."[205]

104. Pirrong also argues that Complainants wrongly deem any export by Shell of power generated in California that occurred in the same hour as a sale of power by Shell into California to be a "false export," even though it did not involve the filing of an export schedule with the CAISO, as is required under the Commission's criteria for a transaction to qualify as a false export.[206] The Commission, however, has already dismissed this argument in Opinion No. 536:

> We reject the assertion by the Indicated Respondents that the California Parties' analysis merely identifies that, in a given delivery hour, an import and export both occurred. As discussed above, the California Parties analysis demonstrates how parking arrangements were used to circumvent the CAISO tariff by falsifying schedules to allow Respondent suppliers to gain access to the real-time markets because the CAISO tariff prohibited marketers, who normally just purchased and resold energy, from participating in such markets. … The documents and dealings of parking providers show that they did nothing more than allow their customers to make use of their name for purposes of day-ahead scheduling and real-time bidding.[207]

105. Pirrong further contends that Complainants improperly brand as "false exports" volumes out of and into the CAISO without requiring them to match, and fail to require

[204] Ex. SNA-202 at 11 (line 352).

[205] Ex. CAL-363.

[206] Ex. SNA-230 at 37:3-7 (Pirrong Answering).

[207] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 123 (2014) (Opinion No. 536).

the export and import to be at the same location.[208] The Commission rejected this contention as well in Opinion No. 536:

> We agree with the California Parties that demonstration of an exact match between forward transactions and offsetting real-time transactions is not necessary because the quantities that were taken in a real-time auction were not known until the real-time dispatch. Therefore, it was possible for CAISO to accept only a portion of a false export bid consistent with the single-price auction market structure, which would not always result in one-to-one matching of the forward and real-time transaction.[209]

106. Pirrong calls into question Complainants' claim that Shell "laundered" energy – that is, that Shell allegedly exported energy out of California and sold it to entities in the Pacific Northwest, then re-purchased the energy and sold it to CDWR, falsely representing the energy to be sourced from the Pacific Northwest.[210] According to Pirrong, Complainants' expert witness, Taylor, at his deposition could point to no tariff or other document prohibiting this transaction.[211] In addition, Pirrong points out that Taylor points to no transaction data submitted by Shell to CDWR that included any false information about the origination of the energy sold to CDWR at COB.[212]

107. Pirrong's focus on the lack of explicitly prohibitive language in the tariffs misconstrues the nature of false export. Although there was no express prohibition of the practice in the tariffs, the purpose behind the practice was to sell energy to CDWR at the OOM price, a price that was higher than the in-market price that the energy was entitled to fetch. Again, as the Commission explained in Opinion No. 536:

> Respondents relied on parking providers outside the CAISO footprint to improperly gain access to real-time markets. Respondent suppliers were able to file an export schedule by framing the export as an ostensible sale to the parking provider outside the CAISO control area, who would resell the

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[208] Ex. SNA-230 at 37:7-10 (Pirrong Answering); Ex. SNA-234 at 19:10-15.

[209] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 131 (2014) (Opinion No. 536).

[210] Ex. SNA-230 at 37:14-38:13 (Pirrong Answering); Ex. CAL-319 at 10:9-12 (Taylor Direct).

[211] Ex. SNA-230 at 38:5-10 (Pirrong Answering); Ex. SNA-234 at 17:9-18:17, 32:8-34:20.

[212] Ex. SNA-230 at 38:11-13 (Pirrong Answering).

> energy back to the supplier in real time for a nominal fee. The repurchased energy was subsequently bid into the CAISO real-time market as Supplemental Energy or into the ancillary service markets as Replacement Reserves by using the parking provider's interchange ID in order to meet the tariff's requirements. Thus, if the delivery leg associated with the sale were scheduled from CAISO's control area and the return leg associated with the repurchase were scheduled back into the CAISO control area, they effectively canceled each other out so that no power actually flowed at the intertie. In simple terms, we find that parking providers were utilized by suppliers as a scheduling convenience to facilitate the deception that energy was sourced outside the CAISO footprint, when all along, the energy originated from the CalPX or in bilateral markets within CAISO's boundaries. Power scheduled from A (the supplier) to B (the parking provider) in the delivery leg and from B to C (the ultimate purchaser) in the return leg actually just went from A to C. The two elements were falsely documented as if they were unrelated, when, in fact, they were part of the same, self-canceling transaction, which is ultimately a violation of the CAISO MMIP ….[213]

108. Given the thousands of megawatt-hours of false export that have already been determined by the Commission to have taken place during the Summer Period, it is evident that Shell was a player of the false export stratagem during the Crisis Period.

109. In the *SDG&E* case, Judge Baten found, and in Opinion No. 536 the Commission affirmed, that Shell had engaged in false export practices in the CalPX and CAISO markets during the relevant period in that case that had an impact on the market-clearing price.[214]

iii. <u>False Load (a/k/a "Fat Boy") and Load Shift</u>

110. The practice known as "false load," or, as Enron called it, "Fat Boy," involved a market participant with more generation than load falsely overstating to the CAISO its scheduled load that corresponded with an amount of generation in its schedule. This practice permitted the market participant to be dispatched by the CAISO during real-time to its full capacity and to receive the real-time market clearing price, even though it did not have scheduled load equal to its generation capacity when it bid into the day-ahead

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[213] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 122 (2014) (Opinion No. 536).

[214] *Id.* PP 132-133.

market, as called for by the "balanced schedule" requirement.[215] False load ensured the supplier that its generation would not go unsold in the real-time market.[216]

111. "Load shift," a related stratagem, involved a market participant underscheduling load in one CAISO zone and overscheduling load in another, thereby increasing congestion in the direction of the overscheduled zone. Congestion "relief" occurred when the market participant later adjusted the two schedules to reflect actual expected loads. This adjustment created a counter-flow toward the underscheduled zone, earning the market participant a congestion relief payment from the CAISO.[217]

112. Pirrong points out that Shell was found to have engaged in false load and load shift only during the early Summer Period, not during the later times of the Crisis Period.[218] He also states that there is no evidence that these practices had any effect on spot market prices during those later periods.[219] These practices, if anything, were legitimate forms of arbitraging between markets, Pirrong contends. There was a divergence between real-time and day-ahead prices, likely caused by the IOUs underscheduling of their loads, and so-called false load scheduling by Shell and other sellers actually arbitraged between those two markets and tended to move prices toward their competitive levels, he argues.[220]

113. The Commission rejected this rationalization in Opinion No. 536 of the *SDG&E* case, in which it said:

> [E]ven if the Respondents' practices constituted an attempt at arbitrage, there are policy considerations other than facilitation of the convergence of

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[215] Ex. CAL-285 at 51:17-52:3 (Taylor Direct); Ex. CAL-289 at 16 (CAISO Tariff, MMIP 2.2.7.2).

[216] *Am. Elec. Power Serv. Corp.*, 103 FERC ¶ 61,345, at P 59 (2003); Ex. CAL-285 at 50:13-51:16 (Taylor Direct); Ex. SNA-230 at 46: 11-15 (Pirrong Answering).

[217] *Am. Elec. Power Serv. Corp.*, 103 FERC ¶ 61,345, at P 45 (2003); Ex. CAL-285 at 57:14-59:6 (Taylor Direct); Ex. SNA-230 at 46:11-48:5 (Pirrong Answering).

[218] Ex. SNA-230 at 46:21-23 (Pirrong Answering).

[219] *Id*. at 47:1-4.

[220] *Id*. at 47:5-14.

prices in the day-ahead and real-time markets, the ostensible policy benefit of profit-seeking arbitrage. One of the purposes of the CAISO market structure at the time was precisely to avoid the crisis situation of 2000-2001 in California, where energy was being procured at the last second at extremely high prices. … [D]uring the Summer Period, as real-time prices became extremely high, the Respondents contrived ways, such as False Load Scheduling, to remove their energy from the day-ahead CalPX market, where the demand was more elastic and subject to differences in offer price, and moved the energy into the real-time market, where the demand was inelastic and investor-owned utilities had no ability to avoid a high real-time price. … Moving a megawatt between the two markets is not a transaction to legitimately serve higher demand, but to exploit the essentially inelastic demand for electricity that is common to all real-time energy markets, and that all market structures seek to mitigate by rules and regulations. In the CalPX market, the risk of not being able to sell energy is supposed to discipline market participants to bid their marginal cost. By contrast the real-time market was not designed to handle large amounts of power sales and was more susceptible to manipulation. Circumventing CAISO tariff provisions to eliminate the incentive to bid at marginal cost does not serve this market structure, but instead helps to destroy it. [221]

114. Pirrong counters, nevertheless, that false load had a salutary effect. To the extent that the CAISO found that it had more energy available in real time than it had anticipated, it could defer dispatching expensive additional generation. Every increment of generation that had been bid in was dispatched from least expensive to most expensive, he points out. The excess energy used to cover a false load had not been bid into the market, and therefore was compensated as a "price taker" – that is, that it did not increase the market price. By reason of the availability of this energy, Pirrong asserts, the CAISO was able to avoid dispatching generators that had bid in prices above the then-current market price. In short, to the extent that incremental energy was available in real time, it decreased the CAISO market clearing price. [222]

115. This rationalization, too, was rejected by the Commission in Opinion No. 536, as follows:

[T]he Commission has been and remains unconvinced by arguments that there was a price reducing effect of False Load Scheduling on the real-time

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[221] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 172 (2014) (Opinion No. 536) (footnotes omitted).

[222] Ex. SNA-230 at 47:15-24 (Pirrong Answering).

> market, as such arguments seem to rely on the fact that False Load Scheduling increased supply into the real-time market. These arguments again rely on the fallacy that the CalPX market and the real-time market are equivalent separate markets, where supply taken from one market would increase the supply in the other market without affecting demand. If the vast majority of the bids by the Respondents had been made in the day-ahead market, the legal alternative to False Load Scheduling for selling power into CAISO, … the demand that needed to be met in the real-time market would have been far less, as supply would have been secured at lower prices in the CalPX market. [223]

116. In the *SDG&E* case, Judge Baten found, and in Opinion No. 536 the Commission affirmed, that Shell had engaged in false load and load shift in the CalPX and CAISO markets during the relevant period in that case that had an impact on the market-clearing price.[224]

iv. Noncompliant Quarterly Reporting

117. In addition to unlawful activities having price effects in the spot market, Complainants also accuse Shell of failing to file quarterly reports that were compliant with the Commission's reporting requirements in effect during the Crisis Period.[225] According to Complainants, these reports, like many others filed during this period, did not provide the information required by the Commission to fulfill its oversight function. The reports as filed, Complainants assert, provide only aggregate sales volumes on a quarterly or sometimes monthly basis along with a range of prices. There is no hourly transaction detail, nor is there any information on the timing or location of the transactions. [226]

118. Pirrong points out that this issue is being addressed in a different Commission proceeding, Docket No. EL02-71.[227] Pirrong also points out that Complainants have presented no evidence that the filing of quarterly reports had any effect on spot market

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[223] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at P 178 (2014) (Opinion No. 536) (footnotes omitted).

[224] *Id.* PP 138, 176.

[225] Ex. CAL-319 at 114:14-115:4 (Taylor Direct); Ex. CAL-598.

[226] Ex. CAL-319 at 114:18-115:1 (Taylor Direct).

[227] Ex. SNA-230 at 49:18-20 (Pirrong Answering).

prices during the Crisis Period.[228] According to Pirrong, they would not have any such effect.[229]

119. The Commission has rejected the quarterly reporting issue in *State of Cal. ex rel. Lockyer v. B.C. Power Exch. Corp.*, an Order on Clarification and Rehearing, in Docket No. EL02-71.[230] In that Order, the Commission determined that "quarterly reporting violations, by themselves, are insufficient to avoid application of the *Mobile-Sierra* presumption."[231] The Commission further explained that "evidence of quarterly reporting violations would not demonstrate the necessary connection between an unlawful act and an unjust and unreasonable contract rate."[232] Even if there were "evidence of an overt act of manipulation that directly affected the contract rate," the Commission went on to say, "evidence of a reporting violation would be superfluous."[233] This Commission conclusion is dispositive for the same issue in this case. Accordingly, the quarterly reporting issue will not be further considered here.

v. False Natural Gas Reporting

120. Complainants further accuse Shell natural gas energy traders at its "West Desk" of falsifying reports of natural gas prices that they provided to gas price index publishers during the Negotiation Period of the CDWR long term contract.[234] These actions, according to Complainants' expert witness, Berry, "affected or tended to affect the price of natural gas in interstate commerce and could have affected or tended to affect the price of natural gas futures contracts traded on the New York Mercantile Exchange."[235]

121. As Berry further explains, gas-fired electricity generation is often the power source that is dispatched "on the margin" of daily supply, meaning that it is the most expensive power source. It therefore influences the market price for electricity. This was

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[228] *Id*. at 49:21-24.

[229] *Id*. at 50:1-6.

[230] 154 FERC ¶ 61,154 (2016).

[231] *Id*. at P 16.

[232] *Id*. (brackets omitted).

[233] *Id*.

[234] Ex. CAL-268 at 3:5-4:4 (Berry Direct).

[235] *Id*. at 4:1-4 (internal punctuation marks omitted).

the case for most hours during the Crisis, Berry explains. Consequently, Berry contends, Shell's manipulation of natural gas forward price reports to index publishers altered natural gas prices and thereby directly affected electricity prices.[236]

122. Complainants' evidence of Shell traders' falsification of gas data is derived from investigations that were conducted by the U.S. Commodity Futures Trading Commission (CFTC), and the settlement orders and consent decree that the CFTC entered into with Shell and certain of its West Desk traders in 2004 and 2007.[237] Shell signed a settlement agreement with CFTC on July 28, 2004, in which Shell agreed to pay a civil monetary penalty of $30 million without admitting or denying the findings of fact that CFTC made.[238] Five of six accused Shell traders against whom CFTC filed a suit for civil penalties in federal district court entered into a consent order with CFTC to cease such activity and to pay collectively a penalty of $1 million.[239] The sixth trader went to trial in the suit, but was not found liable.[240]

123. The CFTC investigation uncovered a pattern of activity at Shell's West Desk from October 2000 through June 2002 whereby its traders submitted monthly price and volume data to the gas industry publications that compiled and disseminated price index data. The data, however, was not based on Shell's actual trades. Instead, traders reported to their supervisor their "marks," or estimates of what the price was expected to be in the following month at each reported hub. The supervisor would then e-mail back to them a three-column chart that listed, for each hub, the trader's mark in the first column and an indication in each of the next two columns as to whether a higher ("Up") or lower ("Down") index price would be "Good" or "Bad" for the West Desk's book.[241] Traders then reported to the publications prices for each hub that, in most instances, were higher

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[236] Ex. CAL-268 at 13:10-17 (Berry Direct).

[237] *Id*. at 6:11-13 and 10:3-9.

[238] Ex. CAL-270 at 1, 5.

[239] Ex. CAL-274.

[240] Ex. CAL-268 at 10:8-9 (Berry Direct); *CFTC v. Dizona*, 594 F.3d 408 (5th Cir. 2010).

[241] Ex. CAL-273 at 4-23 (Kaminski Declaration); *CFTC v. Dizona*, 594 F.3d 408, 412 (5th Cir. 2010).

or lower than the mark, as instructed by their supervisor.[242] Those reports were evaluated by the publications and formed the basis of published natural gas price indices.

124. According to Heeb, Shell traders indeed misreported their monthly transaction results to the publisher of *Natural Gas Intelligence* (NGI).[243] However, Heeb asserts, when he replaced Shell's incorrect reports of transactions with transactions that Shell actually made and that he believes Shell should have reported, the weighted average price of all the transactions on which NGI based its indices changed very little.[244] In fact, Heeb contends, during the period from January 2000 to May 2001, Shell's misreports lowered rather than raised the price indices by about $0.001 per MMBtu from what they would have been if Shell's reporting had been accurate.[245]

125. Heeb's finding of an insignificant variation in the gas price indices resulting from replacing Shell's false reports with its real trades starts with a benchmark – the published NGI indices – that was false overall, thanks to rampant misreporting by other traders in addition to Shell, as the FERC Staff found to be the case.[246] As Berry points out on rebuttal:

> Dr. Heeb completely disregards the environment in which Shell's false reporting takes place – rampant misreporting by many entities across the West, trader admissions of and convictions for misreporting, and index prices that did not reflect the actual market. Dr. Heeb makes no effort to correct for the fact that the index prices were manipulated by dozens of entities in the market, and instead uses the manipulated prices obtained by NGI as the benchmark against which to analyze the effects of Shell's false reporting. Because he compares the impacts of Shell's actions within a fixed manipulated price framework, Dr. Heeb's results reveal nothing about how Shell's unlawful actions would have affected the "real" natural gas

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[242] Ex. CAL-273 at 23-24 (Kaminski Declaration); *CFTC v. Dizona*, 594 F.3d 408, 412 (5th Cir. 2010).

[243] Ex. SNA-265 at 4:15-18 (Heeb Answering).

[244] *Id*. at 4:18-22.

[245] *Id*. at 5:6-12.

[246] Ex. CAL-291 at 114-168 (FERC Staff, *Final Report on Price Manipulation in Western Markets*, Docket No. PA02-2-000 (March 2003)).

price (price with no false reporting or market manipulation) up to and during the Negotiation Period.[247]

b. Causal Connection of Unlawful Activities to Contract

126. The Order on Remand requires Complainants to show in this proceeding, in addition to the existence of Shell's unlawful activities, that "such activity had a direct effect on the negotiations of the contract at issue (*i.e.*, a causal connection between an unlawful activity and the terms of the contracts)" in order to satisfy the "avoidance" prong of the *Mobile-Sierra-Morgan Stanley* Rule.[248]

127. Complainants raise several grounds for a causal connection between Shell's unlawful activities and contract negotiations: (i) the price effects of Shell's unlawful spot market activities;[249] (ii) Shell's exercise of market power in the Pacific Northwest market that had the effect of elevating spot market prices;[250] (iii) unlawful activities in the natural gas markets that affected CDWR's evaluation of the Shell contract terms and conditions during negotiations;[251] and (iv) bad faith, unconscionability, duress, and fraud.[252]

i. Price Effects

128. The Commission established in the *SDG&E* case that several of Shell's unlawful activities elevated prices in the CalPX and CAISO spot markets.[253] Complainants

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[247] Ex. CAL-706 at 6:8-20 (Berry Rebuttal).

[248] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 23 (2014) (Order on Remand).

[249] Complainants Post-hearing Initial Br. at 37-41; Complainants Post-hearing Reply Br. at 21-24.

[250] Complainants Post-hearing Initial Br. at 28.

[251] Complainants Post-hearing Initial Br. at 35-37; Complainants Post-hearing Reply Br. at 20-21.

[252] Complainants Post-hearing Initial Br. at 28-33, 44-45; Complainants Post-hearing Reply Br. at 16-20.

[253] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at PP 57, 62, 97, 102, 120, 127, 174, and 176 (2014) (Opinion No. 536).

presented an analysis in that case prepared by their expert witness, Dr. Peter Fox-Penner, of the price effects of several Shell violations on an hour-by-hour basis for every day of the Summer Period. Judge Baten found in his ID, and the Commission affirmed, that each of Shell's unlawful acts of anomalous bidding of types 2 and 3, false export, and false load scheduling raised market-clearing prices in the spot markets.[254] No evidence was presented by Complainants in *SDG&E* of price effects for any of the other unlawful activities named earlier that Shell is alleged to have committed.

129. In addition to the foregoing violations found in *SDG&E*, a discovery sanction for Shell's failure to produce requested audiotapes has been imposed in this case in the form of an adverse factual inference. It has been deemed to be a fact that on every day that an audiotape was missing on which Shell made sales to CDWR (*i.e.*, May 18-24 and May 30-31, 2001), Shell engaged in unspecified unlawful activity, and each such unlawful activity had a price effect in spot market.[255]

130. The foregoing findings constitute this Initial Decision's determination that Shell committed unlawful activities in the spot market that possessed the requisite price effects. With that, Complainants allege that these unlawful spot market activities affected forward prices for electric power, which in turn upset negotiations between Shell and CDWR on long term contract rates.[256] To begin with, a chronology of the contract negotiations is set forth.

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[254] *SDG&E v. Sellers*, 149 FERC ¶ 63,011, at PP 14, 34, 35, 37, 58, 62, and 63 (2013) (Baten, J.), *aff'd*, 149 FERC ¶ 61,116, at PP 57, 62, 97, 102, 120, 127, 174, 176 (2014) (Opinion No. 536).

[255] Order Memorializing November 10, 2015 Bench Ruling on Motion to Compel Production of Audio Recordings and Request for Sanctions, at P 10 (November 13, 2015).

[256] Ex. CAL-319 at 8:8-12 (Taylor Direct) ("Manipulation affected spot prices, spot prices in turn affected CDWR's expectations concerning scarcity and market expectations generally about future spot prices and, hence, forward contract prices, and finally forward contract prices affected the terms of the Shell Contract."); Tr. 1428:17-1429:2 (Taylor Cross) ("The manipulation in the market affected spot prices and then forward prices, and the forward prices were the basis upon which these contracts were negotiated."); Complainants Post-hearing Initial Br. at 54-63; Complainants Post-hearing Reply Br. at 5-10.

(a) Formation of the Shell-CDWR Contract

131. The contract between Shell and CDWR was negotiated between the parties from February 20, 2001 through the day of its signing.[257] It was signed on May 25, 2001, although the writing bears a date of May 24, 2001.[258]

132. The contract term ran from May 25, 2001 through June 30, 2012.[259] The base products consisted of Shell's delivery to CDWR of peak 6x16 energy (*i.e.*, at peak hours, on Mondays-Saturdays between 7:00 a.m. and 10:00 p.m. [260]), ranging from 50-400 MW; and 7x24 energy ranging from 50-100 MW. The contract also included options for Shell to increase the peak hour volumes by 175 MW in July 2003, and by another 175 MW commencing in July 2004 through the remainder of the contract term.[261]

133. The contract's pricing was tiered as follows: $169/MWh through May 31, 2001; $249/MWh from June 1, 2001 through October 31, 2001; $115/MWh from November 1, 2001 through June 30, 2002; $169/MWh from July 1, 2002 through December 31, 2003; $72.87/MWh from January 1, 2004 through December 31, 2005; and $25.16/MWh plus fuel costs from January 1, 2006 through June 30, 2012. [262] A "tolling" structure was included in this latter price tier, in which CDWR had the right to supply its own natural gas fuel at its own cost. [263] CDWR was also obligated to pay capacity payments from

[257] Ex. CAL-200 at 15:4-8 (Nichols Direct).

[258] Ex. CAL-200 at 20:17-19 (Nichols Direct); Ex. CAL-31 (CDWR-Shell Contract). Section 10.17 of the CDWR-Shell contract states that "[n]either Party will exercise any of its respective rights under Section 205 or Section 206 of the Federal Power Act to challenge or seek to modify any of the rates or other terms and conditions of this agreement." Ex. CAL-031. No party has raised this provision as grounds for dismissal, given that CDWR itself never filed a complaint under section 206. The complaints that initiated this proceeding were filed by CPUC and EOB.

[259] Ex. CAL-636.

[260] Ex. CAL-200 at 13:15-16

[261] *Id*. at 21:2-7

[262] *Id*. at 21:7-12.

[263] *Id*. at 19:15-16.

July 1, 2002 through December 31, 2005 for each Shell generating facility (the Wildflower Peaking Units) that was online during that time period.[264]

134. People who participated in the negotiation of the CDWR-Shell contract in 2002 have testified in this proceeding. Among them is Ronald O. Nichols, who in 2002 was a Senior Managing Director at Navigant Consulting, Inc. (NCI), an entity retained by CDWR to assist it in establishing and running the State of California's power purchase program.[265] Also testifying was Raymond Hart, who in 2001 served as Deputy Director of the California Energy Resources Scheduling division of CDWR (CERS), the division directly in charge of negotiating the Shell contract.[266] The CDWR employee who had the most direct daily involvement in the Shell contract negotiations – Tara Nolan Reed (née Tara Nolan) – did not testify in person.[267] However, excerpts from the written transcript of Nolan's October 10, 2002 videotaped deposition in the early part of this case was admitted into evidence by Judge McCartney and is part of the record here.[268]

135. Edward Brown, who testified on behalf of Shell, in 2001-2002 was Vice President of Structured Transactions for Shell's predecessor, Coral. He had primary responsibility for Shell's side of the negotiations with CDWR.[269] Also testifying was Beth A. Bowman, who in 2000-2001 was General Manager of the Shell's San Diego power trading office and was responsible for Shell's West Region short-term and long-term electric power trading.[270]

136. Others who were not directly connected to the negotiation of the Shell-CDWR contract, but who submitted relevant testimony, include Lynn A. Lednicky, who at the time of the negotiation worked on a separate, unrelated long term contract with CDWR

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[264] *Id*. at 21:12-15.

[265] Ex. CAL-51 at 2:20-4:2 (Nichols Direct); Ex. CAL-156 (Nichols Rebuttal); CAL-200 at 2:8-11 (Nichols Direct); Ex. CAL-670 (Nichols Rebuttal).

[266] Ex. CAL-12 at 2:1-7 (Hart Direct); Ex. CAL-210 at 2:14-3:7 (Hart Direct).

[267] Tr. 288:11-13 (Nichols); Tr. 1587:12-13 (counsel).

[268] Ex. COR-67 (Nolan Dep.); *see also* Ex. SNA-222 (Nolan Dep.); Tr. 2642:21-23 (McKeon Closing Arg.).

[269] Ex. SNA-219 at 5:15-19 (Brown Answering).

[270] Ex. SNA-200 at 4:18-22, 7:1-13 (Bowman Answering); Tr. 1499:3-6 (Bowman Cross).

on behalf of Dynegy Power Marketing, Inc.[271] Also testifying was Susan T. Lee, who at the time of the negotiation worked as CDWR's Manager of Trading and Scheduling, and was in charge of its spot market transactions.[272] Another was Jim McIntosh, who was CAISO's Director of Scheduling during the Crisis.[273]

137. As Nichols and Hart explain, CDWR was tasked at the height of the Western Energy Crisis, by a Proclamation of a State of Emergency issued by Governor Gray Davis on January 17, 2001,[274] to "enter into contracts and arrangements for the purchase and sale of electric power … as expeditiously as possible" in order to meet the "Net Short" energy requirements of the then failing California IOUs, PG&E, SCE, and SDG&E.[275] The "Net Short" energy requirements of the IOUs consisted of the difference between (1) the total energy requirements of the IOUs' retail and end use customers, and (2) the sum of the energy generated by IOU-owned electric generating plants, qualifying facilities (QFs) under contract with the IOUs, and existing bilateral contracts between the IOUs and other suppliers.[276] The Proclamation was followed by enabling and funding legislation from the California Legislature on February 1, 2001.[277]

138. In accordance with these goals, CDWR issued two requests for bids (RFBs), one dated January 23, 2001 and one dated February 2, 2001.[278] According to Nichols, CDWR sought deals for terms of one to three years, but left open the possibility for longer terms in order to encourage sellers to offer CDWR's average price target of $70/MWh.[279] Shell did not respond to the first RFB, but did respond to the second.[280]

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[271] Ex. SNA-228 at 3:8-14 (Lednicky Answering).

[272] Ex. CAL-222 at 3:5-18 (Lee Answering).

[273] Ex. CAL-680 at 1:16-18 (McIntosh Rebuttal).

[274] Ex. CAL-12 at 4:4-16 (Hart Direct); Ex. CAL-13.

[275] Ex. CAL-200 at 4:3-7 (Nichols Direct); Ex. CAL-12 at 4:4-6:1 (Hart Direct); Ex. CAL-13.

[276] Ex. CAL-200 at 4:15-20 (Nichols Direct).

[277] Ex. CAL-210 at 7:11-18 (Hart Direct).

[278] Ex. CAL-200 at 8:14-15 (Nichols Direct); Ex. CAL-51 at 31:1-13 (Nichols Direct); Ex. CAL-66; Ex. CAL-67.

[279] Ex. CAL-51 at 31:1-13 (Nichols Direct).

139. Prior to that time, Shell participated in a Summer Reliability Agreement (SRA) with CAISO to provide reliability generation during the summer months.[281] In return for CAISO's payment of incentive fixed prices in the form of capacity payments to expedite the construction of new generation resources, Shell agreed to build five 43-MW gas turbine generators through Shell's affiliate, Wildflower Energy, L.L.C. (Wildflower).[282] Shell also built a peaking unit in La Rosita, Mexico, for use in the California market.[283] Under the SRA, CAISO could cause the plants to operate for a limited number of hours, but it was Shell's responsibility to arrange for the sale of the plants' power within the CAISO control area.[284] So Shell was building the Wildflower and La Rosita plants without a third-party power purchase agreement – that is, with no assured buyer for this power.[285]

140. In response to CDWR's second RFB, Shell offered to sell CDWR 100 MW of 7x24 power at a fixed price of $71.50/MWh for five years commencing January 1, 2002.[286] This offer was lower than spot prices at the time and lower than the prevailing forward price for 2002 delivery. On the date of the second RFB, forward prices at SP-15 stood at approximately $130/MWh for 2002 delivery and $75/MWh for 2003 delivery.[287] Spot electric prices at SP-15 stood at approximately $200/MWh.[288]

141. CDWR did not respond back, and when Shell contacted CDWR about it, CDWR informed Shell that it was not interested in the bid.[289] CDWR was more interested at that

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[280] Ex. SNA-219 at 7:13-8:4 (Brown Answering).

[281] Ex. SNA-219 at 5:20-6:1 (Brown Answering); Ex. S-101 (SRA Agreement).

[282] Ex. SNA-219 at 6:3-23 (Brown Answering); Ex. S-100R at 11:11 (Poffenberger Answering).

[283] Ex. SNA-219 at 9:14-19 (Brown Answering).

[284] *Id*. at 6:8-11.

[285] *Id*. at 6:15-17.

[286] Ex. CAL-203; SNA-219 at 8:5-8 (Brown Answering); Ex. COR-1 at 12:7-14 (Brown Answering).

[287] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

[288] *Id*. at 25, fig.5.

[289] Ex. SNA-219 at 8:8-9 (Brown Answering); Ex. COR-1 at 12:12-14 (Brown *(continued ...)*

time in procuring 6x16 energy (that is, delivered at peak hours, on Mondays-Saturdays between 7:00 a.m. and 10:00 p.m.) that began deliveries in 2001, which Shell did not offer in its bid.[290]

142. By early February 2001, Shell's Wildflower generating facility was undergoing siting, predevelopment and permitting to build the gas turbine generators called for in the SRAs. However, by that time, SCE and PGE's credit ratings had fallen to junk or near junk status. Shell worried that it might not be able to find creditworthy purchasers of power from Wildflower.[291] In addition, the CalPX had suspended all trading and would soon go bankrupt, and the CAISO looked like it would follow suit. Worse still, Shell had not been paid several millions of dollars for energy that it had already delivered to the CAISO and CalPX.[292]

143. CDWR contacted Shell again on February 20, 2001 with purchasing interest.[293] CDWR informed Shell that, due to the credit issues, CDWR was taking over CAISO's SRAs, including the agreements concerning the Wildflower units.[294] CDWR wanted to turn the SRAs into capacity and energy sales contracts and was open to terms longer than three years in duration, including both capacity and energy payments and either a tolling or fixed price structure for the energy. CDWR asked Shell to meet with CDWR representatives to discuss these concepts.[295]

144. Shell was concerned about the impact of CAISO's financial health on its Wildflower and La Rosita construction plans, so its representatives met with CDWR officials on February 23, 2001.[296] CDWR was concerned about the dire financial

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Answering).

[290] Ex. CAL-200 at 13:16-17 (Nichols Direct); Tr. 245:7-246:4 (Nichols Cross).

[291] Ex. COR-1 at 13:3-8 (Brown Answering); Ex. SNA-219 at 8:10-18 (Brown Answering); Tr. 1624:13-22 (Brown).

[292] Ex. SNA-219 at 8:10-23 (Brown Answering).

[293] Ex. COR-1 at 13:15-16 (Brown Answering); Ex. COR-10.

[294] Ex. COR-1 at 13:17-21 (Brown Answering); Ex. COR-10.

[295] Ex. COR-1 at 13:21-14:4 (Brown Answering); Ex. COR-10.

[296] Ex. SNA-219 at 9:11-21 (Brown Answering); Ex. CAL-200 at 15:9-14 (Nichols Direct).

circumstances of the IOUs, the CalPX, and the CAISO, and wanted power sellers having SRAs to sell it as much power as they could manage during the critical summer 2001 period.[297]

145. At the meeting, CDWR informed Shell that the State had a critical need for power deliveries during March and April 2001, before Shell's Wildflower units were scheduled to come online in July 2001.[298] In response, Shell made on February 26, 2001 a 10-year offer to provide capacity and energy, beginning July 1, 2001, of principally 6x16 and 7x24 power for 210 MW for the first two years, with increasing base quantities and additional volumes over time.[299]

146. Shell offered CDWR a price for energy of $93.95 per MWh for delivery during the period July 1, 2001 through June 30, 2004, and $58.75/MWh for delivery during the period July 1, 2004 through June 30, 2011.[300] Shell requested capacity payments for four years commencing on July 1, 2002 at a price of $352,000 per month for each of the five Wildflower units, for a total of $1,760,000 per month.[301]

147. Shell's energy offer was well below prevailing spot prices and below 2002 forward prices. As of Shell's February 26, 2001 offer date, forward market electricity prices at SP-15 stood at approximately $120/MWh for 2002 delivery and $60/MWh for 2003 delivery.[302] Spot electric prices at SP-15 on the offer date stood at approximately $200/MWh.[303]

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[297] Ex. CAL-200 at 14:12-15:1 (Nichols Direct).

[298] Ex. CAL-200 at 15:16-16:2 (Nichols Direct); Ex. SNA-219 at 10:5-9 (Brown Answering).

[299] Ex. CAL-200 at 16:3-6 (Nichols Direct); Ex. SNA-219 at 10:21-11:3 (Brown Answering); Ex. COR-11.

[300] Ex. CAL-200 at 16:6-8 (Nichols Direct); Ex. SNA-219 at 11:3 (Brown Answering); Ex. COR-11.

[301] Ex. CAL-200 at 16:8-9 (Nichols Direct); Ex. SNA-219 at 11:3 (Brown Answering); Ex. COR-11.

[302] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

[303] *Id*.

148. CDWR did not accept Shell's February 26, 2001 offer "as is." CDWR and NCI evaluated Shell's term sheet using its spot market pricing model.[304] On March 12, 2001, Tara Nolan of NCI reported to CDWR the results of the analysis: "Absent another benchmark not sure where to go with the analysis but I think overall the deal looks acceptable."[305]

149. Intense negotiations ensued. CDWR asked Shell to begin deliveries sooner than July 1, 2001, before the Wildflower units were to come online.[306] Shell would have to buy these quantities from the market.[307] Higher volumes were obtained from Shell for August through September 2001, and lower volumes in later years.[308] Other changes in CDWR's favor were also made, including changes to the product mix (*i.e.*, more 6x16 power, less 7x16 power), a change to the delivery location (*i.e.*, from SP-15, where the Wildflower units were located, to NP-15, with Shell assuming the delivery risk to that location), a tolling structure for later deliveries, and other modifications.[309]

150. In return, Shell demanded a price increase. Its energy price for 2001 through 2003 increased from $93.95/MWh to $169/MWh, and the price for 2004 through 2005 increased from $58.75/MWh to $72.87/MWh.[310] The capacity payment rose slightly to $1,790,000 per month for the five Wildflower units.[311] The term of the contract was extended by one year. Also, for the period from January 1, 2006 through June 30, 2012,

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[304] Ex. CAL-200 at 17:13-18:11 (Nichols Direct); Ex. CAL-51 at 11:10-14:2 (Nichols Direct); Exs. CAL-53, CAL-54, CAL-161, CAL-162.

[305] Ex. CAL-205.

[306] Exs. CAL-200 at 16:11-13 (Nichols Direct); CAL-204; SNA-219 at 12:12-15 (Brown Answering).

[307] Ex. SNA-219 at 12:16-18 (Brown Answering).

[308] Ex. CAL-200 at 16:16-18 (Nichols Direct); Ex. SNA-219 at 12:20-21 (Brown Answering).

[309] Ex. SNA-219 at 13:1-23 (Brown Answering).

[310] Ex. CAL-200 at 17:5-9 (Nichols Direct); Ex. COR-14.

[311] Ex. COR-14 at 3.

the fixed price of \$58.75/MWh was changed to a variable charge of \$25.16/MWh plus fuel costs.[312]

151. Shell's new proposal exceeded prevailing forward rates for 2002 and 2003 but remained below then-current spot rates. The new deal was tentatively approved by CDWR on March 16, 2001.[313] As of that date, forward market electricity prices at SP-15 stood at approximately \$130/MWh for 2002 deliveries and \$70/MWh for 2003 deliveries.[314] Spot electric prices at SP-15 on that date stood at approximately \$300/MWh.[315]

152. After further wrangling on terms, CDWR and Shell signed a Letter of Intent (LOI) on April 6, 2001 for a power purchase agreement that would span eleven years and three months.[316] The LOI provided for Shell's energy sales to commence in April 2001 for 100 MW at a price of \$169/MWh. Shell purchased this power on the market and sold it to CDWR at a loss to Shell, with the understanding that Shell would be made whole in the event that the agreement was not executed.[317] The LOI provided that if the anticipated long-term contract was not signed by April 30, 2001, the \$169/MWh price would be retroactively revised upward to \$260/MWh.[318]

153. The LOI also provided for Shell's delivery of increasing quantities of power during the summer of 2001, and even greater quantities for 2002 through 2010. Energy pricing was set as \$169/MWh through 2003, and \$72.87/MWh thereafter through 2005. The capacity payment was set at Shell's requested \$1,790,000 per month for the five Wildflower units (\$21,480,000 per year).[319] For 2006-2012, the LOI provided for a gas-

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[312] Ex. CAL-200 at 17:8-11 (Nichols Direct); Ex. COR-14.

[313] Ex. CAL-200 at 16:18-17:1 (Nichols Direct); Ex. SNA-219 at 15:1-17:2 (Brown Answering); Ex. COR-14.

[314] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

[315] *Id.*

[316] Ex. CAL-200 at 18:12-17 (Nichols Direct); Ex. SNA-219 at 17:8-18:4 (Brown Answering); Ex. COR-16.

[317] Ex. SNA-219 at 21:8-11 (Brown Answering).

[318] Ex. CAL-200 at 19:1-9 (Nichols Direct); Ex. COR-16.

[319] Ex. COR-19 at 9.

indexed price structure under which CDWR paid a $25.16/MWh fixed charge plus fuel costs. Alternatively, a tolling structure permitted CDWR to provide the volumes of natural gas needed to serve the contract.[320]

154. The final long term agreement was not completed by the April 30, 2001 LOI expiration date, so the parties agreed to extend the LOI to May 31, 2001, with May deliveries handled the same as April's at the same price of $169/MWh, and a fallback price of $315/MWh if a final deal was not signed in May.[321]

155. Tensions between Shell and CDWR ran high during the final negotiations in May. California experienced rolling blackouts on May 7 and 8, 2001.[322] Shell was concerned about delays in CDWR's plan to issue bonds to finance its long-term power procurement efforts and repay the State for funds borrowed to support power purchased during the Crisis.[323] Shell worried that the delay would obligate Shell to absorb losses by having to sell power to CDWR below market through the summer months in order to keep negotiations alive.[324]

156. Near the end of May, CDWR agreed to reimburse Shell for its power purchases on CDWR's behalf by paying for April through September 2001 purchases at monthly forward rates ranging from $245 to $350 per MWh.[325] CDWR estimated that if it did not complete the deal with Shell by May 31, 2001, it would owe Shell about $9.4 million in retroactive payments for the power that Shell had sold to CDWR in April and May 2001.[326]

157. This deal fell apart at the last minute in the office of the Governor of California. According to Hart, "CDWR was told by the administration that the Shell deal as structured on May 24, 2001 would have been a political nightmare because under it CDWR was agreeing as a contingency to retroactively pay Shell astronomical Spot

[320] Ex. CAL-200 at 19:10-16 (Nichols Direct); Ex. COR-16.

[321] Ex. CAL-200 at 20:3-9 (Nichols Direct); Ex. SNA-219 at 20:17-20 (Brown Answering).

[322] Ex. CAL-200 at 25:12-14 (Nichols Direct).

[323] Ex. SNA-219 at 21:22-22:3 (Brown Answering).

[324] *Id*. at 22:3-5.

[325] Ex. SNA-219 at 23:4-9 (Brown Answering); Ex. COR-20.

[326] Ex. CAL-200 at 20:13-17 (Nichols Direct); Ex. CAL-207.

Market prices – the very prices that were the driving force for CDWR getting into long-term contracts."[327]

158. In place of that deal, CDWR proposed to Shell a price change for the initial period of the agreement.[328] Instead of $169/MWh through 2003 with retroactive protection as agreed upon, CDWR proposed: (i) $169/MWh for April and May 2001 purchases through May 31, 2001; (ii) $249/MWh for purchases from June 1, 2001 through October 31, 2001; (iii) $115/MWh for purchases from November 1, 2001 through June 30, 2002; and then (iv) $169/MWh for purchases from July 1, 2002 through December 31, 2003.[329]

159. This deal was signed; although the contract bears the date May 24, 2001, the parties actually executed it on May 25, 2001.[330] By this time, both spot and forward prices had fallen well below the rates set forth in the agreement. As of May 25, 2001, forward market electricity prices at SP-15 stood at approximately $75/MWh for 2002 delivery and $50/MWh for 2003 delivery.[331] Spot electric prices at SP-15 stood at approximately $110/MWh.[332]

160. In addition to the price terms for 2001 through 2003, the rest of the deal remained the same as the earlier offer: (i) $72.87/MWh from January 1, 2004 through December 31, 2005; (ii) $25.16/MWh plus fuel costs for January 1, 2006 through June 30, 2012, with a tolling structure option; and (iii) capacity payments from July 1, 2002 through December 31, 2005 for each Wildflower peaking unit that was online during that period, at the rate of $358,000 per month per unit.[333]

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[327] Ex. CAL-673 at 8:8-12 (Hart Rebuttal).

[328] Ex. SNA-219 at 23:14-25:4 (Brown Answering).

[329] *Id*. at 25:5-9.

[330] Ex. CAL-200 at 20:17-18 (Nichols Direct); Ex. CAL-31 (executed agreement).

[331] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

[332] *Id*.

[333] Ex. CAL-200 at 21:1-15 (Nichols Direct); Ex. SNA-219 at 26-27 (Brown Answering); Ex. CAL-31.

(b) Relationship of Spot Prices to Forward Prices

161. According to Complainants, the spot market's dysfunction affected forward prices during the Crisis Period. [334] Complainants rely in part on the findings of FERC Staff and its consulting economics experts, Drs. Robert S. Pindyck and Michael Quinn, in its March 2003 report in Docket No. PA02-2-000, that "the forward power contracts negotiated during the period 2000-2001 in the western United States were influenced by then-current spot prices, presumably because spot power prices influenced buyers' and sellers' expectations of spot prices in the future."[335]

162. Complainants also rely on an analysis by its own expert witness, Dr. Richard E. Goldberg, a risk management analyst, that "forward power prices at that time were likewise inflated due to Spot Market manipulation by Shell and other sellers."[336] The findings of the 2003 FERC Staff report and Goldberg's analysis are challenged by the testimony of Shell's economics expert witness, Dr. Craig Pirrong,[337] and Iberdrola's economics expert witness, Dr. Christopher L. Cavanagh.[338] For convenience, Cavanagh's critique on behalf of Iberdrola is dealt with here in addition to all the others.

163. The following charts compare the course of spot market electricity prices in the CAISO SP-15 zone to the course of forward electricity prices in that zone during the Crisis Period, from January 2000 through mid-September 2001. [339] The chart of forward electricity prices shows the price (indicated on the vertical axis) that was offered on each forward contract transaction date (indicated on the horizontal axis) for future wholesale electric power, and each separate line or dot on that chart represents a different year in which the power under the forward contract is to be delivered.

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[334] Ex. CAL-200 at 15:4-8 (Nichols Direct); Complainants Post-hearing Initial Br. at 54-62; Complainants Post-hearing Initial Br. at 5-9.

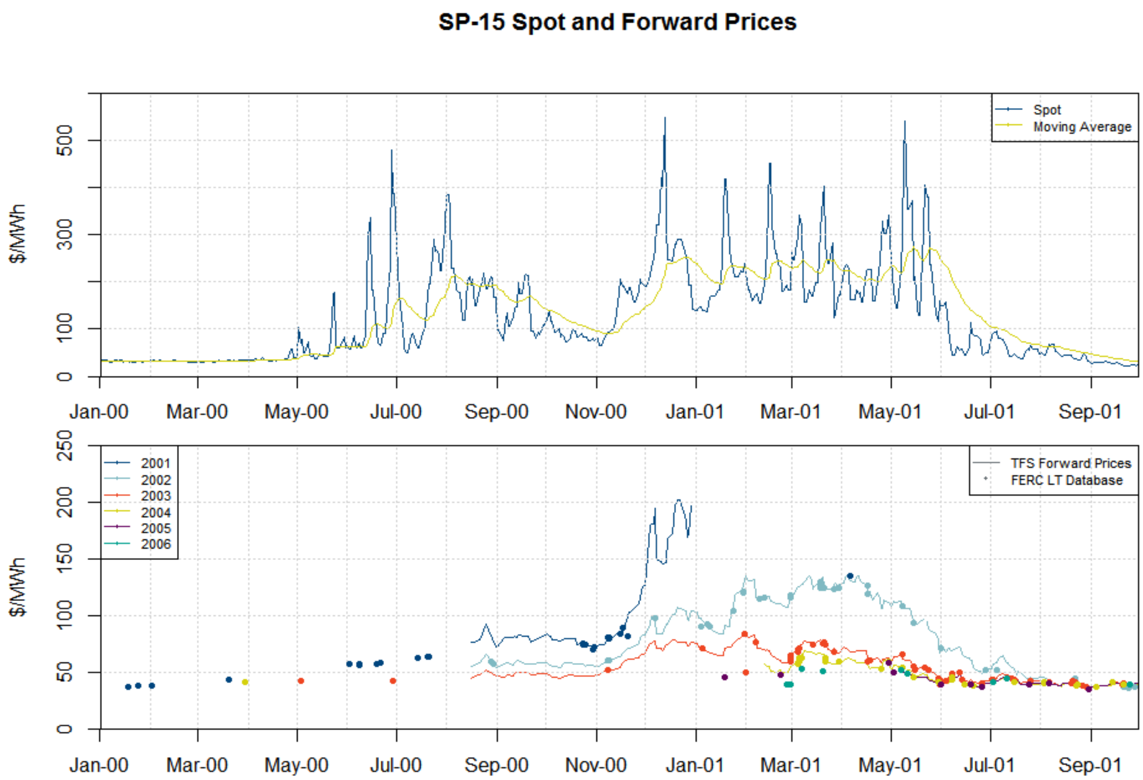
[335] Ex. CAL-291 at 189 (FERC Staff, *Final Report on Price Manipulation in Western Markets*, Docket No. PA02-2-000 (March 2003)).

[336] Ex. CAL-604 at 42:15-16 (Goldberg Direct).

[337] Ex. SNA-230 at 70-85 (Pirrong Answering).

[338] Ex. IB-242 (Cavanagh Answering).

[339] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).



Sources: Power Markets Week WSCC Spot Price Indices.
TFS Energy. Electricity West, 1999-2002.
FERC Long Term Power Contracts.

164. As the charts show, forward prices set during November-December 2000 for delivery of electricity in 2001 reached a high of $200/MWh at about the same time that spot market prices were at their highest, reaching over $500/MWh in December 2000. Forward prices set during February-April 2001 for delivery in 2002 reached a high of approximately $130/MWh at about the same time that spot prices hovered between $300/MWh and $400/MWh. By contrast, forward prices for delivery in 2003 and beyond fell to lower levels, as did spot market prices that were transacted after June 2001.

165. These graphs portray the FERC Staff's inference in its 2003 report that high spot market prices during the Crisis Period coincided with high forward market prices for the delivery of power through the next two years. In the FERC Staff's view, this coincidence signified that "the trauma of the dysfunctional spot power prices at that time so influenced buyers that they placed great weight on these prices in forming future expectations."[340]

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[340] Ex. CAL-291 at 25 (FERC Staff, *Final Report on Price Manipulation in Western Markets*, Docket No. PA02-2-000 (March 2003)); Ex. CAL-319 at 140:15-141:4 (Taylor Direct).

166. Complainants share this view, and to support it, their expert, Goldberg, ran his own regression analysis for this proceeding in order to measure the impact on forward power prices of changes in average spot power prices from typical levels in CAISO's SP-15 zone.[341] Like the Staff analysis, Goldberg's econometric model strongly correlates forward prices in long-term electricity contracts to spot electricity prices and natural gas prices.[342]

167. Pirrong finds Goldberg's regression analysis to be flawed and has conducted his own regression analysis to test the relationship between spot electricity prices and forward electricity prices during the Crisis Period, in accordance with his own economic views.[343] Pirrong used a different regression technique than Goldberg.[344] He tested data from the SP-15, NP-15, COB, Mid-Columbia, and Palo Verde CAISO hubs.[345] The time period he tested was September 2000 through June 2001.[346] Pirrong considers his analysis to be more rigorous than Goldberg's because Pirrong's covers several hubs in the west besides just SP-15, and because it focuses on the Negotiation Period and the period immediately preceding it rather than the Crisis Period as a whole.[347]

168. Iberdrola's expert Cavanagh's analysis adds an explanatory variable to Goldberg's formula (along with correcting what Cavanagh calls Goldberg's "data processing errors") that allows for different forward contract delivery periods to have different price levels.[348] Goldberg restricted the inputs to his dependent variable for forward electric contracts to "calendar-year contracts for delivery of on-peak power to SP-15 in the FERC

[341] Ex. CAL-604 at 36:8-9 (Goldberg Direct); Ex. CAL-607 (Regression Results tab).

[342] Ex. CAL-604 at 36:14-15 (Goldberg Direct); Ex. CAL-607 (Regression Results tab).

[343] Ex. SNA-230 at 77:3-13 (Pirrong Answering); Ex. SNA-237; Ex. SNA-238.

[344] Ex. SNA-230 at 83:10-21 (Pirrong Answering); Tr. 2022:10-2027:3 (Pirrong Cross).

[345] Ex. SNA-237 (Appendix); Ex. SNA-238.

[346] Ex. SNA-230 at 84, tbl.8 (Pirrong Answering).

[347] *Id*. at 82:7-11.

[348] Ex. IB-242 at 11:14-21 (Cavanagh Answering); Ex. IB-244; Ex. IB-245.

LT Database."[349] In other words, Goldberg's database of forward contract prices consists of calendar-year long blocks of deliveries of electric power. Cavanagh's additional explanatory variable uses as an input the calendar year of the forward contract delivery in question (*i.e.*, delivery years 2002 through 2006) in order to control for "differences in expectations with respect to capacity, other costs, demand, and other market conditions that vary depending on the contract period."[350]

169. As all four studies examined price effects in the CAISO SP-15 zone, it is instructive to look at the following table comparing the key findings of the most readily comparable regression that was conducted by each expert for that zone:

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[349] Ex. IB-242 at 8:13-14 (Cavanagh Answering) (*quoting* Ex. CAL-604 at 37:1-2 (Goldberg Direct)).

[350] Ex. IB-242 at 11:17-19 (Cavanagh Answering); Tr. 2480:18-2485:4 (Cavanagh Cross).

Study	Time Period of Study	Spot Electric Price Coefficients			Number of Observations	R^2 [* = Statistically Significant]
		Delivery Year	Coefficient and Sign	Statistically Significant		
FERC Staff Report ("During" Period; OLS Regression)[351]	January 1, 2000-June 30, 2001	1-2	+ 0.23	Yes	89	0.60
		3-4	+ 0.07	Yes	142	0.39
		5-8	+ 0.04	No	83	0.46
Complainants (Goldberg)[352]	January 2000-March 2002	0-1	+0.27	Yes	288	0.93*
		1-2	+0.20	Yes		
		2-3	+0.18	Yes		
		3-4	+0.18	Yes		
		4-5	+0.15	Yes		
Shell (Pirrong)[353]	September 2000-June 2001	Year 1	- 0.07	Yes	157	0.81*
		Year 2	- 0.04	Yes		0.79*
		Year 3	- 0.03	Yes		0.51
Iberdrola (Cavanagh)[354]	January 2000-March 2002	0-1	+0.11	Yes	288	0.95*
		1-2	+0.12	Yes		
		2-3	+0.12	Yes		
		3-4	+0.22	Yes		
		4-5	+0.03	No		

170. Shell's spot electric price coefficients differ significantly from those of Complainants, Iberdrola, and the 2003 FERC Staff report in that Shell's have negative signs compared to the others' positive signs. Shell's negative signs suggest an inverse relationship between the direction of changes in forward contract prices and the direction of changes in spot prices, whereas the positive signs of the coefficients of FERC Staff, Complainants and Iberdrola suggest a direct relationship between such changes. Shell's range of data covers the narrowest time period of any of the studies.

171. While Pirrong's finding is the opposite of what the FERC Staff report, Goldberg and Cavanagh collectively found, one overarching conclusion is supported by all four

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[351] Ex. CAL-291 at 391 (FERC Staff, *Final Report on Price Manipulation in Western Markets*, Doctket No. PA02-2-000 (March 2003)) (tbl.V-C1).

[352] Ex. CAL-604 at 48 (Goldberg Direct).

[353] Ex. SNA-230 at 84:11 (tbl.8); Ex. SNA-237 at 2.

[354] Ex. IB-242 at 18 (tbl.3) (Cavanagh Answering); Ex. IB-244 (Column 5).

analyses: *that spot electric prices correlated closely with forward electric prices within a period of two to three years following the end of the Crisis*.

172. Moreover, the positive, statistically significant signs of the spot price coefficients of three out of the four regressions (that is, the FERC Staff report, Goldberg for Complainants, and Cavanagh for Iberdrola) support the conclusion that *forward electric prices rose as spot electric prices rose and fell as spot electric prices fell* during this period. The countervailing negative signs of the coefficients of Pirrong's regression on behalf of Shell suggest an opposite relationship between spot and forward prices, but only for the much narrower time period of the Crisis that Pirrong observed (*i.e.*, September 2000-June 2001).

173. A 2000 paper by Pirrong that Complainants introduced in evidence during Pirrong's cross-examination makes the point that, in a study that he conducted of the PJM market, forward prices incorporate a significant risk premium over the spot prices of corresponding delivery dates, and overreact to load shocks.[355] Unlike forward prices, Pirrong's paper continues, spot prices themselves are predictable by "very well behaved" independent variables, particularly weather and fuel prices.[356]

174. Pirrong's paper and testimony do not contradict the results of the other experts. That dysfunctional spot prices during the Crisis Period influenced forward prices for deliveries occurring up to two years after that period fits Pirrong's narrative that risk premiums are significant drivers of forward prices. The dysfunctional spot prices undoubtedly amplified the perceived risk for market participants setting forward prices during the Crisis. That they drove the risk premium embedded in forward prices down as well as up, as Pirrong found in his more narrowly-focused regression, should come as no surprise. This finding underscores that the California Crisis was a unique and anomalous event –indeed, an "extraordinary circumstance" that should impel avoidance of the *Mobil-Sierra-Morgan Stanley* presumption.[357]

175. In conclusion, the preponderance of the evidence demonstrates that forward market participants during 2000-2001expected the dysfunctions present in the spot electric market of that time to have an impact on future spot prices, as reflected in 2000-2001 forward prices, for at least two years into the future; that is, on deliveries during

[355] Ex. CAL-912 at 4, 25, 39.

[356] *Id*. at 38.

[357] *Morgan Stanley*, 554 U.S. at 551 ("We think that the FPA intended to reserve the Commission's contract abrogation power for those extraordinary circumstances where the public will be severely harmed.")

2002 and 2003.[358] All but one analysis suggest that spot price increases induced forward prices for deliveries in 2002 and 2003 to rise, and that decreases induced those forward prices to fall.

176. Accordingly, Complainants have proved that dysfunction in the spot market in 2001 had an upward influence on forward market pricing through delivery years 2002 and 2003.

(c) <u>Relationship of Forward Prices to Contract Negotiations</u>

177. Both Shell and CDWR claim to have considered prices in the forward market when formulating their negotiating strategies for the long term contract at issue and in evaluating the offers made by Shell.[359] As stated earlier, in order for Complainants to meet their burden of proving that forward electric prices, as influenced by Shell's unlawful manipulation of spot market electric prices, directly affected the Shell-CDWR long term contract negotiations, Complainants must prove that Shell's unlawful activities "eliminated" the premise of a "fair, arms-length negotiation" by upsetting the balance of bargaining power between itself and CDWR.[360]

178. Complainants rely on the testimony of Nichols and Hart for the impact of forward prices on CDWR's negotiating posture.[361] The CDWR employee who had the most direct daily involvement in the Shell contract negotiations – Tara Nolan – did not testify in person, but excerpts from the written transcript of her October 10, 2002 videotaped

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[358] Ex. CAL-90 at 24:18-30:11 (Stoft Direct); Ex. CAL-604 at 26:1-8 (Goldberg Direct).

[359] Ex. COR-1 at 18:11-23 (Brown Answering); Ex. SNA-219 at 29:10, 31:6-22 (Brown Answering); Ex. SNA-222 at 2:25-3:17 (Nolan Dep.).

[360] *Morgan Stanley*, 554 U.S. at 554 (The direct effect must be one which "eliminates the premise on which the *Mobile-Sierra* presumption rests: that the contract rates are the product of fair, arms-length negotiations."); *Am. Soc. of Composers, Authors & Publishers v. Showtime/The Movie Channel, Inc.*, 912 F.2d 563, 584-585 (2d Cir. 1990) ("If the negotiating parties exert generally equivalent bargaining leverage, the results may be viewed as a reasonable equivalent of a competitive market.").

[361] Ex. CAL-51 at 2:20-4:2 (Nichols Direct); Ex. CAL-156 (Nichols Rebuttal); Ex. CAL-200 at 2:8-11 (Nichols Direct); Ex. CAL-670 (Nichols Rebuttal); Ex. CAL-12 at 2:1-7 (Hart Direct); Ex. CAL-210 at 2:14-3:7 (Hart Direct).

deposition were admitted into the record of this case.[362] Brown and Bowman testified on behalf of Shell.[363] Commission Staff also offered the testimony of its expert witness, Daniel L. Poffenberger, a FERC rate filings specialist, on whether forward market prices affected the pricing and other terms and conditions negotiated between Shell and CDWR.[364]

179. In terms of forward prices, Shell assessed the contract with CDWR to be a winning deal for itself. According to Bowman, the downward course of forward electric prices starting in April 2001 increased the value of the fixed-price long term agreement.[365] When the deal was struck, Shell had locked in some of its natural gas fuel supply as a hedge against price increases, but not all of the fuel that was necessary.[366] Shell's contract position benefitted from the portion that was not hedged as a result of the decline in forward gas prices.[367] From shortly after execution of the CDWR long term contract through year-end bonus time in 2001, Bowman was reporting to her superiors at Shell that the value of the long term contract with CDWR had reached nearly $500 million, "reflect[ing] the outcome in today's lower power and gas market."[368]

180. CDWR's view of the contract negotiations came from a more complex perspective. CDWR's goal was to reduce the Net Short by entering into fixed-price, long term contracts, thereby reducing the remaining Net Short's exposure to high spot market prices. By so doing, CDWR hoped to drive down demand in the spot market, and thereby drive down spot market prices. As for the cost of the long term contracts, CDWR was more concerned with meeting immediate power needs, not the cost of power needs

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[362] Ex. COR-67 (Nolan Dep.); Ex. SNA-222 (Nolan Dep.).

[363] Ex. SNA-219 at 5:15-19 (Brown Answering); Ex. SNA-200 at 4:18-22, 7:1-13 (Bowman Answering); Tr. 1499:3-6 (Bowman Cross).

[364] Ex. S-100R at 31:18-43:17 (Poffenberger Answering).

[365] Tr. 1567:23-1568:5 (Bowman Cross).

[366] Tr. 1568:3-10 (Bowman Cross).

[367] *Id*. at 1568:3-10.

[368] Tr. 1573:5-16 (Bowman Cross); Ex. CAL-888 at 2; Ex. CAL-319 at 185:4-6 (Taylor Direct); Ex. CAL-451 at 3; Complainants Post-hearing Initial Br. at 70. Although Shell disputes this fact, it does so by misinterpreting the meaning of a draft Shell document. Shell Post-hearing Reply Br. at 24-25; Ex. CAL-889 at 22; Tr. 1561:12-1562:7 (Bowman).

many years into the future. Long term contracts were viewed by CDWR as a way to pay off immediate power needs over time, not as a hedge to lock in the cost of future power purchases. [369]

181. It is not surprising, therefore, that there is little evidence that CDWR compared the costs of its long term contract offers (including Shell's offers) to then-prevailing forward prices, which by April 2001 were declining for deliveries in future years. The evidence shows only that CDWR focused on reliability and reducing the size of the Net Short in early 2001.[370] CDWR appeared to be oblivious to the cost of locking up the long term power that it was incurring, as a comparison of its deals to then-available forward prices for alternative sources shows.

182. CDWR's disregard for forward prices as it entered into long term contract negotiations is confirmed by the following CDWR response to a discovery request that is mentioned by Staff's expert, Poffenberger, in his testimony:

> Estimated ranges of potential forward prices were reviewed in preparing for the evaluation of proposals submitted to CDWR. However, the nature of the dysfunctional market made use of such forward price curves of very limited value. *As a result of the difficulty in using forward price curves, through April 2001, CDWR did not rely upon forward price curves in its negotiation of long-term forward contracts, but rather ranked the proposals that were received.* Later, when the market began to become more stabilized, forward price curves were used to determine potential savings realized when compared to spot market trends and the uncertainty of those trends. [371]

183. Complainants counter that CDWR indeed took forward prices into account when it evaluated contract offers in response to its RFPs using a computer model.[372]

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[369] Ex. CAL-200 at 5:11-6:17 (Nichols Direct); Ex. CAL-670 at 10:9-14 (Nichols Rebuttal); Tr. 642:20-25 (Pacheco Cross); Tr. 2688:13-20 (Ritchie Closing Arg.) ("PRESIDING JUDGE: … [CDWR] wanted to have those long-term contracts because then they could delay out the payments for the high spot prices they had to pay in the beginning; right? MR. RITCHIE: That was the exchange. That was the cost to keep the lights on … in California. They were forced to take these longer term deals, yes.").

[370] Tr. 2645:2-2647:1 (McKeon Closing Arg.); Tr. 2679:7-21 (Berman Closing Arg.).

[371] Ex. S-100R at 33:17-26 (Poffenberger Answering) (emphasis added); Ex. S-7.

[372] Ex. CAL-200 at 17:12-18:11 (Nichols Direct); Ex. CAL-205; Ex. CAL-51 at *(continued ...)*

Complainants point to only one contemporaneous item of evidence in the record that purports to show how this model was used to evaluate the Shell offer.[373]

184. This evidence consists of a one-page internal CDWR memo dated March 12, 2001 from Tara Nolan to Ron Nichols and others evaluating the Shell contract proposal as negotiations stood at that time.[374] The memo states in relevant part as follows:

> Attached is a pricing model that Arun Mani did this afternoon. The pricing represents an attempt to put all of the capacity payments AND an estimate of the above market cost of the 7x24 power onto the 6x16 power so that we can compare this deal to other deals. Because of this if we change the value of the 7x24 pricing the this model and decide that we can live with that "effective 6x16 price, then we need to evaluate the balance of the deal as though the 7x24 power was priced at the assumed input price and the 7x16 shaped monthly is priced at the energy prices quoted by Coral, through 2005.
> If we set the value of the SHAPED 7x24 power (which is what we are buying from Coral) at
> 2002 $65
> 2003 $65
> 2004 $55
> 2005 $55
> The effective cost of the 6x16 power (most of which is SRA driven) which is shaped monthly as well, is:
> 2001 $169
> 2002 $232
> 2003 $269 (we are getting less MW overall so the number pops up)
> 2004 $118.94
> 2005 $118.90
> All other power purchased under the contract, which is the 7x16 is priced at $169 through 2003, $72.87 2004 through Dec 31, 2005, and Tolling charge of $25.16 MWh plus fuel pass through at 7,250 HR.[375]

11:10-14:2 (Nichols Direct); Ex. CAL-53; Ex. CAL-54.

[373] Tr. 286:14-24 (Nichols Cross).

[374] Ex. CAL-205; Tr. 286:14-24 (Nichols Cross).

[375] Ex. CAL-205 (*sic*; emphasis in original).

185. Translated into plain English, Nolan's memo describes an effort by Arun Mani, CDWR's pricing analyst, to compare the yearly costs of the Shell contract offer to other 6x16 power offers being made to CDWR. To do so, Mani apparently converted the energy and capacity costs of the 7x24 power that Shell offered to CDWR in late February 2001[376] into an "effective" cost for 6x16 power, the form that CDWR preferred to receive from sellers.[377] A unit of 7x24 power is a larger quantity of energy than a unit of 6x16 power. A unit of 6x16 power is generally considered to be more valuable and, hence, more expensive, than 7x24 power because it is the output of a peaking generator. In taking 7x24 power, CDWR presumably dispensed with the extra day and the extra eight hours of energy, even though it still paid for them.

186. The result for this "reshaped" configuration of energy (that is, the cost of 7x24 energy and capacity applied to a 6x16 configuration)[378] appears in the memo as the second listing of yearly costs for 2001-2005, ranging from a high of $269/MWh in 2003 to a low of $118.94/MWh in 2004. It is unclear how CDWR derived what it lists as an annual "value" for the 7x24 power that it intended to buy from Shell during 2002-2005, which drops gradually from $65 to $55 per MWh. There is no evidence of whether these values represent CDWR's calculated forecast of what forward prices would be for deliveries in the listed years, or just guesses.

187. The yearly costs for "reshaped" 6x16 power that are calculated in the Nolan memo are far above what prevailing forward market prices then were for power deliveries in the listed years. As of that date, forward market electricity prices at SP-15 stood at approximately $130/MWh for 2002 deliveries and $70/MWh for 2003 deliveries.[379] By contrast, spot electric prices at SP-15 on that date stood at about $300/MWh.[380]

188. If CDWR had been taking forward prices into account, then this memo should have signaled to CDWR that the Shell proposal would cost far too much as a source of electric energy going forward. CDWR, however, appeared to be focused exclusively on

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[376] Ex. COR-11.

[377] Ex. CAL-205; *see* Ex. COR-67 at 179:19-180:2 (Nolan Dep.) (6x16 power was important to CDWR "[b]ecause load increases aren't steady, so this would help them with the net short, which was exacerbated during the peak periods."), 202:4-12 ("In terms of just price and a product, seven by 24 was ugly.").

[378] *See* Tr. 2720:20-2722:10 (Watkiss Closing Arg.).

[379] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

[380] *Id*.

the upcoming summer of 2001. During the months of April through September 2001, CDWR expected electricity prices to range between $245/MWh and $350/MWh.[381] Shell's offer for 2001, by contrast, stood firmly at $169/MWh for that narrow time period.[382] Despite the implications of her memo for the course of future prices, Nolan thought that the deal looked acceptable, and her boss, Ray Hart, thought after its execution that it was a good deal.[383]

189. Thus self-convinced, CDWR made its final offer to Shell on May 24, 2001: (i) $169/MWh for April and May 2001 purchases through May 31, 2001; (ii) $249/MWh for purchases from June 1, 2001 through October 31, 2001; (iii) $115/MWh for purchases from November 1, 2001 through June 30, 2002; and then (iv) $169/MWh for purchases from July 1, 2002 through December 31, 2003.[384]

190. CDWR appeared to be oblivious to the fact that, by the time this contract was signed, forward prices had fallen further below the Nolan memo's estimated cost for power. As of May 25, 2001, forward market electricity prices at SP-15 stood at approximately $75/MWh for 2002 delivery and $50/MWh for 2003 delivery.[385] Spot electric prices at SP-15 stood at approximately $110/MWh.[386]

191. There is no evidence that CDWR's modeling technology was capable of alerting CDWR about declining spot and forward prices. Its sole purpose was to estimate the cost of the Net Short through 2003 based upon a projection of production costs, after taking into account whatever executed and proposed long term contracts were executed or under consideration when the model was run.[387] The model did not predict forward prices that

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[381] Ex. COR-67 at 229:17-232:10 and Dep. Ex. 11 (Nolan Dep.).

[382] Ex. COR-14 at 3.

[383] Ex. CAL-205; Ex. SNA-223 at 5:14-19, 8:2-4; Ex. COR-67 at 230:9-232:10 (Nolan Dep.) ("Q: … The $169 per megawatt hour price is actually under the market for six by 16; correct? A: It was less than DWR expected to pay if they had to go buy that elsewhere on the open market. … Q: That fact, among other things, was driving your recommendation to the contracts committee that this power purchase agreement makes sense. A: Yes.").

[384] Ex. SNA-219 at 25:5-9 (Brown Answering).

[385] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

[386] *Id*.

[387] Ex. CAL-156 at 14:12-19:16 (Nichols Rebuttal); Ex. CAL-161; Ex. CAL-162;
(continued ...)

CDWR was actually observing in the market during the Crisis. To correct for this flaw, CDWR adjusted the model's results with "adders."[388] Even then, there is no evidence that the model's projections accurately represented conditions in the forward market. Hence, there is no evidence that the model could tell CDWR whether the deal with Shell made economic sense.

192. The continuing decline of forward prices after the deal was signed proved to be costly to CDWR. It signaled that paying the high locked-in power prices of the Shell contract over the next two to three years would be more expensive for CDWR than acquiring power in the forward market would have been. In its testimony, CDWR explains away this paradox by viewing the excess payment as a necessary cost of avoiding a $9.4 million debt that it would have owed Shell for summer 2001 power purchases on its behalf if it had not signed the contract.[389] This view, however, neglects the opportunity cost of foregoing the more reasonable forward prices that were already available for alternative sources of power.

193. The deal was also costly to CDWR because it agreed to pay for capacity as well as energy. It paid Shell for capacity from its Wildflower units at a fixed rate of $358,000 per unit per month for each of the five generating units for a period of three years and five months.[390] Paying for capacity made sense as an incentive to build more generation in California. But in the absence of an organized capacity market, energy prices alone are supposed to compensate generators for their fixed costs of building and maintaining capacity in the long run. Had CDWR relied on the forward energy market over the long term instead of the Shell contract, it would have paid only energy charges and would not have had to pay capacity charges. Shell's energy-only initial offer to CDWR in February 2001 is an example of the type of deal that CDWR could have arranged, without any capacity payment at all.[391]

194. Shell, as a large multinational corporation, had indisputably strong bargaining power during the Crisis Period. Complainants allege that CDWR, by comparison, was in a weak bargaining position, with a small staff, minimal resources, and little time to plan,

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Ex. COR-67 at 181:17-24, 191:8-20, 136:24-137:12 (Nolan Dep).

[388] Ex. CAL-156 at 17:16-19:16 (Nichols Rebuttal).

[389] Ex. CAL-200 at 20:13-17 (Nichols Direct);

[390] Ex. CAL-31 (Shell-CDWR Contract, ¶ 3.5).

[391] Ex. CAL-203; Ex. SNA-219 at 8:5-8 (Brown Answering); Ex. COR-1 at 12:7-14 (Brown Answering).

negotiate and analyze deals in the face of its enormous mandate of meeting the Net Short every hour of every day.[392] The evidence of record, however, does not support the notion advanced by Complainants that Shell was in a more advantageous bargaining position than CDWR.

195. Several facts of record belie Complainants' image of a hapless CDWR. CDWR had experienced personnel in charge and a close liaison with the Governor of California; it also hired a multi-million dollar stable of consultants that was a veritable "Who's Who" of the financial world.[393] As the entity responsible for making up the Net Short, it benefitted from being the principal purchaser of electricity in the State.[394] Throughout the negotiations with Shell, the terms and conditions of the contract were largely dictated to Shell by CDWR.[395] CDWR's bargaining strength, therefore, was at least equal to Shell's.

196. All told, it is evident that forward electricity prices did not play a decisive role in the long term contract negotiations between CDWR and Shell because one of the two parties to the negotiation – CDWR – did not act consistently with the economic signals that such prices sent. CDWR's short-term political and reliability concerns narrowed its attention to acquiring enough power to meet the Net Short right away and to mitigate the spot market cost of that power by stretching its payment out over a long period of time. Indeed, CDWR was encouraged by FERC to pursue this course and ignore the cost of acquiring long term power, according to the testimony of Jim McIntosh, CAISO's Director of Scheduling.[396]

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[392] Ex. CAL-210 at 9:1-10:4 (Hart Direct); Ex. CAL-673 at 3:1-4:13 (Hart Rebuttal).

[393] Tr. 209:4-214:22 (Nichols Cross).

[394] Tr. 182:2-7 (Nichols Cross); Ex. MSC-17 at 3 ("As more and more of the energy supply to meet the net short obligation is placed under contract by CDWR, the more the CDWR purchases set the market.")

[395] Ex. S-100R at 42:17-43:17 (Poffenberger Answering); Ex. S-105 at 3 (originally AYE-51; CDWR memo reviewing progress of negotiations and noting that "sellers had to concede numerous points to obtain the terms and provisions they ultimately ended up with in the agreements").

[396] Ex. CAL-680 at 7:7-10, 9:6-8 (McIntosh Rebuttal) ("During several phone calls FERC had made clear to me that cost should not be a factor in procuring power, even though FERC knew we often had to pay 5 to 10 times the usual price for energy."); Tr. 605:14-606:8 (McIntosh Cross).

197. As stated earlier, the Commission requires Complainants in this case to show "that the unlawful behavior must have directly affected contract negotiations in order for the *Mobile-Sierra* presumption to be overcome."[397] In doing so, Complainants must show that Shell's behavior influenced forward prices in a way that upset the balance of bargaining power between itself and CDWR.[398] While a preponderance of the evidence shows that forward prices influenced Shell's view of the contract, it fails to show that forward prices had anything to do with CDWR's approach to the contract. Indeed, Complainants concede that Shell's unlawful activities had only an indirect impact on negotiations for the Shell-CDWR long term contract.[399] Shell cannot be faulted for something that played no part in the balance of bargaining power between Shell and CDWR.

198. Accordingly, Complainants have not shown that forward prices influenced negotiations for the Shell-CDWR long term contract.

ii. <u>Market Power by Credit Rationing</u>

199. Complainants offer testimony from Fox-Penner to show that Shell exercised market power in the spot market by "rationing credit" during the Crisis Period, which elevated its own sale prices to CDWR above the sale prices that other sellers received from CDWR during the same period.[400]

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[397] *CPUC v. Sellers of Long-Term Contracts*, 150 FERC ¶ 61,079, at P 12 n.17 (2015) (Clarifying Order); *accord*, 149 FERC ¶ 61,127, at P 25 (2014) (Order on Remand); *see also Morgan Stanley*, 554 U.S. at 554 ("[U]nlawful market activity that directly affects contract negotiations eliminates the premise on which the *Mobile–Sierra* presumption rests: that the contract rates are the product of fair, arms-length negotiations.").

[398] *Morgan Stanley*, 554 U.S. at 554 (The direct effect must be one which "eliminates the premise on which the *Mobile-Sierra* presumption rests: that the contract rates are the product of fair, arms-length negotiations."); *Am. Soc. of Composers, Authors & Publishers v. Showtime/The Movie Channel, Inc*., 912 F.2d 563, 584-585 (2d Cir. 1990) ("If the negotiating parties exert generally equivalent bargaining leverage, the results may be viewed as a reasonable equivalent of a competitive market.").

[399] Ex. CAL-717 at 106:3-8, 123:10-124:2 (Taylor Rebuttal).

[400] Ex. CAL-513 at 8:1-70:2 (Fox-Penner Direct); Complainants Post-hearing Initial Br. at 28.

200. Shell's expert witness, Pirrong, counters that Fox-Penner fails to show that Shell caused the spot market to be non-competitive, or that its conduct caused prices to exceed the levels that would be observed in a workably competitive environment.[401] Hence, Pirrong argues, Fox-Penner shows no nexus between Shell's actions and the allegedly supercompetitive prices that Shell charged CDWR.[402]

201. Unlike the southern end of California, the northern end was a constrained market during the Crisis Period that relied heavily on imports of electricity from a small, highly concentrated group of suppliers at the California-Oregon Border, or "COB," particularly as the time for dispatch approached in any given supply hour.[403] Shell was particularly active at COB, and because of its large credit line was able to command high prices from CDWR in Real Time sales by reselling power that other suppliers were unwilling to sell directly to CDWR because of its credit problems.[404] As a result, Shell's prices to CDWR were consistently higher at COB than the prices of other sellers to CDWR at COB.[405]

202. Shell's opportunity for high margins with its strong credit position came when other parties, who had exhausted their credit lines, were willing to "sleeve" their sales of power to CDWR through Shell by selling to Shell for resale to CDWR.[406] Complainants equate this opportunity with the power to raise prices in a constrained region by withholding transmission to CDWR.[407]

203. "Market power" is described as "[t]he ability to price profitably above the competitive level," and such conduct "leads to welfare losses by society."[408] It is usually demonstrated when a firm or group of firms possess "the ability profitably to maintain

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[401] Ex. SNA-230 at 26:24-27:2 (Pirrong Answering).

[402] Ex. SNA-230 at 27:2-3 (Pirrong Answering).

[403] Ex. CAL-717 at 88:3-5 (Taylor Rebuttal).

[404] *Id*. at 91:2-6, 101:1-102:20.

[405] *Id*. at 91:6-94:16.

[406] I*d*. at 102:18-20.

[407] I*d*. at 103:9-17.

[408] Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* 8 (4th ed. 2005).

prices above competitive levels for a significant period of time."[409] The original February 25, 2002 complaints in this case allege that the long term contracts that Shell and the other accused sellers had entered into with CDWR must be abrogated because they were "tainted with the exercise of market power, rendering each challenged contract unjust and unreasonable in violation of § 206 of the FPA."[410]

204. Complainants' burden of proving their allegation that Shell exercised market power by rationing credit at COB is not met, however, merely by asserting that Shell realized high prices for large sales of power to CDWR. Proof that Shell has exercised market power by manipulating credit first requires Complainant to prove that Shell *has* market power in a relevant market. This is not accomplished merely by saying so, or merely by listing a group of Herfindahl-Hirschman Indices (HHIs).[411]

205. Rather, an analysis must be made of many factors that Complainants do not mention at all, including the horizontal or vertical structure of the market, the relevant product and geographic markets, the existence of barriers to entry, the availability of alternatives, the concentration of market shares, and other factors.[412] Complainants have already failed in a previous case before the Commission to prove that Shell had market power in connection with bilateral wholesale energy contracts in the Pacific Northwest, which is the same locale for the exercise of market power that Complainants allege against Shell here. [413]

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[409] U.S. Dep't of Justice & Federal Trade Comm'n, *Horizontal Merger Guidelines* § 0.1 (1992, revised 1997).

[410] *See CPUC v. Sellers of Long-Term Contracts*, Section 206 Complaint, at 4 (Docket No. EL02-60-000, February 25, 2002) ("The contracts challenged herein must be rejected as in violation of the applicable statutory standard. The prices, terms, and conditions in each challenged contract are tainted with the exercise of market power, rendering each challenged contract unjust and unreasonable in violation of § 206 of the FPA.").

[411] Ex. CAL-717 at 91:1-94:16 (Taylor Rebuttal).

[412] *See*, *e.g.*, *Refinements to Policies and Procedures for Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, 153 FERC ¶ 61,065 (2015).

[413] *Puget Sound Energy v. All Jurisd. Sellers*, 151 FERC ¶ 61,173, at PP 165-166 (2015) (Opinion No. 537).

206. Although proof that Shell had exercised market power in the Real Time spot market at COB might show that it potentially influenced forward market prices, it says nothing about whether Shell engaged in unlawful activity in the spot market that violated a tariff provision, a key element for showing that the *Mobile-Sierra-Morgan Stanley* Rule is avoided in this case.[414]

207. The mere juxtaposition of the phrases "market power" and "credit rationing" with one another does not prove anything relevant to the more limited issue here of whether the public interest concerns of the *Mobile-Sierra-Morgan Stanley* rule are avoided. Nor is it necessary to offer such proof; the Commission here only wants to know (1) whether Shell engaged in unlawful manipulation in the spot market (which the evidence discussed above shows that it did); and (2) whether that manipulation directly affected its contract with CDWR (which is discussed below). Complainants' "credit rationing" theory of market power strays too far outside of those narrow confines.

iii. Gas Market Manipulation

208. Complainants also presented testimony from Berry on the alleged price effects on electric forward markets of Shell's unlawful activities in the natural gas market. Berry testified at the hearing that these activities had direct effects on the negotiations of the Shell-CDWR long term contract.[415]

209. In their December 17, 2014 request for rehearing of the Order on Remand in this case, Complainants asked the Commission to make clear for purposes of the "avoidance" prong of the *Mobile-Sierra-Morgan Stanley* Rule that evidence of manipulation may be introduced in this proceeding that extends beyond "unlawful market activity in the spot market."[416] In particular, they asked the Commission to make clear that evidence could

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[414] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 24 (2014) ("The Complainants, when they allege unlawful spot market manipulation by the Respondents, are expected to be specific when presenting their arguments and evidence on this issue; the Complainants are required to specify which tariff provision and/or portion of the tariff provision the Respondents' conduct violated.").

[415] Tr. 977:12-979:23 (Berry Cross); Complainants Post-hearing Initial Br. at 35-37; Complainants Post-hearing Reply Br. at 20-21.

[416] *California Parties' Request for Clarification or Rehearing*, at 4 (December 17, 2014).

be introduced of "Respondent's unlawful manipulation activity in … the markets for natural gas as they existed prior to and during the time of contract negotiation…."[417]

210. The Commission, however, did not go that far. In the Clarifying Order, the Commission decided:

> … [T]hat relevant evidence is not limited to the spot market, and could include the respondents' *market practices and behaviors to the extent that such conduct violated a then-current tariff or Commission order*. The Commission leaves it to the Presiding ALJ to make a finding, based on the record compiled at hearing, on whether the market practices offered as evidence of the respondents' unlawful behavior *violated the MMIP or other tariff provisions and Commission orders*. [footnote omitted] We reiterate here that Complainants are expected *to be very specific as to which tariff provision and/or portion of the tariff provision was allegedly violated*.[418]

In short, the Commission in its Clarifying Order confined this proceeding to unlawful activity in the spot electric market in which the tariffs and Commission orders in question controlled, and did *not* extend its reach to unlawful activity in the natural gas markets.

211. Berry's testimony is based on investigations by the Commodity Futures Trading Commission of Shell's activities in the natural gas market that violate the Commodity Exchange Act.[419] It is not based on any violation of the MMIP or other tariffs or Commission orders that are related to the California electricity market. Berry offers no testimony to that effect.

212. Complainants assert that CDWR used natural gas forward prices in its modeling to evaluate the Shell contract, and therefore that Shell's unlawful activity in the natural gas market affected contract negotiations.[420] However, the fact that CDWR did so misses the point. It is not CDWR's use of natural gas forward prices for its modeling that is the focus of the Clarifying Order; it is *Shell's unlawful activities in the electric spot market* that is the focus. CDWR's use of natural gas prices in its contract analysis models does

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[417] *Id.*

[418] *CPUC v. Sellers of Long-Term Contracts*, 150 FERC ¶ 61,079, at P 12 (2015) (Clarifying Order) (emphasis added).

[419] 7 U.S.C. §§ 1 *et seq.* (2014); Exs. CAL-270 through CAL-274.

[420] Ex. CAL-268 at 21:2-12 (Berry Direct); Ex. CAL-51 at 6:15-18 (Nichols Direct); Tr. 1005:10-21 (Berry Cross).

not demonstrate that Shell's activities in the gas markets violated an *electric* tariff or Commission Order affecting the electric market. Accordingly, CDWR's use of gas forward prices in its modeling to evaluate the Shell contract is irrelevant.

213. In sum, Berry's testimony falls outside the scope of this proceeding and presents no adequate showing that Shell's activities in the natural gas markets had any price effect in the California spot electricity market or directly affected the contract negotiations between CDWR and Shell.

iv. Bad Faith, Unconscionability, Duress, and Fraud

214. The Supreme Court held in *Morgan Stanley* that "FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage," such as the "traditional grounds for the abrogation of the contract" like bad faith, fraud, or duress.[421] Finding any of these grounds serves as a basis for "avoiding" the *Mobile-Sierra-Morgan Stanley* Rule.

215. By its own terms, the Shell-CDWR contract is "governed by and construed and enforced and performed in accordance with the laws of the State of California."[422] California law recognizes the common law torts of "bad faith," "duress," "unconscionability," "fraud in the inducement to contract," and "fraud in the inception of a contract."[423] These torts embody *Morgan Stanley*'s "traditional grounds" for abrogating a bilateral power contract.

216. Under California common law, "bad faith" is "equated with dishonesty, deceit or unfaithfulness to duty," and usually involves a factual inquiry into the perpetrator's subjective state of mind, based largely on circumstantial evidence.[424] A contract is

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[421] *Morgan Stanley*, 554 U.S. at 557.

[422] Ex. CAL-31 (amended section 10.6).

[423] *Rosenthal v. Great W. Fin. Sec. Corp.*, 14 Cal. 4th 394, 926 P.2d 1061 (1996); *Ford v. Shearson Lehman Am. Express, Inc.*, 180 Cal. App. 3d 1011, 225 Cal. Rptr. 895 (Ct. App. 1986).

[424] *Alpha Mech., Heating & Air Conditioning, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 35 Cal. Rptr. 3d 496, 512 (Ct. App. 2005) ("Good faith, or its absence, involves a factual inquiry into the [perpetrator's] subjective state of mind: Did he or she believe the action was valid? What was his or her intent or purpose in pursuing it? A subjective state of mind will rarely be susceptible of direct proof; usually the trial court will be required to infer it from circumstantial evidence." (citations and some punctuation omitted)).

"unconscionable" under California tort law where in the formation there is "an absence of meaningful choice on the part of one of the parties, together with contract terms that are unreasonably favorable to the other party."[425] The tort of "duress" exists under California law where "the doing of a wrongful act" is "sufficiently coercive to cause a reasonably prudent person faced with no reasonable alternative to succumb to the perpetrator's pressure."[426]

217. Regarding "fraud in the inducement to contract" and "fraud in the inception of a contract," the meaning of, and difference between, the two torts has been described by the California courts as follows:

> In the usual case of fraud, where the promisor knows what he is signing but his consent is *induced* by fraud, mutual assent is present and a contract is formed, which, by reason of the fraud, is *voidable*. In order to escape from its obligations the aggrieved party must rescind, by prompt notice and offer to restore the consideration received, if any.
>
> The cases recognize the familiar distinction between fraud in the inducement ... and fraud in the *inception, factum, or execution*. If the fraud goes to the inception or execution of the agreement, **so that the promisor is deceived as to the nature of his act, and actually does not know what he is signing**, or does not intend to enter into a contract at all, mutual assent is lacking, and it is *void*. In such a case it may be disregarded without the necessity of rescission.[427]

218. Complainants allege that Shell's manipulation in its Spot Market sales to CDWR during the Negotiation Period at the same time that Shell was negotiating the Shell Contract constitutes "unfaithfulness to duty" amounting to bad faith.[428] They claim that Shell's behavior also demonstrates, consistent with unconscionability, that as of May 24,

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[425] *Kinney v. United HealthCare Services, Inc.*, 83 Cal. Rptr. 2d 348, 352-353 (Ct. App. 1999); CAL. CIV. CODE §1670.5 (West 2015).

[426] *Rich & Whillock, Inc. v. Ashton Dev., Inc.*, 157 Cal. App. 3d 1154, 1158 (Ct. App. 1984).

[427] *Ford v. Shearson Lehman Am. Express, Inc.*, 180 Cal. App. 3d 1011, 1028, 225 Cal. Rptr. 895, 904 (Ct. App. 1986) (citations omitted; nonsubstantive punctuation omitted; emphasis in bold added; all other emphasis in original).

[428] Complainants Post-hearing Initial Br. at 44-45.

2001, with summer rapidly approaching, there was an absence of meaningful choice for CDWR and that Shell obtained unreasonably favorable terms. [429] Furthermore, Complainants maintain that Shell's manipulation constituted a "wrongful act" of duress that was "sufficiently coercive" to cause "a reasonably prudent person faced with no reasonable alternative to succumb to the perpetrator's pressure," thus accounting for CDWR's capitulation to the terms that Shell demanded.[430]

219. There is insufficient evidence of unconscionability here. Under California law, unconscionability "focuses on factors of oppression and surprise. The oppression component arises from an inequality of bargaining power of the parties to the contract and an absence of real negotiation or a meaningful choice on the part of the weaker party." [431] As discussed earlier, both Shell and CDWR exhibited relatively equal bargaining power during negotiations for the long-term contract.[432]

220. As to duress, CDWR did not typify an entity devoid of alternatives and cowed by a seller's demands. Rather, CDWR received many bids that it did not choose to pursue because it deemed them unfavorable, mostly for economic reasons.[433] CDWR turned down offers from large energy suppliers in the region, including Dynegy, PG&E, Williams Power, and LADWP.[434]

221. Despite the high prices that these sellers demanded, CDWR was able to assemble a portfolio of contracts at prices that met its $70/MWh target average price[435] and reduced the Net Short that it inherited from the IOUs from about 40 percent during the

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[429] *Id*. at 45.

[430] *Id*. at 45.

[431] *Kinney v. United HealthCare Services, Inc.*, 83 Cal. Rptr. 2d 348, 353 (Ct. App. 1999).

[432] Tr. 182:2-7, 209:4-214:22 (Nichols Cross); Ex. MSC-17 at 3; Ex. S-100R at 42:17-43:17 (Poffenberger Answering); Ex. S-105 at 3.

[433] Tr. 227:18–231:3 (Nichols); 459:1–12 (Hart).

[434] Ex. COR-24; Ex. COR-42; Tr. 228:8–231:3, 232:13–20 (Nichols); 459:1–15 (Hart).

[435] Tr. 235:26-236:9 (Nichols); Tr. 393:18-22; Tr. 489:16-20 (Hart).

Crisis[436] to about 33 percent by July 2001.[437] By late May 2001, before the Shell contract was signed, Hart of CDWR was able to record on tape:

> … [W]e are no longer in the position of duress; we're in a position of strength. And that while we will honor all the contracts we've entered, we certainly do not intend to enter into any more that have provisions in them that we do not find favorable. So hopefully we can make that stick.[438]

222. A post-Crisis CDWR internal memo regarding contract offers that CDWR rejected provides some insight into the strength of CDWR's negotiating freedom. Veronica Hicks, the CDWR employee who prepared the memo, pointed out that at one point during contract negotiations, "[o]ne of the last 'Letter[s] of Intent' was signed after a compilation of five 'deals' were evaluated and the Contracts Committee chose the best offer. In this case, the four other Sellers were informed that their offers were not accepted and the negotiations were terminated."[439] These outcomes do not portray a CDWR victimized by duress in its negotiations for long-term contracts, from Shell or any other power marketer.

223. Regarding bad faith, the two Administrative Law Judges who reviewed the facts in the *Puget Sound Energy* case found Shell to have acted in bad faith in its dealings in the Pacific Northwest spot market, a charge that Shell failed to rebut in that case.[440] Those findings were made according to Utah law, which applied to the contracts at issue in that case.[441]

224. Judge McCartney, in her Initial Decision in *Puget Sound Energy*, found that Shell had exploited CDWR by charging spot market bilateral contract prices that were far

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[436] Ex. CAL-210 at 8:8-12 (Hart Direct).

[437] Tr. 500:16-501:7 (Hart); Ex. IB-266.

[438] Ex. SNA-219 at 42:3-7 (Brown Answering); Ex. SNA-223 at 3.

[439] Ex. COR-42 at 2.

[440] *Puget Sound Energy v. All Jurisd. Sellers*, 146 FERC ¶ 63,028, at PP 3, 1415-1422 (2014) (Initial Decision, McCartney, J.); 154 FERC ¶ 63,004, at PP 3.c, 34-63 (2016) (Revised Partial Initial Decision) (Baten, J.).

[441] *Puget Sound Energy v. All Jurisd. Sellers*, 146 FERC ¶ 63,028, at PP 979, 1419 (2014) (Initial Decision) (McCartney, J.); 154 FERC ¶ 63,004, at P 40 (2016) (Revised Partial Initial Decision) (Baten, J.).

above the competitive market level and well above the prices that Shell charged other buyers, because Shell knew that CDWR lacked reasonable alternatives.[442] Also, Judge McCartney found that Shell had engaged in deceptive false export activity in connection with those contracts, without a legitimate business reason.[443]

225. Judge Baten, in his Partial Initial Decision in the remand of *Puget Sound Energy* that modified some of Judge McCartney's earlier findings, reiterated that Shell's false exports constituted bad faith.[444] He further found that Shell had engaged in a coordinated trading strategy of misrepresenting its sources of energy in order to obtain higher contract prices, thus taking advantage of CDWR during contract formation.[445] He found several Shell practices to be deceptive and discriminatory.[446]

226. In contrast to the evidence adduced in connection with the spot market bilateral contracts in the Pacific Northwest market, Complainants here did not conduct any factual inquiry, either directly or by circumstantial evidence, into the "subjective state of mind" of any Shell employee who was engaged in negotiating the long-term contract with CDWR to demonstrate Shell's alleged bad faith.[447] The hearing testimony of Edward Brown, Shell's negotiator, reveals no such motivation.[448] Indeed, when Nichols, a CDWR negotiator, was asked during his own cross-examination at the hearing whether he had ever observed Shell's representatives act deceptively during the long-term contract negotiations, he answered, "Not personally."[449]

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[442] *Puget Sound Energy v. All Jurisd. Sellers*, 146 FERC ¶ 63,028, at P 1416 (2014) (Initial Decision) (McCartney, J.).

[443] *Id.* P 1418.

[444] *Puget Sound Energy v. All Jurisd. Sellers*, 154 FERC ¶ 63,004, at PP 47-48 (2016) (Revised Partial Initial Decision) (Baten, J.).

[445] *Id.* P 48 (2016).

[446] *Id.* PP 47-58.

[447] *Alpha Mech., Heating & Air Conditioning, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 35 Cal. Rptr. 3d 496, 512 (Ct. App. 2005).

[448] Ex. COR-1 (Brown Direct); Ex. SNA-219 (Brown Answering); Tr. 1584-1631, 1644-1733 (Brown).

[449] Tr. 297:13-17 (Nichols).

227. Last of all is the question of fraud. The record and legal briefs of Complainants are replete with allegations of fraud on Shell's part.[450] Complainants allege fraud, although their legal theory of fraud is not well-developed.[451] Under the California law of fraud in contracting set forth above, this does not appear to be a case of "fraud in the inducement" because the long-term contract between Shell and CDWR has already been carried out in full; neither party ever rescinded it.[452] If anything, the fraud allegations of this case are best evaluated in the context of California's rule of "fraud in the inception, factum, or execution."[453]

228. Under the California law of fraud in the inception of a contract, it must be determined whether CDWR was "deceived as to the nature of [its] act" of negotiating and signing the contract with Shell, such that "mutual assent [was] lacking," thereby rendering the contract void.[454] Unlike bad faith, the mistaken understanding of the defrauded party, not just the deceitful intent of the defrauder, informs the inquiry.[455] If

[450] *See*, *e.g.*, Ex. CAL-319 at 2:17-3:1, 8:16, 10:17, 26:6, 28:1, 41:8, 57:6 (Taylor Direct); Tr. 1738:5-1739:8 (Pirrong); Complainants Pre-hearing Br. at 35, 42, 44; Complainants Post-hearing Initial Br. at 15, 22, 23, 29; Complainants Post-hearing Reply Br. at 16, 17, 22.

[451] Tr. 2641:1-2642:3 (McKeon Closing Arg.) ("PRESIDING JUDGE: But if I find, for some technical reason, that there was no bad faith here, are you still alleging fraud? MR. MCKEON: Yes.").

[452] *Ford v. Shearson Lehman Am. Express, Inc.*, 180 Cal. App. 3d 1011, 1028, 225 Cal. Rptr. 895, 904 (Ct. App. 1986).

[453] *See, e.g.*, *Day v. McDonough*, 547 U.S. 198, 209 (2006) (district courts are permitted, but not obliged, to consider, *sua sponte,* the timeliness of a state prisoner's habeas petition, provided court accords parties fair notice and an opportunity to present their positions); *Worley v. Islamic Republic of Iran*, 75 F. Supp. 3d 311, 330 (D.D.C. 2014) (noting with approval district judge's *sua sponte* consideration of statute of limitations even though the defendant did not appear to raise the issue); *Blumberg Associates Worldwide, Inc. v. Brown and Brown of Conn, Inc.*, 311 Conn. 123, 145, 84 A.3d 840, 857 (2014) ("Because judges continue to see their role as doing justice in the tradition of equity (or at least avoiding miscarriages of justice), courts frequently refuse to apply the waiver rule and instead raise issues *sua sponte* to avoid an unjust result." (quotation marks and footnote omitted)).

[454] *Ford v. Shearson Lehman Am. Express, Inc.*, 180 Cal. App. 3d 1011, 1028, 225 Cal. Rptr. 895, 904 (Ct. App. 1986).

[455] *Bonacci v. Massachusetts Bonding & Ins. Co.*, 58 Cal. App. 2d 657, 664, 137 *(continued ...)*

fraud in the inception is found, then the *Mobile-Sierra-Morgan Stanley* presumption is avoided.[456]

229. The defrauder's actions in the formation of a contract are specified by section 1572 of the California Civil Code as "any of the following acts, committed by a party to the contract, or with his connivance, with intent to deceive another party thereto, or to induce him to enter into the contract:

> "1. The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;
> "2. The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
> "3. The suppression of that which is true, by one having knowledge or belief of the fact;
> "4. A promise made without any intention of performing it; or,
> "5. Any other act fitted to deceive."[457]

230. Shell's assertions to CDWR falling within this statutory definition occurred after CDWR rejected Shell's February 26, 2001 offer. As a result of CDWR's demand for Shell to purchase power for CDWR beginning in April 2001 and throughout the summer, Shell demanded a price increase for 2001 through 2003 deliveries from $93.95/MWh to $169/MWh.[458] Shell demanded in the April 6, 2001 LOI a fallback power price, in case the long term deal was not signed by April 30, in the amount of $260/MWh. [459] This

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P.2d 487, 491 (Ct. App. 1943) ("In this case the fraud was not in securing the respondent's signature to a document the nature of which was known to him, but in misrepresenting the nature of the document. [Respondent] testified, and the trial court found, that he believed, because of appellant's fraud, that he was signing a mere receipt. … In the case of fraud in the inception (which is the present case) the writing is void ab initio, and need not be formally rescinded as a prerequisite to a right of avoidance.").

[456] *Morgan Stanley*, 554 U.S. at 557 ("FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage—for instance, if it finds traditional grounds for the abrogation of the contract such as fraud or duress.").

[457] CAL. CIV. CODE § 1572 (West 2016); *cited in Dumas v. First N. Bank*, No. CIV. S-10-1523 LKK, 2011 WL 4906412, at *3-4 (E.D. Cal. Oct. 14, 2011).

[458] Ex. CAL-200 at 17:5-9 (Nichols Direct); Ex. COR-14.

[459] Ex. CAL-200 at 19:1-9 (Nichols Direct); Ex. COR-16.

fallback price was increased to $315/MWh when the LOI was extended to May 31, 2001.[460]

231. Shell's demand for these prices, made at a time when the spot price for April and May 2001 deliveries hovered near $300/MWh,[461] was based on an untrue assertion of fact that Shell made to CDWR – that Shell was being "forced" to purchase power for CDWR in these months "at a loss."[462] By making this assertion, Shell impelled CDWR to take steps that would make Shell whole for the "loss." Shell's witness, Brown, put Shell's stance this way:

> Q: And what happened to the deliveries that were supposed to start in April?
>
> A: Prior to April, as the LOI was being negotiated, it became apparent that neither the LOI nor the final contract would be signed prior to April 1. Coral and CDWR agreed to continue negotiations, while treating the April deliveries separately. Coral held its April price at $169/MWh, *far below the prevailing forward market price for April of $260-290/MWh*. Coral's losses on these sales were to be made up in future periods under the long-term agreement.
>
> Q: Was CDWR aware that Coral was supplying from the market at a loss?
>
> A: *Yes. CDWR was fully aware* and we were able to reach agreement on a price adjustment in the event the long-term contract was not completed. Coral and CDWR agreed that the price for these April deliveries would change from $169/MWh to $260/MWh. *The $260/MWh price was an agreed upon forward market price that Coral would be paid in the event the long-term contract was not signed in order to negate the $3.6 million in losses associated with the below market sales for April.*[463]

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[460] Ex. CAL-200 at 20:3-9 (Nichols Direct); Ex. SNA-219 at 20:17-20 (Brown Answering).

[461] Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

[462] Ex. SNA-219 at 18:5-21, 21:3-17 (Brown Answering); Tr. 2734:25-2739:3 (Watkiss Closing Arg.).

[463] Ex. SNA-219 at 18:5-21 (Brown Answering) (emphasis added).

232. Shell maintained this assertion when, upon being "forced" to make May deliveries of power to CDWR in addition to April deliveries as talks dragged on, the LOI was further extended to May 31:

> The deliveries for May would be handled separately, holding the price at $169/MWh, with a fallback price of $315/MWh. The $315/MWh price was an agreed upon forward market price that [Shell] would be paid in the event the long-term contract was not signed *in order to negate the $6.1 million in anticipated losses associated with the below market sales for May*.[464]

233. CDWR thought that it was striking a "favorable deal" for itself. CDWR's Deputy Director, Raymond Hart, stated in taped comments on May 23, 2001:

> And today I finished negotiations with [Shell] for about 300 [megawatts] this year and increasing amounts in future years. Might be wrong. Might be 150 this year. I'll have to check that. But anyway, pretty favorable deal.[465]

234. And again on May 24, 2001, Hart made the following taped comment:

> But [Shell], I was gonna sign it today. She said don't sign it. And I says, well, it's a good deal.[466]

235. CDWR was unaware of the extent to which Shell, Enron, and other traders were using the manipulative strategies already described here in their dealings in the California spot markets while CDWR's negotiations with Shell were being conducted.[467] As CDWR's witness, Nichols, testified:

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[464] *Id*. at 20:20-21:2.

[465] *Id*. at 48:17-20.

[466] *Id*. at 48:24-25.

[467] Ex. CAL-200 at 29:7-12 (Nichols Direct); Ex. CAL-680 at 14:5-14 (McIntosh Rebuttal) ("I strongly suspected that sellers, particularly Enron, were playing unlawful games in the Spot Market in 2000 and 2001. However, it was not until after the Crisis, including through recent revelations, that I learned how widespread the wrongful practices were or the specific nature of such practices.").

> NCI and CDWR personnel suspected that sellers were withholding supply. But the long term contracting team had no awareness at the time of all of the various price-raising market manipulation schemes by Shell and other sellers in the Spot Market that came to light after the infamous Enron Memos surfaced, and after the California Parties discovered, and introduced in other FERC proceedings, additional evidence of such schemes. [468]

236. The Enron memos that detailed the strategies did not come to light until May 2002,[469] after Enron went bankrupt[470] and well after the Shell-CDWR contract was signed.

237. During negotiations, the Shell personnel who were negotiating the long term contract with CDWR enlisted the help of Shell's spot market traders who were engaged in unlawful, manipulative activities to find power for CDWR's summer needs.[471] Shell's negotiator, Arlin Travis, e-mailed Shell's spot market trader, Hank Harris, that CDWR "is looking for power for April, May, June. Anything you can do, even if we only make a buck or two would be good for getting the larger deal done."[472] Harris replied, "We'll look to throw them April through June power, if we find it."[473] The impression is inescapable that Shell's negotiating team would have been willing to sell summer power to CDWR at a discount in order to close the deal, but Shell's traders would not have complied without being fully compensated at the spot market rates that they were used to getting.

238. Shell's spot market traders and long term contract negotiators were well aware of the profitable outcomes of their spot market sales from employing these strategies.[474]

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[468] Ex. CAL-200 at 29:7-12 (Nichols Direct) (citation omitted).

[469] Ex. CAL-291 at 209 (FERC Staff, *Final Report on Price Manipulation in Western Markets*, Docket No. PA02-2-000 (March 2003)).

[470] *See Public Utilities Com'n of State of Cal. v. FERC*, 462 F.3d 1027, 1044 (9th Cir. 2006) (Enron filed for bankruptcy on December 2, 2001).

[471] Tr. 1663:25-1667:2 (Brown); Ex. CAL-204.

[472] Ex. CAL-204; Tr. 2738:3-6 (Watkiss Closing Arg.).

[473] Tr. 1666:11-14 (Brown); Ex. CAL-204.

[474] Ex. CAL-717 at 57:23-28 (Taylor Rebuttal) (December 7, 2000 e-mails and telephone conversations show "that Ms. Bowman and Mr. Turrent, who were later involved with the long-term-contract negotiations, were fully apprised of the
(continued ...)

The audio tape recordings and e-mails of Shell trader conversations that have been admitted in evidence are replete with references to the traders' knowledge of unlawful activities and how profitable they were.[475] Beth Bowman, the head of Shell's trading office that negotiated the CDWR-Shell contract and conducted Shell's spot market trades, was aware of these activities.[476]

239. It strains credulity to accept that Shell was forced to purchase power for CDWR "at a loss" to itself of approximately $10 million in April and May 2001,[477] when in fact Shell's traders were simultaneously puffing up spot prices that they were charging to CDWR with fraudulent trading schemes. Shell's Margin Reports to the WSPP show that Shell profited from its combined spot and LOI sales by nearly $1 million in April and May 2001.[478] Moreover, when Shell reported the financial results of its California energy trading office to its corporate parent, it stated that "US power margins generated US$20 million in January [2001], compared to a plan of US$2.2 million, reflecting the positive margins generated from West Coast real-time power trading (positive US$19.0 million)."[479] In other words, in the month of January 2001 alone, Shell's spot market traders made over *nine times* the amount of profit that Shell expected to make in that month and double the purported $10 million "loss" it told CDWR that it would take – thanks in part to its unlawful trading activity.[480]

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manipulative schemes of Shell's Real Time traders and the profits that Shell was reaping from those activities."); Exs. CAL-727, CAL-543A, B.

[475] Ex. CAL-423B at 2:21-5:4 ("Well. Yeah, that… (laughs) It wouldn't be done if there wasn't money involved"); Ex. CAL-328 at 9:12-11:4 ("It's candy from a baby"); Ex. CAL-363 ("I am pretty sure there is a reserved parking space in Hell waiting for me"); Ex. CAL-340-B at 9:2-7 ("TRAVIS: I don't know how honest that is, but, we're not in the honesty game are we? ROY: We're in optimizing. It's not a question of honesty. TRAVIS: Yeah. ROY: It's a question of optimization").

[476] Tr. 1517:18-24, 1523:22-1524:5 (Bowman Cross); Ex. CAL-322 at 2.

[477] Ex. COR-1 at 36:6-12 (Brown Answering), Ex. SNA-219 at 18:5-21, 20:20-21:2 (Brown Answering).

[478] Ex. CAL-717 at 132:13-133:2 (Taylor Rebuttal); Ex. CAL-313 at 71-74, 95-99.

[479] Ex. CAL-461 at 4; Tr. 1679:11-1680:16 (Brown Cross).

[480] Tr. 1680:9-13 (Brown Cross).

240. The prices that Shell and CDWR settled upon in May 2001 were far above the "benchmark" price of $74/MWh that the Commission ruled in December 2000 was a just and reasonable target price for long-term contracts to have in order to solve the Crisis.[481] It was well over CDWR's own target average price of $70/MWh that it had set for all of its long term contracts.[482] Shell's assertion that accepting $169/MWh and more would place it in a "loss" position, virtually shaming CDWR into naming that price, was an exaggeration on which CDWR relied to its detriment.

241. Given the requirement that a direct causal relationship must be shown between unlawful activity and contract negotiations, [483] it is important to note that Shell's manipulation of *spot* prices *directly* caused this fraud in the formation of the Shell-CDWR long term contract. Shell's purported "losses" that it insisted CDWR must make up through an inflation of long-term contract prices stemmed directly from the puffed-up spot market price levels that Shell's own traders had a hand in churning by manipulative means and strategies. Shell goaded CDWR into offering Shell exorbitant prices for power during 2001 through 2003 by falsely claiming that it would suffer losses. CDWR did not know, but Shell knew, that these prices were the product of Shell's manipulation in the spot market.

242. In its defense, Shell claims that "Complainants do not allege that [Shell] misled them, withheld information, or otherwise was anything other than forthright with them in contract negotiations or otherwise."[484] This assertion is incorrect. Complainants allege that Shell's unlawful activities in the spot market, unknown to CDWR at the time of negotiations, misled CDWR in its decision to execute the Shell Contract.[485] No matter

[481] *SDG&E v. Sellers*, 93 FERC ¶ 61,294, at 61,994-95 (2000) ("[I]t is our view that five-year contracts for supply around-the-clock executed at or below $74/MWh can be deemed prudent.").

[482] Ex. CAL-200 at 6:17-7:2 (Nichols Direct).

[483] *CPUC v. Sellers of Long-Term Contracts*, 150 FERC ¶ 61,079, at P 12 n.17 (2015) (Clarifying Order); *accord*, 149 FERC ¶ 61,127, at P 25 (2014) (Order on Remand); *see also Morgan Stanley*, 554 U.S. at 554 ("[U]nlawful market activity that directly affects contract negotiations eliminates the premise on which the *Mobile–Sierra* presumption rests: that the contract rates are the product of fair, arms-length negotiations.").

[484] Shell Prehearing. Br. at 22; Shell Post-hearing Initial Br. at 21.

[485] *See* Complainants Post-hearing Reply Br. at 19-20 ("The evidence is clear and compelling that Shell engaged in electricity market manipulation throughout the Crisis, including throughout the Negotiation Period, that increased spot prices in the ISO and PX *(continued ...)*

how hard they tried on cross-examination at the hearing, Shell's counsel could not get CDWR's witnesses Nichols and Hart, who took part in the contract negotiations, to admit that Shell did not deceive Complainants.[486] It would be naïve to read Complainants' case for abrogating the contract as anything other than a condemnation of Shell for hiding its price-inflating subterfuges under a ruse of "financial loss."

243. The California courts have held that "[i]f a misrepresentation as to the character or essential terms of a proposed contract induces conduct that appears to be a manifestation of assent by one who neither knows nor has a reasonable opportunity to know of the character or essential terms of the proposed contract, his conduct is not effective as a manifestation of assent."[487] Thus, neither CDWR's signing of the Shell contract nor the laudatory statements about the deal by CDWR and California officials[488] signify CDWR's assent to the contract, when all were made by CDWR without knowing about Shell's fraudulent activities in the CalPX and CAISO markets. The contract is void as a matter of California law.

244. Accordingly, the preponderance of the evidence demonstrates that the presumption of justness and reasonableness that is normally attributed to bilateral agreements under the *Mobile-Sierra-Morgan Stanley* Rule is avoided in the case of the CDWR-Shell contract because it is void for fraud in its formation.[489]

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and then in sales to CDWR. All the while, Shell was across the table from CDWR offering a way out through a long-term contract that CDWR never would have needed or entered into but for the extreme direct and indirect pressure Shell's manipulative conduct exerted on CDWR.").

[486] Tr. 297:13-299:11 (Nichols); Tr. 428:5–431:14 (Hart) ("Q: Now, you're not aware of anyone from Coral during the negotiation of the contract lying to CDWR; isn't that true? A: How would I know if they are lying? Q: You know what a lie is? A: Yeah, once it's been exposed, but I don't know at the time if they're lying to me or not. Q: At the time when you were negotiating the contract, you didn't believe anyone was lying to you or trying to mislead you, did you? A: I had no reason to believe so.").

[487] *Rosenthal v. Great W. Fin. Sec. Corp.*, 14 Cal. 4th 394, 420, 926 P.2d 1061, 1076-77 (1996) (emphasis omitted).

[488] *See* Ex. SNA-219 at 47:1-48:32 (Brown Answering).

[489] Of course, beyond the *Mobile-Sierra-Morgan Stanley* presumption that is the focus of this Initial Decision, it should be the case that a void contract cannot pass a presumption-free test of "justness and reasonableness" either.

2. **Iberdrola Contract**

245. Unlike Shell, the Commission has never ruled that Iberdrola engaged in unlawful trading activity during the Western Energy Crisis. Iberdrola has participated in only two Western Energy Crisis cases before the Commission – Docket No. EL03-197-000 and this case – from which it was dismissed in both instances.[490]

246. Iberdrola's predecessor, PacifiCorp Power Marketing, Inc., was incorporated in 1995 as a subsidiary of PacifiCorp.[491] In 1999, PacifiCorp was acquired by Scottish Power PLC.[492] PacifiCorp Power Marketing, Inc. was transferred in 2001 to PacifiCorp Holdings, Inc., another subsidiary of Scottish Power, in a corporate reorganization.[493] In 2003, it changed its name to PPM Energy, Inc.[494]

247. In 2005, PacifiCorp was sold to MidAmerican Energy while PPM remained a part of Scottish Power.[495] In 2007, Scottish Power, including PPM, was acquired by Iberdrola, S.A.[496] References here to "PacifiCorp Power Marketing," "PPM," and "Iberdrola" are used interchangeably to refer to the power marketing entity.

248. Complainants refer in many instances to "Iberdrola's parent, PacifiCorp," as if PacifiCorp was some kind of separate player from Iberdrola during the events in question.[497] However, the evidence of record suggests that PacifiCorp's energy trading activities were the work of a single entity within the PacifiCorp organization. PacifiCorp Power Marketing, Inc. is the only PacifiCorp entity that was originally named in this case and subsequently dismissed from it by the Commission.[498] There is evidence in the

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[490] *Colorado River Comm'n of Nev.*, 106 FERC ¶ 61,022, at P 37 (2004); *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087, at 61,383 (2002).

[491] Ex. CAL-285 at 4 n.3 (Taylor Direct).

[492] *Id*.

[493] *PacifiCorp,* 95 FERC ¶ 61,417 (2001).

[494] Ex. IB-211 at 1:13-14 (Hudgens Answering); Ex. CAL-300.

[495] Ex. IB-200 at 14:16 (Harlan Answering).

[496] Ex. IB-200 at 1:8-9 (Harlan Answering); Tr. 2339:6-8 (Hudgens).

[497] *See*, *e.g.*, Ex. CAL-319 at 6 n.16, 11:8, (Taylor Direct).

[498] *CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087, at 61,386 (2002) (App. B).

record that one working group within PacifiCorp worked on power purchasing and selling on behalf of the PacifiCorp public utility on the one hand, while another working group within PacifiCorp worked on power marketing with third parties.[499] Both groups shared many organizational activities.[500]

249. There is no reason to doubt, as a result, that all activities that were allegedly performed by PacifiCorp are attributable to the PacifiCorp power marketing entity now known as Iberdrola. In describing these activities, the names "PacifiCorp" and "Iberdrola" will be used interchangeably for the same entity unless the context requires otherwise.

a. Unlawful Spot Market Activities

250. Complainants, through the testimony of their expert witness, Gerald Taylor,[501] accuse PacifiCorp of providing "parking" service for sellers to CDWR.[502] They also accuse PacifiCorp of facilitating false exports by others by laundering energy from within California for resale to CDWR.[503]

251. According to Taylor, PacifiCorp facilitated such multi-party false exports over nearly 40 days between March 5 and May 15, 2001, and facilitated two-party false exports on another 30 days between January 26 and June 18, 2001.[504]

252. Taylor alleges that PacifiCorp provided parking service all through the Western Energy Crisis to Enron, Powerex, and Shell, as evidenced by transcripts of recorded

[499] Ex. IB-200 at 14:3-7, 11-22 (Harlan Answering); Ex. IB-211 at 3:4-10:2 (Hudgens Answering).

[500] *See*, *e.g.*, Ex. CAL-319 at 160:12-163:13 (Taylor Direct).

[501] Exs. CAL-285 & CAL-319 (Taylor Direct).

[502] Ex. CAL-285 at 43:6-7, 50:11-12 (Taylor Direct); Complainants Post-hearing Initial Br. at 47-51; Complainants Post-hearing Reply Br. at 24-29.

[503] Ex. CAL-285 at 81:13-17; Ex. CAL-319 at 153:8-9 (Taylor Direct); Complainants Post-hearing Initial Br. at 47-51; Complainants Post-hearing Reply Br. at 24-29.

[504] Ex. CAL-319 at 156:15-157:3 (Taylor Direct); Ex. CAL-489 (CAL-489_PAC_Multiparty False Exp.xls).

telephone conversations with PacifiCorp traders and responses to data requests from the Commission.[505]

253. Taylor asserts that transactions in which PacifiCorp knowingly laundered energy out of California for resale in Real Time to the CAISO or to CDWR were fraudulent, and thus, were a violation of PacifiCorp's market-based rate authorization.[506]

254. Taylor is unwilling to say whether Iberdrola contributed to or was involved in illegal activity similar to PacifiCorp because, in his view, critical evidence necessary to answer this question is missing – Iberdrola claims to be unable to locate any of its audio recordings of trader telephone conversations and therefore has produced none in discovery.[507] According to Taylor:

> We know that energy often passed through several entities on its way to CDWR, so it is entirely possible that energy sold by Iberdrola was bound for CDWR and the [CA]ISO. It is my experience after listening to thousands of trader audio recordings representing many of the companies involved in trading activity during the Crisis, that traders often discussed among themselves the strategies that were being employed by them or others to manipulate markets during this period. Thus, the missing recordings could have shed light on Iberdrola's knowledge and participation in fraudulent activities if it was engaged or had knowledge of such activities, as well as the impacts of its or PacifiCorp's activities on the long-term contract negotiations, and the relationship between PacifiCorp and Iberdrola traders and contract negotiators during the Negotiation Period. The failure by Iberdrola to find and produce these recordings in this proceeding has left an evidentiary hole that cannot be filled by any other evidence.[508]

255. Complainants filed a motion against Iberdrola to compel production of the audiotapes and for sanctions in view of Iberdrola's loss of those tapes, despite their acknowledged existence at one time and a litigation hold on them against evidentiary

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[505] Ex. CAL-319 at 158:1-7 (Taylor Direct); Ex. CAL-406 at 24-26 (admission in data request that "PacifiCorp was an intermediary in 'Ricochet' transactions with Enron.").

[506] Ex. CAL-319 at 160:17-161:3 (Taylor Direct).

[507] *Id*. at 164:15-165:2.

[508] *Id*. at 167:5-19.

spoliation. The motion was granted and a sanction was imposed on Iberdrola in the form of an adverse factual inference. Specifically, it is deemed to be a fact that PacifiCorp's unlawful activities in the spot market during the Crisis Period, such as parking and megawatt-laundering, are attributable to Iberdrola.[509]

256. Iberdrola argues that simultaneous buy-resell arrangements, also known as parking arrangements, are not unlawful.[510] It touts Complainants' witness Taylor's acknowledgment during cross examination that "I don't think parking, per se is necessarily a violation unless it's used to disguise the source of the energy," and his affirmance of a suggestion of the cross-examining attorney that "parking in and of itself without something more doesn't constitute evidence of market manipulation."[511]

257. Taylor's statements, however, do not support Iberdrola's claim that parking is inherently lawful activity. They include an express exception that encompasses the very behavior that PacifiCorp (and, by sanction, Iberdrola) has been accused of committing – parking for the purpose of disguising the source of energy as OOM rather than in-CAISO energy.

258. Iberdrola also cites a 2015 Commission decision in *Puget Sound Energy, Inc.*, for its contention that parking is lawful.[512] In that case, the Commission decided that it "will not permit the marketing function of a transmission provider to engage in simultaneous exchanges involving that transmission provider's system absent prior Commission authorization *as evaluated on a case-by-case basis*."[513]

259. *Puget Sound Energy, Inc.*, concerned the Commission's longstanding policy against buy/sell agreements, also known as simultaneous exchanges, by the marketing arm of a transmission provider that utilized the transmission provider's own transmission system. The Commission approves such transactions only if certain Commission

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[509] *Order Memorializing November 10, 2015 Bench Ruling on Motion to Compel Production of Audio Recordings and Request for Sanctions*, at P 11 (November 13, 2015).

[510] Iberdrola Post-hearing Initial Br. at 24-25; Iberdrola Post-hearing Reply Br. at 14-15.

[511] Tr. 1419:9-20 (Taylor).

[512] *Puget Sound Energy, Inc.*, 153 FERC ¶ 61,131 (2015).

[513] *Puget Sound Energy, Inc.*, 153 FERC ¶ 61,131 at P 18 & n.37 (2015) (emphasis in original).

concerns are met regarding the use of such transactions to circumvent transmission service regulation.[514] As to all other simultaneous exchange transactions, the Commission acknowledged that its prior approval is not required.[515]

260. *Puget Sound Energy, Inc.* has nothing to do with "unlawful activities" that are the subject of the California Energy Crisis cases. Those are defined as "market practices and behaviors [that] constitute a violation of the then-current CAISO and CalPX and individual seller's tariffs, as well as Commission orders."[516] PacifiCorp's parking and false export activities are accused of violating these rules, but there is no evidence that they run afoul of the Commission's concern about the use of a transmission provider's own system for simultaneous exchanges transacted by its own marketing arm as opposed to the use of other systems. The identity of the owner of the transmission system used by a parking arrangement simply makes no difference to the issue addressed here. Consequently, *Puget Sound Energy, Inc.* does not support Iberdrola's claim that parking was lawful.

261. Iberdrola's economics expert witness, A. Joseph Cavicchi, challenges Taylor's testimony for conflating Iberdrola with PacifiCorp "without any valid evidence that the two companies operated as one."[517] He characterizes Iberdrola as only a minor player in the California spot market, controlling only 1 MW of wind generation capacity during the Crisis Period and selling only 0.29-0.72% of the megawatt-hours sold in Western spot markets between February and June 2001.[518] Iberdrola notes that it did not transact with CDWR until July 2001.[519]

262. In addition to the evidentiary sanction, there is ample evidence *from Iberdrola itself* that Iberdrola and PacifiCorp operated as one entity during the Crisis Period. Iberdrola's president and chief executive officer from May 2001 through November 2008, Terry Hudgens, served previously for PacifiCorp as Senior Vice President for

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[514] *Id.* P 3.

[515] *Id.* P 4.

[516] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 24 (2014) (Order on Remand) (c*iting SDG&E v. Sellers*, 135 FERC ¶ 61,183, at P 31 (2011)).

[517] Ex. IB-222 at 15:19-16:2 (Cavicchi Answering).

[518] *Id*. at 4:1-9, 17:1-12.

[519] Iberdrola Pre-hearing Br. at 11.

Power Supply.[520] Hudgens testifies that "certain corporate functions were shared" between PacifiCorp and PacifiCorp Power Marketing.[521] Although PacifiCorp Power Marketing's offices were located several blocks away from the PacifiCorp offices and its employees' badges were locked out from accessing the latter's power trading floor,[522] both entities shared a single U.S. chief risk officer and shared mid-office personnel.[523] The chief financial officers of PacifiCorp and Scottish Power had access to the accounting personnel of both entities.[524]

263. Among the corporate functions that PacifiCorp and PacifiCorp Power Marketing shared were legal, credit, human resources, public relations, risk management, and information technology.[525] John Fryer of PacifiCorp's credit department participated in analyzing the credit issues that arose between CDWR and PacifiCorp Power Marketing during the contract negotiations.[526] Even PacifiCorp Power Marketing's now-missing tapes of conversations between its traders and counterparties in the California spot market during the Crisis period were routed through PacifiCorp's legal department when a legal hold was placed on them pursuant to the advent of litigation in this case.[527]

264. Even without the evidentiary sanction, it is not credible to treat the activities of PacifiCorp and PacifiCorp Power Marketing during the Crisis as those of utterly separate entities. The actions of one are clearly attributable to the other as the actions of a single organization. Hence, as there is undisputed evidence that PacifiCorp engaged in parking activities and megawatt laundering in aid of the false export activities of other sellers, constituting unlawful activity in the California spot markets, that evidence is attributable to Iberdrola as well.

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[520] Ex. IB-211 at 1:20-21 (Hudgens Answering).

[521] *Id*. at 3:6-7.

[522] *Id*. at 3:17-20.

[523] *Id*. at 5:1, 6.

[524] *Id*. at 5:19-6:2.

[525] *Id*. at 6:8-10

[526] *Id*. at 6:11-14

[527] *See* Iberdrola Renewables, LLC's Answer to Motion to Compel Production of Audio Recordings, at 6 (Oct. 21, 2015).

b. Causal Connection of Unlawful Activities to Contract

265. Having established the existence of unlawful activities in the spot market during the Crisis Period that are attributable to Iberdrola, we turn to whether a causal connection to Iberdrola's contract negotiations with CDWR exists. Complainants assert in this regard that Iberdrola's unlawful activities in the spot market had a dysfunctional effect on that market that, in turn, had a dysfunctional effect on forward prices, and thereby induced "dysfunctional" conditions for contract negotiations in Iberdrola's favor.[528]

266. The contract between Iberdrola and CDWR was negotiated between the parties from January 24, 2001 through the day of its signing.[529] It was signed on July 6, 2001.[530]

267. The contract term ran from July 29, 2001 through June 30, 2011.[531] Iberdrola was to deliver 7x24 energy in the following amounts: from July 29, 2001 through June 30, 2002, 150 MW; from July 1, 2002 through June 30, 2004, 200 MW; from July 1, 2004 through June 30, 2011, up to 300 MW.[532]

268. For deliveries from July 2001 through December 2002, the contract price was fixed at $70/MWh.[533] For deliveries from January 1, 2003 through June 30, 2011, the price was calculated according to fixed and variable charges and a natural gas cost index, and included a tolling arrangement by which CDWR controlled the dispatch of energy from the Klamath generating plant.[534]

269. There is no previous Commission determination showing that Iberdrola's unlawful activities (which include the parking and megawatt-laundering activities of PacifiCorp that are attributable to Iberdrola) elevated prices in the CalPX and CAISO markets, as

[528] Complainants Post-hearing Initial Br. at 54-62.

[529] Ex. CAL-604 at 5:3-6 (Goldberg Direct).

[530] Ex. CAL-200 at 23:1-2 (Nichols Direct); Ex. CAL-41 (CDWR-Iberdrola Contract).

[531] Ex. CAL-637.

[532] *Id*.

[533] Ex. CAL-604 at 4:14-15 (Goldberg Direct); Ex. CAL-637.

[534] Ex. CAL-210 at 18:10-15 (Hart Direct); Ex. CAL-604 at 4:14-5:2 (Goldberg Direct); Ex. CAL-637; Ex. IB-200 at 12:1-17 (Harlan Answering).

there is with Shell.[535] Complainants have not offered any evidence in this case to show such a nexus.[536] The price set for the initial year and a half of the Iberdrola-CDWR contract met the target average price of $70/MWh that CDWR had set as the goal for its portfolio of long-term contracts.[537]

270. Apart from Taylor's bare statement that PacifiCorp's charges for parking services affected spot market prices, he offers no evidence to back that statement up. Iberdrola, through the testimony of its expert economic witness, A. Joseph Cavicchi, draws particular attention to this absence of substantiation.[538]

271. In the absence of evidence of spot market price effects resulting from unlawful activities attributable to Iberdrola, no nexus can be established between those activities and forward prices during the Crisis Period.

272. In the absence of any nexus between unlawful activities attributable to Iberdrola and forward prices, no nexus can be established between forward prices and the contract negotiations of Iberdrola and CDWR.

273. Accordingly, Complainants have failed to carry their burden of proving that the *Mobile-Sierra Morgan Stanley* presumption of the justness and reasonableness of the CDWR-Iberdrola contract is avoided.

B. Whether the Contracts at Issue Imposed an Excessive Burden on Consumers Relative to the Rates They Could Have Obtained After Elimination of the Dysfunctional Spot Market, or Otherwise Seriously Harmed the Public Interest, Such That the *Mobile-Sierra-Morgan Stanley* Rule Is Overcome?

274. As an alternative to "avoiding" the *Mobile-Sierra-Morgan Stanley* Rule, Complainants may instead "overcome" the Rule by proving an "unequivocal public necessity" or "extraordinary circumstances" that warrant abrogating the contracts with Respondents.[539] These impacts may be shown by demonstrating that "the contracts

[535] *SDG&E v. Sellers*, 149 FERC ¶ 61,116, at PP 57, 62, 97, 102, 120, 127, 174, and 176 (2014) (Opinion No. 536).

[536] Ex. CAL-319 at 153:3-15 (Taylor Direct).

[537] Tr. 197:4-12, 199:18-201:6 (Nichols); Tr. 489:16-20 (Hart).

[538] Ex. IB-222 at 17:13-18:4 (Cavicchi Answering); Ex. IB-228.

[539] *Morgan Stanley*, 554 U.S. at 550.

imposed an excessive burden on consumers 'down the line,' relative to the rates they could have obtained (but for the contracts) after elimination of the dysfunctional market," or otherwise seriously harmed the public interest.[540] It is unnecessary to prove any of the elements of "avoidance" – including unlawful activity or price effects – in order to set aside the *Mobile-Sierra-Morgan Stanley* presumption as having been "overcome."[541]

275. In elaborating upon this part of *Morgan Stanley*, the Commission stated that the term "down the line" means "measured based on the life of the contract," and that "[a] relevant factor in the down-the-line analysis is the cost of substitute power in the absence of the contracts."[542] An appropriate measure of the cost of substitute power, the Commission determined, "may be the actual market prices available at that time for comparable long-term contracts," together with evidence on how to account for "negotiated non-rate terms" in establishing a market price.[543]

276. In line with this guidance, the parties have introduced into evidence several different analyses that compare the payments that CDWR made to Respondents under the contracts at issue with payments for substitute power that could have been made in alternative ways. The difference between these payment levels found through each analysis is offered to show the degree to which the contracts at issue burden – or do not burden – consumers.

277. Furthermore, "[t]he impact on consumers," the Commission noted, "is a key element of this analysis."[544] In keeping with this directive, Complainants, Respondents and Staff have also introduced into evidence analyses that measure the impact (or lack thereof) that the Shell and Iberdrola contracts have had on the electric bills charged by the three California IOUs that consumers have been paying during the post-Crisis period from 2002 through 2012.

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[540] *Id*. at 552.

[541] Tr. 2759:19-2760:2 (Watkiss Closing Arg.) ("PRESIDING JUDGE: … The overcoming rule doesn't have anything to do with unlawful activity or negotiations for the contract as the avoidance rule does; is that correct? MR. WATKISS: That's my reading of Mobile-Sierra.").

[542] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 21 (2014) (Order on Remand).

[543] *Id*.

[544] *Id.* P 22.

1. Shell Contract

a. The Parties' Analyses

i. The Complainants' Analysis

278. Complainants offer the testimony of Dr. Metin Celebi, an economist, to analyze the down-the-line economic burden on California consumers caused by the Shell contract.[545] They also offer the testimony of Commissioner Michael Peter Florio, a member of the California Public Utility Commission, regarding the impact of that burden on consumer rates.[546] Further, they offer the testimony of Dr. Peter Berck, an economist, to model the impact on California's real state personal income and employment of Celebi's computation of the down-the-line consumer burden.[547]

279. Celebi compares CDWR's payments under its contract with Shell to three different alternatives: (i) actual long term contracts of one year or longer for comparable energy products delivered to the same locations that were executed by Shell and others between September 1, 2001 and December 31, 2002, a time period by which Celebi felt the dysfunctional market had subsided; (ii) post-Crisis forward market prices reported during September 2001 for comparable energy products and delivery volumes over the life of the Shell contract; and (iii) payments that would have been made over the life of the Shell contract using prices estimated by computer simulation on the basis of underlying cost elements of producing electric power as of the date that the Shell contract was executed.[548]

280. For his first analysis, Celebi examines hundreds of contracts executed by Shell and Iberdrola, long term contracts executed by the California IOUs, and contract information that was publicly available in a FERC database.[549] Although Celebi concludes that the Shell contract was "very highly priced as compared to long-term contracts executed in

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[545] Ex. CAL-634R (Celebi Direct).

[546] Ex. CAL-241 at 63:6-65:7 & tbl.5 (Florio Direct).

[547] Ex. CAL-666 (Berck Direct).

[548] Ex. CAL-634R at 3:13-5:18 (Celebi Direct).

[549] *Id*. at 17:13-19.

the September 2001-December 2002 period," Celebi does not attempt to determine a cost of substitute power based on these other post-Crisis contracts.[550]

281. In his second analysis, Celebi calculates a cost of substitute power during the term of the Shell contract on the basis of forward prices reported by major brokers during trading days in September 2001, with adjustments to account for differences in non-price terms in the CDWR contracts.[551] Forward prices from September 2001 are used to determine prices for each delivery location in each delivery month through 2005.[552] For the period 2006 through 2012, Celebi escalates the prior year's monthly post-Crisis forward market prices for the same month by the growth rate implied by natural gas price forecasts as of September 2001 at Henry Hub.[553] These calculations, according to Celebi, represent his "best estimate of the market prices that would have been available to CDWR for substitute power when the markets were no longer dysfunctional."[554]

282. Celebi's methodology estimates the total down-the-line burden on California consumers to be the difference between the total payment to Shell over the entire contract term and the total payment under post-Crisis forward market prices for the same volumes. This amount, in nominal dollars, comes to approximately \$1.37 billon (*i.e.*, \$2.762 billion in actual payments to Shell - \$1.396 billion in forwards-based payments = \$1.37 billion).[555] With FERC quarterly interest rates applied through May 2015, the amount comes to \$2.14 billion.[556] Celebi's down-the-line difference between actual payments to Shell and post-Crisis forward market-based payments is depicted in the following figure:[557]

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[550] *Id*. at 24:4-11.

[551] *Id*. at 24:11-15, 25:1-36:2.

[552] *Id*. at 31:14-16.

[553] *Id*. at 34:4-8.

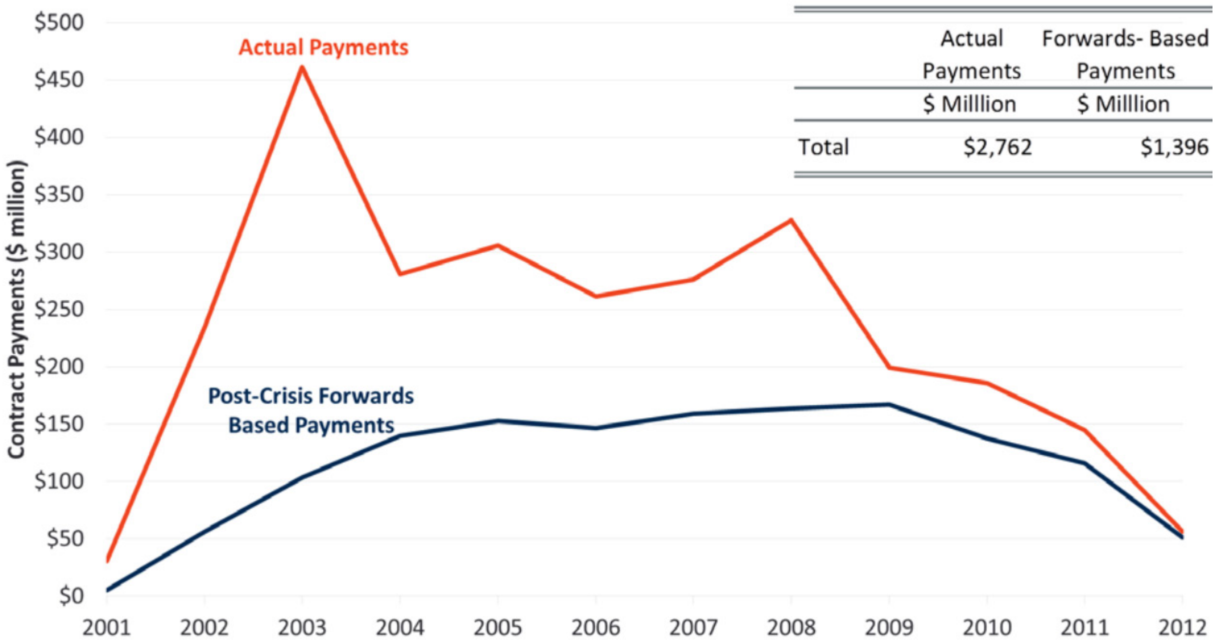
[554] *Id*. at 24:15-17.

[555] Ex. CAL-634R at 39:1-8 (Celebi Direct); Ex. CAL-668 (Shell tab).

[556] Ex. CAL-634R at 41:1-5 (Celebi Direct); Ex. CAL-668 (Shell tab).

[557] Ex. CAL-634R at 40 (fig.12) (Celebi Direct).

Actual Shell Contract Payments vs. Post-Crisis Forward Market-Based Payments (Nominal $s)



283. In his third analysis, Celebi compares the payments under the Shell contract to what payments would have been if they had been based on prices derived from the underlying cost elements of producing electric power.[558] For the years 2001-2004, Celebi estimates spot market Day Ahead prices using Day-Ahead Locational Market Clearing Prices Analyzer (DAYZER) market simulation software, which simulates short-run marginal prices expected for conditions of supply and demand as of the Shell contract execution date.[559] For the years 2005-2012, Celebi estimates prices that are consistent with long-run equilibrium conditions – that is, "long run marginal costs" (LRMC) – by projecting the costs to build and operate a new gas-fired combined-cycle plant as of the contract execution date and translating those costs into a dollar per MWh figure that is applied to each product delivered under the contract.[560]

[558] *Id*. at 46:10-17.

[559] Ex. CAL-634R at 47:8-11, 47:16-48:4, 49:3-51:2, 51:3-54:16, 62:1-63:2 (Celebi Direct); Ex. CAL-643.

[560] Ex. CAL-634R at 47:11-15, 48:4-49:2, 63:10-71:2 (Celebi Direct); Ex. CAL-646 (at second page: "The calculation was conducted for a new gas-fired combined-cycle plant (gas CC) because a gas CC (as opposed to a simple-cycle gas turbine), would provide the products delivered under the Shell and Iberdrola Contracts at the lowest cost. A gas CT would be better suited to provide the lowest costs only during the hours with *(continued ...)*

284. Celebi finds in this analysis that Shell's contract prices were substantially higher than these "fundamentals-based" prices in the initial years of the contract, and then narrowed the gap in later years.[561] He estimates the consumer burden represented by the difference between projected payments under the Shell contract and projected payments under fundamentals-based prices to be $384.8 million ($779 million, including FERC interest to May 2015).[562]

285. Commissioner Florio extrapolates from Celebi's forward prices-based analysis a table, the Shell part of which is shown here, indicating how much in cents per kilowatt-hour California customers paid to Shell for the power that it sold to CDWR during each year of the term of the Shell-CDWR contract in excess of the rates that they would have paid for those deliveries at post-Crisis prices:[563]

the highest load conditions.").

[561] Ex. CAL-634R at 73:3-74:3 (fig.22) (Celebi Direct).

[562] Id. at 76:1-6 & tbl.8.

[563] Ex. CAL-241 at 63:6-65:7 & tbl.5 (Shell part) (Florio Direct).

Excess Consumer Rates -- Difference Between Actual CDWR-Shell Contract Prices and Post-Crisis Forward Market Prices

Year	Shell Contract		
	actual rate (¢/kWh)	post-crisis rate (¢/kWh)	**excess rate (¢/kWh)**
2001 (Oct-Dec)	18.46	3.06	**15.40**
2002	16.15	3.85	**12.30**
2003	17.73	3.96	**13.76**
2004	7.89	3.93	**3.96**
2005	7.84	3.93	**3.91**
2006	7.06	3.95	**3.11**
2007	7.07	4.08	**2.99**
2008	8.37	4.17	**4.20**
2009	5.10	4.26	**0.84**
2010	5.78	4.27	**1.51**
2011	5.53	4.43	**1.10**
2012	4.52	4.10	**0.43**

286. Berck uses an econometric computer model of the California economy known as the Environmental-Dynamic Revenue Analysis Model (EDRAM), a peer-reviewed econometric model,[564] to measure the effect of Celebi's second analysis results (which Berck calls the Shell contract's "overcharges") on the sum of nominal income received by all persons in California divided by the consumer price index, a measure of "real" personal income.[565]

287. The EDRAM model starts with a baseline California economy in "general equilibrium," meaning that it accounts for all markets and all income flows at market clearing prices in all economic sectors, and thus represents all supply and demand in equilibrium.[566] Berck then introduces the impact of the contract overcharges into the model, which sets into motion a series of changes in prices and quantities within the model that work to bring the economy as simulated by the model back into equilibrium.[567] The pre-change equilibrium is then compared to the post-change

[564] Tr. 954:15-17, 955:14-23 (Berck).

[565] Ex. CAL-666 at 2:15-3:5, 9:14-10:2 (Berck Direct).

[566] *Id*. at 10:3-12.

[567] *Id*. at 10:16-19.

equilibrium to see the likely change to the economy as measured by real state personal income and employment.[568]

288. Berck runs the EDRAM model for actual conditions in years 2002, 2003, 2005, and 2011 to derive actual real state personal income and employment.[569] Berck then decreases the revenue paid to outside entities for electricity and runs the model again for each of the foregoing years, removing overcharges by (1) Shell only, (2) Iberdrola only, (3) both Shell and Iberdrola, and (4) by all suppliers including Shell and Iberdrola.[570]

289. For the Shell contract alone, Berck converts Celebi's September 2001 forwards market-based overcharge of $1.4 billion to its 2001 net present value (NPV) of $1.1 billion.[571] Berck then calculates that this overcharge reduced the present value of California's real state personal income by $3.4 billion and cost the state approximately 3,300 jobs.[572]

ii. Shell's Analysis

290. Shell offers the testimony of Dr. Scott W. Niemann, an economist, for its analysis of down-the-line consumer burden arising from the Shell contract with CDWR.[573] Shell also offers the testimony of Dr. Andrew Safir, an economist, to critique the analyses of Celebi and Berck.[574] Finally, Shell offers the testimony of Mark Fulmer, an engineer, to address the impact on consumer electric rates of the overcharges that Complainants attribute to the Shell contract.[575]

291. Niemann asserts that the long-run marginal cost of power (LRMC) is an appropriate measure of the long-run competitive price in wholesale power markets and a

[568] *Id*. at 10:13-11:3.

[569] *Id*. at 16:18-17:1.

[570] *Id*. at 17:1-6.

[571] Ex. CAL-666 at 3:6-4:9, 5:13-15, 5:19-6:2 (Berck Direct); Ex. CAL-669 (Summary tab).

[572] Ex. CAL-666 at 6:19-7:3 (Berck Direct); Ex. CAL-669 (Summary tab).

[573] Ex. SNA-244 (Niemann Answering).

[574] Ex. SNA-240 (Safir Answering).

[575] Ex. SNA-256 (Fulmer Answering).

reasonable baseline for assessing down the line costs of long term contracts, including the Shell contract.[576] LRMC is equal to the cost of new entry (CONE) plus variable operating expenses for generation to supply the contracted deliveries.[577] This analysis, Niemann notes, is consistent with the testimony of Dr. Martin Ringo on behalf of Complainants that was provided in the original 2002 hearing in this case, which used CONE to analyze the consumer burden attributable to all of the challenged contracts.[578]

292. Niemann contends that down-the-line impacts for a long-term power sale should be measured against a reasonable estimate of the cost that a buyer could have expected to pay at the time for long term power in the absence of that sale, within a competitive market for long-term power.[579] Hence, a critical component of establishing a reasonable benchmark price, Niemann says, is ensuring that the market conditions at the time the agreement was negotiated are comparable to the market conditions underlying the benchmark pricing.[580]

293. Consequently, it is not necessary to look to a period with more "normal" market conditions to establish a pricing benchmark for contracts entered into during the Crisis Period, Niemann asserts.[581] The better approach is to use CONE, which includes both the initial capital expenditures and on-going fixed costs required to build, operate, and maintain a new power plant.[582] Market prices consistent with CONE will result in expected cash flows over the life of the asset that are sufficient to cover both the variable operating costs of the plant and CONE, thereby equaling LRMC, Niemann asserts.[583]

294. This measure of long term competitive pricing is independent of any short term market dysfunction, and therefore is not tied to any specific type of "normal" market

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[576] Ex. SNA-244 at 8:3-9 (Niemann Answering).

[577] *Id*. at 8:9-11.

[578] Ex. SNA-244 at 8:16-18 (Niemann Answering); Ex. CAL-82 (Ringo Direct).

[579] Ex. SNA-244 at 11:2-5 (Niemann Answering).

[580] *Id*. at 11:11-14.

[581] *Id*. at 11:15-19.

[582] *Id*. at 12:8-9.

[583] *Id*. at 12:18-21.

conditions, Niemann says.[584] Indeed, according to Niemann, there is no need to look to other periods outside of the Crisis Period to establish a reasonable benchmark.[585]

295. Niemann's original estimates of CONE that he submitted with his answering testimony were found after his deposition to contain errors. Consequently, he submitted errata to correct his computations.[586] In his corrected version, Niemann estimates CONE based on the installed cost, in 2001 dollars, of a merchant generator's standard 550 MW combined cycle gas turbine (CCGT) as reported by the California Energy Commission (CEC) in its 2007 report of central station electricity generation technology costs.[587] This amount in 2001 dollars is $737/kW-year.[588] This value is very close to the value used by Ringo in his 2002 testimony, and is similar to Celebi's LRMC analysis which is based on the same technology.[589] From this value and the application to it of certain financing assumptions made by the 2007 CEC report, Niemann estimates the levelized revenue that would be required to allow for recovery of capital (including the cost of debt and equity), taxes, insurance, and O&M.[590]

296. Niemann compares the present discounted value of CCGT carrying charges, as amortized over the run hours that occurred during the contract deliveries, to the present

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[584] *Id*. at 13:9-12.

[585] *Id*. at 13:20-14:3.

[586] Ex. SNA-244R (Niemann Answering Errata); Ex. SNA-248 (Niemann Second Errata); Ex. SNA-255 (Niemann Second Errata).

[587] Ex. SNA-244R at 5 (Niemann Answering Errata); Ex. SNA-247 at 40, tbl.15 (cost of a Merchant's "conventional 550 MW CC with Duct Firing").

[588] Ex. SNA-255 (Niemann Second Errata) (CCGT Capital Costs tab).

[589] Ex. SNA-244 at 20:3-5 (Niemann Answering); *see* Ex. CAL-646 (at second page: "The [Celebi] calculation was conducted for a new gas-fired combined-cycle plant (gas CC) because a gas CC (as opposed to a simple-cycle gas turbine), would provide the products delivered under the Shell and Iberdrola Contracts at the lowest cost. A gas CT would be better suited to provide the lowest costs only during the hours with the highest load conditions."); Tr. 710:2-711:17 ("[B]oth my analysis and Dr. Niemann's analysis of LRMC are using [combined-cycle generation plant technology] as the basis.").

[590] Ex. SNA-244 at 20:11-15 (Niemann Answering); Ex. SNA-255 (Niemann Second Errata) (CONE Summary tab).

discounted value of actual contract payments to Shell from CDWR.[591] Unlike Celebi's analysis, the capacity payments to Shell under the contract are not included in Niemann's stream of actual payments from CDWR.[592] Also, the "below market sales" of power that Shell made to CDWR in April and May 2001 at the contract price is treated by Niemann as a credit to Shell, and therefore the difference between the market-price value of that sale and the contract-price value is deducted from the total of all contract payments that Shell received from CDWR.[593]

297. Niemann finds that the sum of actual payments under the Shell contract between May 24, 2001 and June 30, 2012 is approximately 3.3 percent more than the LRMC pricing payments would be.[594] The present-value and undiscounted analyses are shown in the following table:[595]

	NPV	Undiscounted
Cost of Shell Deliveries Under Contract	$2,213,276,824	$2,772,132,062
Cost at LRMC Pricing	$2,133,580,810	$2,763,445,401
Difference:	$79,696,014	$8,686,661
Percentage Difference:	**3.7%**	**0.3%**
Less Cost of Below Market Sales	($8,779,200)	($8,779,200)
Net Difference:	$70,916,814	($92,539)
Percentage Difference:	**3.3%**	**0.0%**

298. Niemann further points out that when Complainants offered Ringo's analysis in 2002, and particular errors in his analysis of the Shell contract were discovered and corrected, Ringo testified that, "[a]ssuming the quantitative effect of those errors was as

[591] Ex. SNA-244 at 21:1-10 (Niemann Answering); Ex. SNA-244R at 6 (Niemann Answering Errata); Ex. SNA-248 (Niemann Second Errata) (CEC-Based Comparison tab).

[592] Tr. 883:1-5 (Celebi Cross).

[593] Ex. SNA-244 at 22:11-13 (Niemann Answering).

[594] Ex. SNA-244R at 6 (Niemann Answering Errata); SNA-248 (Niemann Second Errata) (CEC-Based Comparison tab).

[595] Ex. SNA-248 (Niemann Second Errata) (CEC-Based Comparison tab).

represented by the Respondents' witnesses, one could not conclude, based on my approach, that the contracts are priced above long-run competitive prices."[596]

299. Niemann contends, therefore, that the Shell contract does not impose a down-the-line burden on consumers. "The core problem" with Celebi's three approaches, Niemann opines, "is that they are untethered from the market conditions facing sellers in early 2001."[597]

300. Safir adds to Niemann's critique of Celebi.[598] Safir argues that Celebi should have made some assessment of whether the long-term contracts actually had a stabilizing influence on post-Crisis rates before assessing so-called "overcharges."[599] Celebi merely proves the obvious, Safir contends – that pricing in the post-Crisis period was much lower than the pricing faced by CDWR during the Crisis Period – and Celebi erroneously labels that difference a "burden."[600]

301. According to Safir, "the real issue is to what extent prices in the post-Crisis Period were reduced from what they otherwise would have been by virtue of the execution of the various long-term contracts, including the [Shell] Contract."[601] If these rates would have been higher as a result of some failure on the part of the market to enter into long term contracts with Shell and the other respondents, Safir notes, then Celebi's price series underestimates what prices actually would have been in the absence of the Shell contract, and his overcharge would be overstated.[602]

302. Safir also criticizes Berck's model of the impact on state personal income and employment.[603] Berck's EDRAM computation of a $3.4 billion reduction in real state personal income and decline of 3,300 jobs does not account for any benefit of the long term contracting process on down-the-line pricing, such as the construction of additional

[596] Ex. SNA-244 at 25:17-21 (Niemann Answering) (*quoting* Ex. CAL-163 at 1-2).

[597] Ex. SNA-244 at 29:7-11 (Niemann Answering).

[598] *Id*. at 18:6-24:2.

[599] *Id*. at 20:5-8.

[600] *Id*. at 20:9-14.

[601] *Id*. at 20:17-19.

[602] *Id*. at 20:15-21:3.

[603] *Id*. at 24:3-41:14.

California power plants, which subsequently proved to be important in bringing down prices.[604] The EDRAM Model, according to Safir, is imprecise and fails to account for any structural economic changes that may arise in response to significant economic shocks such as the disruption to the California electric market.[605]

303. Safir further contends that Celebi's measure of the impact of the alleged overcharges of the Shell contract, even if accurate, is insignificant in relation to the overall amount of income or employment generated in the state.[606] The loss of income to the State of California in 2004 caused by the Shell contract overcharge, Safir says, amounted to no more than 2.9 hundredths of one percent of state personal income for that year.[607] The total job loss over the 2001 to 2012 period that Berck estimates amounted to two one-hundredths of a percent of the total job level in the state.[608]

304. Fulmer adds to Shell's deconstruction of Celebi's analyses that even if one assumes Celebi's calculations of alleged overcharges under the Shell contract to be correct, the impact still cannot be construed as an excessive burden.[609] Using Celebi's alleged overcharge values based on his forward price-based analysis, Fulmer finds on average that the Shell contract constituted only 0.49% of the average electric bill across the entire California electric system for all classes of customers during the entire term of the contract, which translates into a cost of $0.00057/kWh.[610] Fulmer considers this amount not to be an excessive burden on consumers.[611]

305. Fulmer's 0.49% calculation of the impact of the Shell contract on electric rates is derived from the amount collected by the IOUs from ratepayers to reimburse CDWR for its power purchases from Shell in the last quarter of 2001 and all of 2002. These amounts were collected by means of direct remittances from ratepayers during 2001 and 2002, and

[604] *Id*. at 24:11-25:6, 28:3-12.

[605] *Id*. at 28:19-22, 29:12-16.

[606] *Id*. at 32:16-18.

[607] *Id*. at 32:22-33:2.

[608] *Id*. at 36:1-10.

[609] Ex. SNA-256 at 4:19-21 (Fulmer Answering).

[610] Ex. SNA-256 at 4:22-5:2, 19:8-21:13 (Fulmer Answering); Ex. SNA-260.

[611] Ex. SNA-256 at 5:2-4 (Fulmer Answering).

by means of the "Power Charge" that was collected on their electric bills from 2003 through 2012.[612]

306. In addition to this direct impact of power purchases on consumer electric bills, Fulmer also calculates the impact of the Shell contract on payments of the "Bond Charge" that was and continues to be collected on ratepayers' bills to pay for the first nine months of CDWR's 2001 power purchases that were rolled into a bond issuance.[613] Fulmer calculates that payments for the Shell contract represent 0.79% of the total amount of power purchases being financed by the bonds, equaling \$61.2 million, and with bond interest equaling \$96.8 million.[614] This amount, Fulmer opines, comes to approximately two cents per month on the average residential customer's bill.[615]

iii. <u>Staff's Analysis</u>

307. Commission Trial Staff offers the testimony of Daniel L. Poffenberger, a FERC rate filings specialist, for Staff's down-the-line consumer burden analysis of the Shell Contract.[616]

308. Poffenberger first computes what the burden of the Shell contract was on the average monthly electric bills for California's residential, commercial, and industrial customers, and for street and highway lighting.[617] These findings do not reflect an offset for a substitute long term contract to Shell's long term contract.[618] Poffenberger finds that the Shell contract reflected a burden on the average monthly bill for residential customers of a low of \$0.10/month in 2012 to a high of \$2.29/month in 2003 (0.115 to 4.328 percent) depending on the utility; for commercial customers, a low of \$0.73/month in 2012 to a high of \$18.10/month in 2003 (0.128 to 4.387 percent); for industrial

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[612] Ex. SNA-256 at 6:4-7:15, 8:17-10:17, 19:8-20:6 (tbls.3 & 4) (Fulmer Answering); Ex. SNA-260.

[613] Ex. SNA-256 at 6:4-15, 8:1-13 (Fulmer Answering).

[614] *Id*. at 13:3-14.

[615] *Id*. at 14:14-15:2.

[616] Ex. S-100R (Poffenberger Answering).

[617] *Id*. at 18:3-19:15.

[618] Ex. S-100R at 19:9-10 (Poffenberger Answering); Tr. 2498:9-13 (Poffenberger Cross).

customers, a low of $8.00/month in 2012 to a high of $2,226.31/month in 2003 (0.154 to 5.859 percent); and for street and highway lighting, a low of $0.30/month in 2012 to a high of $13.19/month in 2003 (0.126 to 2.759 percent).[619]

309. Next, Poffenberger analyzes the impact on monthly bills of excess revenues that Shell received over Celebi's forward market price-based revenue.[620] In this analysis, Poffenberger takes into account CDWR's right under the Iberdrola contract, commencing on January 1, 2003, to elect whether or not to schedule energy from the Klamath Falls plant, which could have been used by CDWR to save energy costs.[621]

310. Poffenberger finds in connection with Celebi's forward market price-based revenue that the Shell contract imposed excess revenues on California customers' monthly bills for electric service over the contract term as follows: for residential customers, a low of $0.01/month in 2012 to $1.78/month in 2003 (0.02 to 3.35 percent) depending on the utility; for commercial customers, a low of $0.13/month in 2012 to a high of $14.01/month in 2003 (0.02 to 3.40 percent); for industrial customers, a low of $0.74/month in 2012 to a high of $1,723.92/month in 2003 (0.03 to 4.48 percent); and for street and highway lighting, a low of $0.03/month in 2012 to a high of $10.21/month in 2003 (0.01 to 2.14 percent).[622]

311. Finally, Poffenberger essentially duplicates Niemann's LRMC-based analysis using the levelized cost of building a conventional combined cycle generating unit.[623] Poffenberger finds that the amounts CDWR paid to Shell over the life of the long term contract were less than what would have been paid over the same period based on that cost.[624]

312. Based on Poffenberger's analysis, Staff finds that the Shell contract did not result in an excessive burden on consumers down-the-line.[625]

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[619] Ex. S-100R at 19:10-15 (Poffenberger Answering); Ex. S-103R, tbls.9 & 10.

[620] Ex. S-100R at 20:8-23:14 (Poffenberger Answering); Ex. S-103R, tbls.12 & 13.

[621] Ex. S-100R at 20:8-20 (Poffenberger Answering).

[622] Ex. S-100R at 22:4-14 (Poffenberger Answering); S-103R, tbls.12 & 13.

[623] Ex. S-100R at 25:3-26:15 (Poffenberger Answering).

[624] *Id*. at 26:1-3.

[625] *Id*. at 23:7-14.

b. <u>The Shell Contract's "Down the Line" Burden on Consumers</u>

i. <u>Comparison to the Cost of Substitute Power</u>

313. After the Supreme Court in *Morgan Stanley* designated the burden on consumers down-the-line as one of the public interest criteria for overcoming the *Mobile-Sierra* presumption that a bilateral contract is just and reasonable, the Commission pointed to "the cost of substitute power in the absence of the contracts" as a benchmark for telling whether this public interest concern is triggered.[626] The Commission did not specify, however, what form this "cost of substitute power" should take, other than to say that it "may be the actual market prices available at that time for comparable long-term contracts," adjusted to account for "negotiated non-rate terms."[627] It is necessary for the purposes of this Initial Decision to define more precisely this "cost of substitute power."

314. CDWR and Shell were not clairvoyant when they entered into their power contract on May 25, 2001. They could not foresee the future of spot market prices in California at that point. They could not tell whether those prices would rise or fall the next day. Instead, they were faced, as all business persons are faced, with a choice of alternatives at that moment—either to enter into that contract or to do something else to procure power for the State. They made that choice, as all do at such moments, with no concrete information about the future.

315. The most consistent way to evaluate a particular choice among alternatives is to compare it to some objective benchmark. This is what the Commission does when it evaluates the appropriateness of a particular rate of return on equity (ROE) for a public utility to recover in future rates. The ROE is modeled upon a rational shareholder's expectation of a steady stream of dividends and a steady growth rate to be experienced

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[626] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 21 (2014) (Comm'n Order on Remand).

[627] *Id.*

over time.[628] It produces consistent results, unlike the vagaries inherent in trying to estimate price levels in the marketplace.[629]

316. One objective benchmark to compare to the CDWR-Shell contract is the long-run marginal cost of procuring electric power.[630] This is typically represented in economic thought (with the agreement of economics experts on both sides of this case) by the total yearly levelized fixed and variable cost of installing, running, and maintaining a new combined-cycle gas-fired generating plant, expressed as a constant rate in dollars per kilowatt-year.[631] This long-run marginal cost, or "LRMC," is independent of the vagaries

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[628] *Martha Coakley, Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, 147 FERC ¶ 61,234, at P 33 (2014) (Opinion No. 531) ("The DCF model is based on the premise that an investment in common stock is worth the present value of the infinite stream of future dividends discounted at a market rate commensurate with the investment's risk.").

[629] *See* Richard H. Thaler, *Misbehaving: The Making of Behavioral Economics* 230-232 (2015) (discussing Robert Shiller's findings that a firm's stock price is too volatile over time to accurately predict the present value of a future stream of dividends).

[630] Ex. CAL-634R at 48:7-12 (Celebi Direct) ("In the long-run, and under equilibrium conditions of having the amount of capacity in place to balance customer needs for reliability against the costs of additional entry, competitive energy prices should be high enough to provide recovery of capital and operating costs (or all-in costs) of new generation units. I refer to these all-in costs as long-run marginal cost (LRMC)."); Ex. SNA-244 at 32:24-33:6 (Niemann Answering) ("While pricing for near-term forward sales may be more closely tied to expectations of the Crisis Period conditions persisting, longer term transactions can reasonably be evaluated against the long-run competitive pricing that approximates LRMC."); *see also* Kahn, Alfred E., *The Economics of Regulation* 160-61 (1988) ("Apart from possible noneconomic considerations, society's interest is in having transportation, energy, or communications provided at the lowest possible cost, with due allowance for possible differences in the quality of services supplied or the costs imposed on the users. [footnote omitted] And economic efficiency requires, additionally, that no business be turned away that covers the cost to society of providing that service. These basic goals are served by permitting rates to be set at long-run marginal costs.").

[631] Ex. CAL-634R at 48:17-49:2 (Celebi Direct); Ex. SNA-244 at 19:14-15 (Niemann Answering).

of the marketplace and represents a constant cost of power to society over the long haul.[632]

317. The analysis of Shell's expert, Niemann, adheres to the LRMC model, calculating consumer burden as the difference between the total cost of Shell's deliveries to CDWR under the contract during its entire 11-year term and what the cost would have been if priced according to LRMC based on the cost of a new combined-cycle gas turbine generating plant.[633]

318. The so-called "best estimate"[634] of Complainants' expert, Celebi, is not based on LRMC. Instead, it is based on forward market prices that were established during the trading days of September 2001, a month which he says happened after the dysfunction in the spot market had ended.[635] Those forward market prices, established during that single month, are projected in Celebi's analysis over the entire 11-year term of the CDWR-Shell contract.[636]

319. Celebi's other alternative, a so-called "fundamentals-based" analysis, is based in the near term (*i.e.*, deliveries in 2001-2004) on short-run marginal cost pricing using market simulation software; in the far term (*i.e.*, deliveries in 2005-2012), it is based on LRMC pricing that is premised on the cost of a new gas-fired combined cycle plant.[637] This measure is compatible with an objective benchmark analysis in the long run, and also accounts for factors that are readily predictable in the short run.[638]

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[632] Ex. SNA-244 at 13:11-12, 33:3-6 (Niemann Answering); *also see* Paul A. Samuelson and William D. Nordhaus, *Economics* 464 n.1 (12th ed. 1985) (long run marginal cost for firm is constant, not rising or falling as with short run marginal cost, because firm faces "no fixed factors" and experiences "constant returns to scale"); Tr. 2704:10-18 (Ritchie Closing Arg.) ("[LRMC is] an estimate of a competitive price at a particular point in time when long run equilibrium conditions would prevail.").

[633] Ex. SNA-244 at 8:5-11, 19:9-20:15 (Niemann Answering); Ex. SNA-244R (Niemann Answering Errata).

[634] Ex. CAL-634R at 24:15 (Celebi Direct).

[635] *Id*. at 4:5-19.

[636] *Id*. at 31:10-35:1.

[637] Ex. CAL-634R at 46:10-73:3 (Celebi Direct); Ex. CAL-646.

[638] Ex. CAL-634R at 47:16-49:2 (Celebi Direct).

320. Unsurprisingly, there are sharp differences in results among the analyses. Complainants, using their "forward pricing" analysis, find a down-the-line burden to consumers for the Shell contract of approximately $1.4 billion in nominal dollars (*i.e.*, undiscounted dollars) ($2.14 billion with interest). Using their "fundamentals-based" analysis, however, Complainants find a smaller down-the-line burden of $384.8 million in nominal dollars ($778.6 million with interest).[639] Shell, by stark contrast, finds with its CONE-based analysis a small down-the-line *benefit* to consumers for that contract of $92,539 in nominal dollars.[640] On a net present value basis, however, Shell's result finds a down-the-line *burden* on consumers of $70.9 million.[641]

321. Although Celebi's "September 2001 forward prices based" approach has surface appeal because the Supreme Court in *Morgan Stanley* focused on price levels "after elimination of the dysfunctional market,"[642] it has several drawbacks. The month of September 2001 immediately followed the end of the Crisis Period and the start of FERC-imposed price caps, two events which caused spot prices to plummet quickly. The month is also notorious, of course, for the disruptions that befell the country as a whole as a result of the tragic events of September 11, 2001, including significant economic disruptions.[643] Hence, the month of September 2001 was not a typical month by any stretch of the imagination.

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[639] *Id*. at 39:1-41:5, 76:1-10.

[640] Ex. CAL-634R at 39:1-8 (Celebi Direct); Ex. SNA-244R at 6 (Niemann Answering Errata); Ex. SNA-248 (Niemann Second Errata (CEC-Based Comparison tab).

[641] Ex. SNA-244R at 6 (Niemann Answering Errata); Ex. SNA-248 (Niemann Second Errata (CEC-Based Comparison tab).

[642] *Morgan Stanley*, 554 U.S. at 552-553 (a relevant consideration is "the disparity between the contract rate and the rates consumers would have paid (but for the contracts) further down the line, when the open market was no longer dysfunctional."); Ex. SNA-240 at 19:10-20 (Safir Answering).

[643] Judicial notice is taken of the fact that the New York Stock Exchange and the NASDAQ did not open on September 11, 2001, and remained closed until September 17, the longest closure since 1933. Upon reopening, the Dow plunged 684 points, a 7.1% decline, setting a record for the biggest loss in exchange history for one trading day. At the close of trading that Friday, the Dow lost almost 1,370 points, a loss of over 14%. *See* http://www.investopedia.com/financial-edge/0911/how-september-11-affected-the-u.s.-stock-market.aspx .

322. Celebi's forward prices based approach also overlooks a recommendation that the Supreme Court in *Morgan Stanley* urged the Commission to take into account, as follows:

> **…** the Commission may have looked simply to whether consumers' rates increased immediately upon the relevant contracts' going into effect, rather than determining whether the contracts imposed an excessive burden on consumers "down the line," relative to *the rates they could have obtained (but for the contracts) after elimination of the dysfunctional market*. For example, the Commission concluded that two of the respondents would experience "rate decreases of approximately 20 percent for retail service" during the period covered by the contracts. [citation omitted] But the baseline for that computation was the rate they were paying before the contracts went into effect. That disparity is certainly a relevant consideration; *but so is the disparity between the contract rate and the rates consumers would have paid (but for the contracts) further down the line, when the open market was no longer dysfunctional*. That disparity, past a certain point, could amount to an "excessive burden."[644]

323. Celebi's forward prices based approach certainly looks at the increase in rates "immediately upon the relevant contracts' going into effect" by comparing them to forward prices that came into being in September 2001. It does not adjust those forward prices, however, to reflect what they *could have been* "*but for the contracts*." In other words, those forward prices might have been different if the long term contracts that CDWR entered into had never been made. They might have been higher, for example, if the "new steel in the ground" that contracts like the Shell contract brought on-line had never been implemented.[645] This consideration raised by the Supreme Court favors the use of a "fundamentals-based" LRMC approach, which accounts implicitly for the Supreme Court's concern, over Celebi's forward prices based approach.[646]

324. Safir alludes to a dampening effect on spot prices that CDWR's entry into long term contracts must have had at the time, and asserts convincingly that spot prices would

[644] *Morgan Stanley*, 554 U.S. at 552-553 (emphasis added).

[645] *See*, *e.g.*, Tr. 235:22-236:9 (Nichols); Ex. SNA-244 at 33:9-34:8 (Niemann Answering) ("[B]etween May 1, 2000 (the start of the Crisis Period) and the spring of 2001 when the Coral Contract was being negotiated, no new generation had come on-line and only 1,380 MW had begun construction. But, by September 1, 2001, 7,470 MW of new generation was operating or under construction." *See* tbl.2, fig.1).

[646] Tr. 2703:11-2706:9 (Ritchie Closing Arg.).

likely have been higher if those contracts had not been made.[647] In rebuttal, Celebi only confirms Safir's point by noting that "any calming effect on the market would likely have been due to a reduction in sellers' incentives to manipulate the spot market or delay bringing new generation online."[648] Hence, measuring consumer burden by comparing long term contract prices to the forward prices of a single month fails to correct for price swings that are prompted by short-term events; comparing long term contract prices to LRMC, by contrast, avoids that problem altogether.

325. Celebi's reliance on prices that were set over a very short time period of one month, and a momentous month at that, fails to capture long term effects accurately. It is tantamount to trying to "time the market" by picking the best moment to buy electricity. No one is able to always buy low and sell high. It is, in fact, the exact opposite of a long-term contracting strategy. As the Supreme Court aptly observed in *Morgan Stanley*, "[m]arkets are not perfect, and one of the reasons that parties enter into wholesale-power contracts is precisely to hedge against the volatility that market imperfections produce. That is why one of the Commission's responses to the energy crisis was to remove regulatory barriers to long term contracts."[649]

326. Celebi's "fundamentals-based" approach[650] is consistent with the LRMC model, unlike his forward price-based approach. His fundamentals-based benchmark is made up of a near-term segment and a far-term segment.[651] The near-term segment is based upon a short-run marginal cost of procuring power, which considers the variable costs of such production and then-current (*i.e.*, 2001) economic conditions.[652] The far-term segment is based upon LRMC.[653] Celebi shows convincingly that the near-term DAYZER simulation closely follows what a LRMC analysis would show for that same period.[654]

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[647] Ex. SNA-240 at 20:15-21:3 (Safir Answering); *accord*, Staff Pre-hearing Br. at 25; *contra*, Ex. CAL-717 at 170:12-171:10 (Taylor Rebuttal); Ex. CAL-789 at 49:3-50:10 (Celebi Rebuttal).

[648] Ex. CAL-789 at 50:4-6 (Celebi Rebuttal).

[649] *Morgan Stanley*, 554 U.S. at 547.

[650] Ex. CAL-634R at 46:9-76:10 (Celebi Direct).

[651] *Id*. at 47:6-49:2.

[652] *Id*. at 49:3-12, 51:5-9.

[653] *Id*. at 63:15-18.

[654] *Id*. at 72:6-73:3 (Figure 21).

Celebi's "fundamentals-based" result showing a consumer burden of $384.8 million in nominal dollars ($778.6 million with FERC interest to May 2015) is, therefore, a reasonable measure of consumer burden on which to rely here.[655]

327. The discrepancy between Celebi's fundamentals-based approach and Niemann's approach can be reconciled in part by resolving a difference between the two concerning the application of capacity payments that CDWR made to Shell. Celebi includes them in his analyses and Niemann ignores them in his.[656] According to Niemann, these payments from CDWR to Shell under the contract totaled $75.2 million from July 2002 through December 2005.[657]

328. It is more fitting to include the capacity payments as part of the long-run analysis. They should not be dismissed as mere "sunk costs," which Niemann claims is his reason for ignoring them.[658] At the time of making the decision whether or not to enter into the contract, CDWR had not yet tendered the capacity payments to Shell. They would not be made until the middle of the term of the contract. The capacity payments were clearly bargained for by the parties to the contract as an incentive to induce Shell to construct the Wildflower peaking units, generation that CDWR desperately wanted built and Shell wanted to run profitably.

329. There is no evidence in the record that the Wildflower units would have been built or the contract would have been entered into without including capacity payments. Therefore, the capacity payments should be taken into account as a legitimate part of the long term cost of the Shell-CDWR contract. The total capacity payment represents 20 percent of the $384.8 million "fundamentals-based" burden found by Complainants, and turns Shell's $92,539 *benefit* to consumers in nominal dollars into a $75.1 million *burden.*[659]

330. The discrepancy is also reconciled in part by disregarding the alleged excess market-price value over contract-price value that Niemann claims Shell absorbed when it

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[655] *Id*. at 39:1-41:5, 76:1-10.

[656] Tr. 882:12-883:5 (Celebi Cross).

[657] Ex. SNA-244 at 54:11-12 (Niemann Answering). According to Staff's witness, Poffenberger, these payments totaled $73,390,000. Ex. S-100R at 12:12-13 (Poffenberger Answering).

[658] Ex. SNA-244 at 54:1-25 (Niemann Answering).

[659] Tr. 883:21-884:14 (Celebi Cross).

sold power to CDWR at "below-market" rates in April and May of 2001.[660] That amount, totaling $8,779,200, was made up to Shell by the deal that CDWR offered immediately prior to the signing of the contract on May 24, 2001, in which the price to be paid to Shell was increased in the first two years of the contract.[661] Shell accepted this offer.[662] Consequently, Shell is not entitled to a double-recovery by crediting the cost of alleged below-market sales against the consumer burden. Eliminating this credit further increases the consumer burden in nominal dollars, according to Niemann's methodology, to $83.9 million (*i.e.*, $75.1 million + $8.8 million = $83.9 million).

ii. Impact on a Ratepayer's Bill

331. Commission Trial Staff's analysis, which includes the capacity payments,[663] looks at the average monthly burden that each of the four classes of customers (*i.e.*, Residential, Commercial, Industrial, and Street Lighting) experienced on their monthly bills during each year of the 11-year term of the Shell contract.[664] Staff's expert, Poffenberger, points to the Shell contract's impact on average residential customer bills that were as small as one cent per month in one year, while the average industrial customer saw an impact on its bill of $1,723.92 per month in another year.[665] Shell's expert, Fulmer, boils the burden down to a single, miniscule percentage of average monthly bills for all years of the contract term in the amount of 0.49 percent, representing a cost of 57 thousandths of a cent per KWh per month ($0.00057/KWh) for the Power Charge and two cents per month for the Bond Charge.[666]

332. On the other hand, Complainants' witness, Commissioner Florio, computes the difference in the rate that Shell charged for its deliveries compared to the rate that Shell would have paid at post-Crisis forward market prices in every year of the contract term, which does not take into account the costs and quantities of all other purchases of power from all other sellers that the analyses of Shell and Staff take into account.

[660] Ex. SNA-244 at 22:11-13 (Niemann Answering).

[661] Ex. SNA-219 at 25:5-9 (Brown Answering).

[662] Ex. CAL-200 at 20:17-18 (Nichols Direct); Ex. CAL-31 (executed agreement).

[663] Ex. S-100R at 23:1-6 (Poffenberger Answering).

[664] Ex. S-100R at 23:7-14 (Poffenberger Answering); Ex. S-103R at tbls.12 & 13.

[665] Ex. S-100R at 23:7-14 (Poffenberger Answering); Ex. S-103R at tbls.12 & 13.

[666] Ex. SNA-256 at 4:22-5:2, 19:8-21:13, 14:14-15:2 (Fulmer Answering).

Commissioner Florio finds that the excesses on Shell's sales at the customer level ranged from a high of 15.40¢/KWh in October through December 2001 to a low of 0.84¢/KWh in all of 2009.[667]

333. Both Poffenberger for Staff and Fulmer for Shell calculated their customer-specific overcharges attributable to the Shell contract on the basis of the forward price-based analysis that Celebi performed for Complainants.[668] This Initial Decision, however, finds that Celebi's fundamentals-based analysis is more appropriate than his forward prices-based analysis. It yields lower overcharges for Shell than the forward price-based analysis yields. Neither Staff nor Shell present customer-specific overcharge results using that analysis. Nonetheless, it can be safely assumed that both would result in lower customer-specific overcharges if it were used instead.

334. The wide degree of variation that each party reaches in calculating an absolute value for the "excessiveness" of the "consumer burden" underscores the inappropriateness of relying on an absolute measure to assess this factor of the *Mobile-Sierra-Morgan Stanley* rule. The term "excessive burden on consumers" has never been defined precisely by the Commission, either before or since *Morgan Stanley* was decided. It is akin to the concept of "economic rent," described by economists as the return earned by a factor of production that furnishes the same amount of output no matter how high the factor's price may go.[669]

335. The term "excessive burden on consumers" begs the question, "Excessive when compared to *what*?" It makes far more sense to measure the excessiveness of a consumer burden by comparing its magnitude to something else, not just by deeming some arbitrary number to be "excessive."[670] An economist would judge consumer burden by comparing

[667] Ex. CAL-241 at 64:1-2 (tbl.5).

[668] Ex. S-100R at 21:16-20 (Poffenberger Answering); Ex. S-103R at tbl.11; SNA-256 at 19:8-17 (Fulmer Answering); Ex. SNA-260 ("Shell Invoice Data" tab).

[669] *See* Paul A. Samuelson and William D. Nordhaus, *Economics* 399-400 (12th ed. 1985).

[670] Indeed, in one of the two Supreme Court cases that spawned the *Mobile-Sierra* doctrine, the concept of "consumer burden" was cast originally in comparative, not absolute terms. The Court identified the central issue in such cases to be "whether the rate is so low as to adversely affect the public interest — as where it might impair the financial ability of the public utility to continue its service, cast upon *other* **consumers** an excessive **burden**, or be unduly discriminatory." *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 355 (1956) (emphasis added). Presumably, the windfall enjoyed by ratepayers receiving the low contract rate was to be compared to the increased "burden" that other *(continued ...)*

it to opportunity costs – that is, by comparing it to the costs of "the things that are given up by taking that particular decision rather than taking an alternative decision."[671] A comparative analysis of an electricity charge in relation to these trade-offs can be approached holistically in terms of overall social choice, or at the granular level of the comparative impact on each customer's electric bill.[672]

336. For instance, at the societal level the excess electricity cost might be compared to the equivalent opportunity cost of a social program or public works project. At the level of a customer's bill, the excess electricity charge may be compared to the equivalent opportunity cost of a charge on the bill that pays a customer's share of the cost of demand response, or for an increment to the transmission charge that pays for the construction of new power lines.[673] Either way, it is the relative merit of paying the excess electric cost compared to paying for a foregone alternative that should determine consumer burdensomeness, not the cost's sheer magnitude.

337. From this perspective, the analyses of Poffenberger and Fulmer are incomplete. Both divide Complainants' calculation of the total state-wide "consumer burden" of the Shell contract by total revenue collected from ratepayers to derive an overall average cost of the "consumer burden" to each ratepayer. Both note that it is a miniscule number in some absolute sense, and both therefore conclude that it is not *really* "burdensome" to the typical consumer after all. But neither mentions the opportunity costs of a consumer's payment of that amount in relation to payment for a socially beneficial alternative.[674]

338. The dynamic impact of the consumer burden is masked by focusing on a single number to represent the average monthly percentage burden for the entire term of the CDWR-Shell contract. A lone number hides the fact that the excessive charges were very high during the early years of the contract and lower in the later years. This

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ratepayers bore as a consequence.

[671] Paul A. Samuelson and William D. Nordhaus, *Economics* 469 (12th ed. 1985); Complainants Post-hearing Initial Br. at 72.

[672] Tr. 2600:11-23 (Poffenberger Cross).

[673] Ex. CAL-699 at 12:4-9 (Florio Rebuttal) ("Utilities recover a myriad of expenses and authorized rate base components that are required to furnish reliable electricity service and achieve California's ambitious policy mandates such as low-income customer programs, energy efficiency improvements, renewable and other preferred resource procurement mandates, and other public policy goals.").

[674] Tr. 2698:14-2699:11 (Ritchie Closing Arg.).

approach measures the height of the fulcrum without accounting for the heights of the two opposing ends of the seesaw.

339. When the Supreme Court in *Morgan Stanley* described the consumer burden "down the line,"[675] and the Commission defined this term to mean that the burden "should be measured based on the life of the contracts,"[676] they did not imply that this measure should be reduced to a single number representative of the entire time period of the contract term. To do so would run counter to the Commission's usual preference for taking inter-generational inequities into consideration, which a single number like this one cannot adequately capture.[677]

340. Commissioner Florio's analysis shows that the rates that consumers paid for power delivered under the Shell contract in early years of 2001-2003 were four to six times higher than what competitive rates would have been once the market dysfunction ended.[678] Four- to six-fold increases in electricity costs cannot be absorbed without severe economic dislocation. The degree of these dislocations is captured in Commissioner Florio's testimony recounting the hardships that residential and business electricity consumers endured during this period and afterward.[679]

341. For instance, the substantial impact that Poffenberger's analysis shows on industrial customers suggests that there was a major impact on California's

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[675] *Morgan Stanley*, 554 U.S. at 552.

[676] *CPUC v. Sellers*, 149 FERC ¶ 61,127, at P 20 (2014) (Order on Remand).

[677] *See*, *e.g.*, *ISO New England Inc., et al.*, 153 FERC ¶ 61,343, at P 8 n.19 (2015) ("PBOP accounts are typically amounts that are amortized over a set period of time much like depreciation or decommissioning expenses. A modification in the amortization without Commission scrutiny can result in over-recovery or intergenerational inequities."); *see also* Ex. CAL-241 at 59:1-7 (Florio Direct) ("Moreover, the fact that ratepayers are still paying today for power delivered under the Long-Term Contracts in 2001 – 2002, including the Shell and Iberdrola Contracts, is astounding. The bonds did not finance anything that provided a lasting benefit. Consumers who are paying back principle plus interest today for electricity consumed way back in 2001- 2002 may not have even lived in California at the time. This is fundamentally unfair to those consumers.").

[678] Ex. CAL-241 at 65:1-4 (Florio Direct).

[679] Ex. CAL-241 at 47:1-56:13 (Florio Direct); Exs. CAL-262 through CAL-265.

manufacturing base that threatened its competitiveness.[680] Commissioner Florio recounted several examples of hardship in the industrial and agricultural sectors, such as the "Shasta Paper Company, which laid off 400 workers on August 20, 2001 … [folding] after its monthly Pacific Gas and Electric Co. bill jumped to about $1.3 million, a $500,000 increase …."[681]

342. Hence, the analyses of Poffenberger and Fulmer are inadequate because they do not take opportunity costs and socio-economic impacts into account. Of course, since Respondents and Staff do not carry the burden of proof, they do not have to take these things into account. Complainants do bear that burden, and they have met that burden by identifying several socio-economic trade-offs that the State has been forced to make because of the excessive consumer burden of the Shell contract.[682]

343. Commissioner Florio describes one:

> One important use of funds collected through electric rates is California's Public Purpose Programs. These public purpose programs fund low income ratepayer assistance programs, energy efficiency programs and other programs that support California's energy goals. [citation omitted] The average annual revenue requirement for public purpose programs from 2008-2012 was just over $1 billion. [citation omitted]. California ratepayers could have funded almost two additional years of these programs if they had not instead carried the burden of the $1.97 billion in total nominal overcharges from late 2001 through the end of the Shell Contract in 2012.[683]

344. The point that Commissioner Florio makes for the opportunity cost of a consumer burden of over $1 billion is equally true at the lesser levels of consumer burden that Celebi's fundamentals-based analysis and the analyses of the other parties in this case make, regardless of whether they are computed holistically for all of society, or computed granularly at the level of each customer's bill. Charging consumers small amounts per kilowatt-hour is a powerful means of raising revenue for socially beneficial causes.[684]

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[680] Ex. S-100R at 19:10-15, 22:4-14 (Poffenberger Answering); Ex. S-103R, tbls 9, 10, 12, & 13 (Poffenberger Answering).

[681] Ex. CAL-241 at 54:8-56:13 (Florio Direct).

[682] Ex. CAL-699 at 16:2-12 (Florio Rebuttal).

[683] *Id*.

[684] Tr. 2601:3-7 (Poffenberger).

Hence, the effectiveness of charging electricity consumers, on average, an extra ten cents per month as Poffenberger measures the excess cost of the Shell contract over its entire term, [685] or an extra 57 thousandths of a cent per kilowatt-hour as Fulmer measures the excess cost of the Shell contract over its entire term, [686] can collectively raise enormous sums for any cause.

345. Another way to look at consumer burden is from the standpoint of a long-term investment. When one makes a long-term investment, one expects a reasonable rate of return on that investment. For example, an investment in building a new power plant will result in the completion of a facility that generates electricity in the future and makes money for its owners at a rate of return in excess of the next best alternative for investing the money.

346. Along these lines, Fulmer compares the rate impact of the Shell's alleged overcharge to the impact of other power purchase agreements entered into by PG&E and approved by the CPUC. In particular, he examines two instances in 2014 in which PG&E purchased power with rate impacts greater than the Shell contract: (i) the sale by Genesis Solar to PG&E of 592,638 MWhs at an average energy price of $216 per MWh, and (ii) the sale by Topaz Solar Farms to PG&E of 1.05 million MWhs at an average energy price of $170 per MWh.[687] These contracts were entered into pursuant to the statutorily-mandated Renewable Portfolio Standards (RPS) that require IOUs to procure a certain percentage of retail electricity sales from qualified renewable resources.[688]

347. Fulmer found that the excess cost of the Genesis Solar deliveries constituted sixty-six hundredths of one percent (0.66%) of PG&E's rates while the excess cost of the Topaz Solar Farm deliveries constituted seventy-eight hundredths of one percent (0.78%) of PG&E's rates. Both of these values, he asserts, are greater than the average alleged overcharge associated with the Shell contract.[689]

348. If anything, Fulmer's examination of these two renewable energy contracts underscores the excessiveness of the Shell contract overcharge compared to paying off a long-term investment. These two contracts build PG&E's portfolio of renewable energy

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[685] Ex. S-100R at 22:4-14 (Poffenberger Answering); Ex. S-103R, tbls.12 & 13.

[686] Ex. SNA-256 at 4:22-5:2, 19:8-21:13 (Fulmer Answering); Ex. SNA-260.

[687] Ex. SNA-256 at 23:5-12 (Fulmer Answering).

[688] Ex. CAL-699 at 28:18-29:2 (Florio Rebuttal).

[689] Ex. SNA-256 at 24:12-19 (Fulmer Answering).

resources for future use. By contrast, the excess burden that consumers pay for the Shell contract is only economic rent; it builds nothing for future use and profit.[690] It only pays off the debt for an unlawful overcharge for one year of electric consumption long ago that should not have been owed. Excusing the overcharge simply because it is smaller than some current investment in future infrastructure does not excuse the fact that it was a waste of resources in the first place.

349. Upon rehearing of Opinion No. 537 in the *Puget Sound Energy* case, the Commission noted that each California resident was paying $0.27 per month for the Respondents' aggregate overcharges to CDWR that were alleged in that case.[691] This amount, the Commission found, was "not of an excessive burden sufficient to overcome the *Mobile-Sierra* presumption."[692] The impacts on customer bills found by the experts in this case, by comparison, range enormously. In comparison to Staff witness Poffenberger's analysis of monthly bills, the impact here is as little as 3.7% of the *Puget Sound Energy* monthly burden for residential customers, but as much as 638,488% of that amount for industrial customers.[693]

350. It defies economic sense to rely on arbitrary absolutes as unchanging borderlines of "consumer burdensomeness" instead of comparing the burden to foregone opportunity costs. "Consumer burden" is a relative quality, not a red line. A comparative analysis is usually preferred by the Commission and the courts over an absolute boundary when analyzing cost impacts.[694] The Commission has recognized opportunity costs as a

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[690] Ex. CAL-699 at 5:13-18 (Florio Rebuttal) ("In my view, the appropriate measure of consumer burden is best captured by the excessive rates paid under the Shell and Iberdrola Contracts themselves, which add up to over $1.97 billion in nominal payments over the contracts' terms, and over $3 billion including interest. Consumers paid these excessive rates to Shell and Iberdrola but received absolutely no commensurate value for the extra payments.").

[691] *Puget Sound Energy v. All Jurisd. Sellers*, 153 FERC ¶ 61,386, at P 122 (2015).

[692] *Id.*

[693] Ex. S-100R at 23:7-14 (Poffenberger Answering); Ex. S-103R at tbls.12 & 13.

[694] *See*, *e.g.*, *FERC v. Elect. Power Supply Ass'n*, __U.S.__, 136 S.Ct. 760, 782-783 (2016) (Approving use of "net benefits test" in evaluating demand response bids); *Ill. Commerce Comm'n v. FERC*, 756 F.3d 556, 564 (7th Cir. 2014) ("If [FERC] continues to argue that a cost-benefit analysis of the new transmission facilities is infeasible, it must explain why that is so and what the alternatives are."); *ISO New England Inc.*, 150 FERC ¶ 61,209, at P 387 (2015) (FERC approves transmission upgrade cost allocations to states "whose customers consume more electric energy at *(continued ...)*

legitimate factor in designing rates in proceedings under section 4 of the Natural Gas Act.[695]

351. It would be unfaithful to the public interest against price manipulation to excuse the defrauding of millions of people simply by saying that the perpetrator stole only a few cents from everybody. Like the harrowing tones of Ludwig von Beethoven's "Rage Over a Lost Penny,"[696] public anger about an unfair charge of even a small amount on an electric bill is no less intensely felt.[697] The public interest is not satisfied by diluting the consumer burden over an immense number of customers. "Under this perverse theory,"

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peak times … than those that consume less. We find that such a cost allocation mechanism is 'roughly commensurate' with the benefits derived from such facilities and consistent with the cost causation principle."); *Pub. Serv. Co. of New Mexico*, 151 FERC ¶ 61,189, at PP 17-19 (2015) (CAISO inter-regional transmission project costs to be allocated among regions in compliance with FERC Order 1000 by method that compares avoided net "cost of the regional transmission solution minus net economic benefits" with "the regional economic benefits of the interregional transmission solution."); *PJM Interconnection, L.L.C.*, 123 FERC ¶ 61,051, at P 29 (2008) (PJM's regional economic transmission planning process, having a "formulaic approach to choosing economic projects that weighs costs and benefits through a specific set of metrics … provides clarity to PJM's approach to economic proposals, and therefore, will give potential investors additional certainty.").

[695] *See El Paso Natural Gas Co.*, 139 FERC ¶ 61,096 (2012); *Columbia Gas Transmission Corp*., 124 FERC ¶ 61,122 (2008); *Columbia Gulf Transmission Co*., 119 FERC ¶ 61,128, at P 29 (2007), *order on reh'g*, 124 FERC ¶ 61,121, at P 6 (2008); *Natural Gas Pipeline of Am*., 103 FERC ¶ 61,174, at P 63 (2003); *but see Transcontinental Gas Pipe Line Corp*., 154 FERC ¶ 61,211, at PP 106 and 108 (2016) (rejecting opportunity cost theory, but distinguishing prior cited cases on the facts of the case then before the Commission).

[696] L. von Beethoven, *Rondo alla ingharese quasi un capriccio* in G major, Op. 129, *available at* http://www.beethoven-haus-bonn.de/sixcms/detail.php?id=15248&template=werkseite_digitales_archiv_en&_eid=1510&_ug=Pieces%20for%20two%20hands&_werkid=131&_mid=Works%20by%20Ludwig%20van%20Beethoven&suchparameter=&_seite=1.

[697] *See*, *e.g.*, Tr. 967:9-968:3 (Berck Cross) ("Q: But you think that's a fair characterization of how you view burdens? You get riled up even for a silly 50 cents if you thought there were no value associated with the charge? A: People are—I, [in] particular, am much more sensitive to having money taken for which I did not receive value. Q: No one likes to be ripped off; right? A: I would hope that is true.").

Complainants aptly point out, "the greater the number of consumers harmed, the more difficult the contract is to challenge."[698] If it were the law, then the *Mobile-Sierra-Morgan Stanley* Rule would immunize all contracts against abrogation, not weigh their relative worth against the public interest. As expressed in the colorful words of Complainants' witness, Commissioner Florio:

> "[P]eanut buttering" the $1.97 billion (nominal) in excessive payments out over two billion MWh of electricity sold by the three IOUs from October, 2001 through 2012 is not an appropriate measure of consumer harm, because it makes the determination of whether an excessive customer burden was imposed turn on how many customers were harmed.… This view loses sight of the trees, just because the forest is lush.[699]

352. The California Energy Crisis generated huge public outrage. Commissioner Florio's testimony reveals many instances of hardship that citizens endured and wrote to the CPUC about because of high electric bills and rolling blackouts—the inability of people on fixed incomes to buy necessities because they must pay electric bills that increased by $100 a month,[700] the disruption of normal routines in order to conserve electricity,[701] the need to reduce home heating to minimal levels during cold winters in order to reduce the bill,[702] the fear of losing one's home,[703] the increased cost of operating medical equipment.[704] Businesses suffered as well, threatening to abort an economic revival in California that had just gotten started.[705]

353. The Commission has an affirmative duty to vindicate the public interest. "[B]oth the courts and the Commission have concluded previously that protecting consumers is

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[698] Complainants Post-hearing Initial Br. at 77.

[699] Ex. CAL-699 at 6:11-16, 7:13-14 (Florio Rebuttal).

[700] Ex. CAL-241 at 47:13-48:18 (Florio Direct).

[701] Ex. CAL-241 at 50:20-36.

[702] *Id*. at 51:18-23.

[703] *Id*. at 51:24-52:4.

[704] *Id*. at 52:24-53:2.

[705] *Id*. at 54:8-56:13.

one of the Commission's primary responsibilities."[706] Recently, the Supreme Court reiterated that the FPA's "core objects" are "to protect against excessive prices and ensure effective transmission of electric power."[707]

354. The purpose behind analyzing consumer burden is not to "reinstitut[e] cost-based rather than contract based regulation,"[708] which the Supreme Court in *Morgan Stanley* urged the Commission to avoid. Rather, the analyses quantify the degree of "public interest" that inures to the contract at issue, an otherwise intangible characteristic that is the touchstone of the *Mobile-Sierra* doctrine. None of the analyses compute precisely what a "just and reasonable" contract rate would have been for the contracts at issue, in the absence of the *Mobile-Sierra Morgan Stanley* presumption.

355. Although the analyses reach results that differ quantitatively from one another, the fact remains that both Complainants' and Shell's fundamentals-based analyses, after capacity payments are properly taken into account, demonstrate in qualitative terms that the Shell contract was an excessive net burden on consumers.

c. <u>Conclusion on the Shell Contract's "Down the Line" Burden</u>

356. Accordingly, Complainants have carried their burden of proving, by a preponderance of the evidence, that the Shell contract imposed an excessive burden on consumers "down the line" in the nominal-dollar amount of $384.8 million ($779 million when FERC interest to May 2015 is included, plus additional FERC interest from May 2015 to date).[709]

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[706] *American Electric Power Service Corp.*, 153 FERC ¶ 61,167, at P 17 (2015) (*citing FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944) ("The primary aim of [the NGA] was to protect consumers against exploitation at the hands of natural gas companies"); *accord Pa. Water & Power Co. v. FPC*, 343 U.S. 414, 418 (1952) (purpose of the FPA is "to protect consumers against excessive prices"); *see also Md. People's Counsel v. FERC*, 761 F.2d at 781 (concluding that the Commission "has not adequately attended to the agency's primary constituency – the consumers"); *Pub. Sys. v. FERC*, 606 F.2d 973, 979 n.27 (D.C. Cir. 1979) ("[T]he Federal Power Act aim[s] to protect consumers from exorbitant prices and unfair business practices.").

[707] *FERC v. Elec. Power Supply Ass'n*, __ U.S. __, 136 S.Ct. 760, 781 (2016).

[708] *Morgan Stanley*, 554 U.S. at 550.

[709] Ex. CAL-634R at 76:1-6 and tbl.8 (Celebi Direct).

2. Iberdrola Contract

a. The Parties' Analyses

i. Complainants' Analysis

357. As with the Shell contract, Complainants' economics experts, Celebi and Berck, analyze the down-the-line economic burden on California consumers caused by the Iberdrola contract.[710] Celebi conducts the same three analyses for the Iberdrola contract that were performed for the Shell contract. [711] Berck applies his EDRAM model to determine the impact on California's real state personal income and employment of Celebi's computation of the Iberdrola contract's down-the-line economic burden.[712]

358. Regarding Celebi's first analysis, he finds that the Iberdrola contract, like the Shell contract, was "very highly priced as compared to long-term contracts executed in the September 2001-December 2002 period."[713] However, as in the case of the Shell contract, Celebi does not attempt to determine a cost of substitute power based on these other post-Crisis contracts.[714]

359. For his second analysis, Celebi compares the difference between the total payment to Iberdrola over the entire contract term and the total payment under his post-Crisis compilation of forward market prices for the same volumes. [715] This amount, in nominal dollars, comes to approximately $601 million (*i.e.*, $1.085 billion in actual payments to Iberdrola - $485 million in forwards-based payments = $601 million).[716] With FERC quarterly interest rates applied through May 2015, the amount comes to $875 million.[717]

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[710] Ex. CAL-634R (Celebi Direct); Ex. CAL-666 (Berck Direct).

[711] Ex. CAL-634R at 3:13-5:18 (Celebi Direct).

[712] Ex. CAL-666 (Berck Direct).

[713] *Id*. at 24:4-11.

[714] *Id*. at 24:9-11.

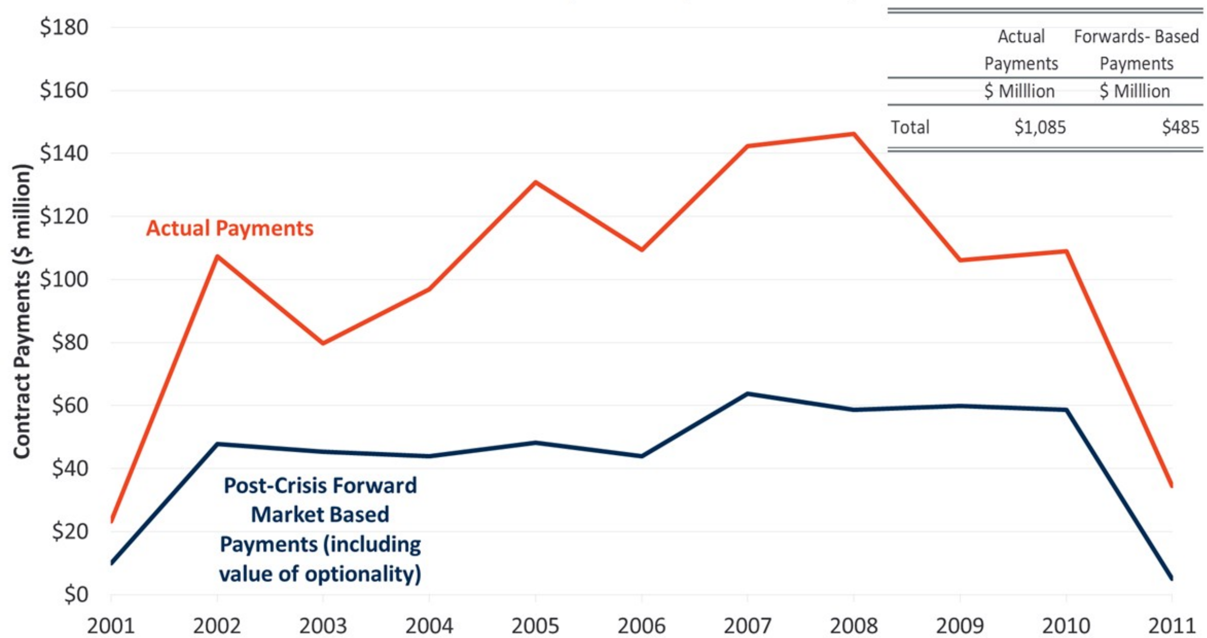
[715] *Id*. at 24:11-15, 25:1-36:2.

[716] Ex. CAL-634R at 39:9-11 (Celebi Direct); Ex. CAL-668 (Iberdrola tab).

[717] Ex. CAL-634R at 41:1-5 (Celebi Direct); Ex. CAL-668 (Iberdrola tab).

Celebi's down-the-line difference between actual payments to Iberdrola and post-Crisis forward market-based payments is depicted in the following figure:[718]

Actual Iberdrola Contract Payments vs. Post-Crisis Forward Market-Based Payments (Nominal $s)



360. For his third analysis, Celebi finds that Iberdrola's contract prices exceeded fundamentals-based prices in all years except 2001 and 2011.[719] He estimates the consumer burden represented by the difference between projected payments under the Iberdrola contract and projected payments under fundamentals-based prices to be $258.7 million ($371 million, including FERC interest to May 2015).[720]

361. Commissioner Florio's table, the Iberdrola part of which is shown here, indicates how much in cents per kilowatt-hour California customers paid to Iberdrola during each year of its contract term in excess of the rates that they would have paid for the same deliveries at post-Crisis prices:[721]

Excess Consumer Rates -- Difference Between Actual CDWR-Iberdrola

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[718] Ex. CAL-634R at 40 (fig.13) (Celebi Direct).

[719] *Id*. at 74:4-75 (fig.23).

[720] *Id*. at 77:1-5 & tbl.9.

[721] Ex. CAL-241 at 63:6-65:7 & tbl.5 (Florio Direct).

Contract Prices and Post-Crisis Forward Market Prices

Year	Iberdrola Contract		
	actual rate (¢/kWh)	post-crisis rate (¢/kWh)	**excess rate (¢/kWh)**
2001 (Oct-Dec)	7.00	2.98	**4.02**
2002	7.00	3.12	**3.88**
2003	7.73	3.89	**3.85**
2004	9.64	3.84	**5.81**
2005	11.79	3.86	**7.92**
2006	11.35	4.00	**7.36**
2007	9.77	4.01	**5.75**
2008	11.25	4.10	**7.15**
2009	8.42	4.32	**4.09**
2010	8.69	4.25	**4.44**
2011	57.05	3.97	**53.08**
2012			

362. Finally, Berck applies his EDRAM model to Celebi's September 2001 forwards market-based overcharge attributable to the Iberdrola contract of $601 million, as adjusted to its 2001 net present value (NPV) of $500 million.[722] Berck then calculates that this overcharge reduced the present value of California's real state personal income by $1.4 billion and cost the state approximately 1,400 jobs.[723]

ii. Iberdrola's Analysis

363. Iberdrola offers the testimony of A. Joseph Cavicchi, an economist, to respond to Celebi's analysis on behalf of Complainants that the Iberdrola contract with CDWR imposed an excessive burden on California consumers.[724] Iberdrola also offers the testimony of William A. Monsen, an energy consultant, to address the Iberdrola contract's impact on consumer electric rates.[725]

[722] Ex. CAL-666 at 3:6-4:9, 5:16-18, 5:19-6:2 (Berck Direct); Ex. CAL-669 (Summary tab).

[723] Ex. CAL-666 at 7:4-8 (Berck Direct); Ex. CAL-669 (Summary tab).

[724] Ex. IB-222 (Cavicchi Answering).

[725] Ex. IB-246 (Monsen Answering).

364. According to Cavicchi, Celebi's analysis makes the unremarkable observation that once supply and demand fundamentals had reversed themselves, CDWR may have been able to secure a lower-cost contract when compared to the Iberdrola contract's total, "all-in" costs.[726] That CDWR's placement of 12,800 MW of power under long term contract turned a situation of shortage into one of surplus is no surprise, Cavicchi asserts.[727] It is to be expected that new capacity and conservation efforts at the end of the Crisis drove power prices down and alleviated expectations of future shortages, Cavicchi says.[728] Long term contracts like Iberdrola's made that possible, he claims.[729]

365. According to Cavicchi, Celebi's forward price based benchmark is not high enough to support new generation additions over the term of the Iberdrola contract.[730] He points out that power plant costs rose considerably over the term of the Iberdrola contract and the CPUC has subsequently approved new IOU ratepayer-backed capacity additions at much higher prices for new plant additions "down the line." Hence, Cavicchi states, Celebi's analysis is inconsistent with actual capacity prices experienced over the term of the Iberdrola contract.[731]

366. Cavicchi criticizes Celebi for combining capacity and energy costs incurred by CDWR under the Iberdrola contract instead of analyzing capacity costs alone.[732] The Iberdrola contract "tolled" to CDWR the low-cost power supply generated by the Klamath Cogeneration Project whenever CDWR requested dispatch, in return for a monthly capacity charge.[733] CDWR, therefore, could call on the plant whenever its power supply was economically attractive compared to other sources of supply, saving CDWR higher alternative energy costs.[734] As a "tolling agreement," Iberdrola argues, the

[726] Ex. IB-222 at 23:18-20 (Cavicchi Answering).

[727] *Id*. at 23:20-22.

[728] *Id*. at 24:11-12.

[729] *Id*. at 24:13-16.

[730] *Id*. at 25:3-5.

[731] *Id*. at 25:8-12, 40:21-41:5.

[732] *Id*. at 27:1-3.

[733] *Id*. at 28:7-8.

[734] *Id*. at 28:9-13.

capacity charges of the Iberdrola contract cannot be compared to the energy cost of Celebi's forward price-based benchmark.[735]

367. Cavicchi compares the Iberdrola contract to similar long-term tolling contracts with developers of new combined-cycle generation capacity that SCE executed after the Energy Crisis passed.[736] Cavicchi states that these contracts were similarly priced and contained comparable features to the Iberdrola contract.[737] The capacity pricing in these contracts was very close together at $13.89/kW-month and $15.41/kW-month, whereas the Iberdrola capacity price fell in the middle of them at $14.23/kW-month.[738] These contracts were unaffected by spot market dysfunction and represented "possibly the best indication of a reasonable price for combined-cycle capacity just after the Energy Crisis was alleviated," Cavicchi asserts.[739]

368. Monsen adds to Iberdrola's analysis that the impact of the Iberdrola contract on ratepayers was very small.[740] The "gross impact" on average ratepayers of each IOU – that is, the impact of all costs associated with the Iberdrola contract without offsetting any costs related to power purchases that the IOUs would have had to make if not for the Iberdrola contract – ranged as follows during the years that the Iberdrola contract was in place:[741]

[735] Ex. IB-222 at 5:4-9, 24:6-9 (Cavicchi Answering); Iberdrola Post-hearing Initial Br. at 45-48; Iberdrola Post-hearing Reply Br. at 23-25.

[736] Ex. IB-222 at 32:5-12 (Cavicchi Answering); Ex. IB-233.

[737] Ex. IB-222 at 32:12-14 (Cavicchi Answering); Ex. IB-233.

[738] Ex. IB-222 at 32:17-33:2 (Cavicchi Answering); Ex. IB-233.

[739] Ex. IB-222 at 34:18-21 (Cavicchi Answering); Ex. IB-233.

[740] Ex. IB-246 at 4:1-4 (Monsen Answering).

[741] *Id*. at 35:4-10, tbl.11.

Iberdrola Impact on Average Rates by IOU ($/MWh)

	PG&E	SCE	SDG&E
2001	0.21	0.24	0.23
2002	0.58	0.64	0.62
2003	0.71	0.23	0.22
2004	0.84	0.28	0.27
2005	1.18	0.33	0.32
2006	0.89	0.32	0.31
2007	1.23	0.34	0.32
2008	1.26	0.33	0.31
2009	0.82	0.35	0.32
2010	0.86	0.36	0.34
2011	0.19	0.18	0.17

369. The "net impact" on average ratepayers – that is, the impact of all costs associated with the Iberdrola contract offset by the value of energy and capacity estimated by Celebi – ranged as follows for the same years:[742]

Iberdrola Unavoidable Net Market Rate Impact by IOU ($/MWh)

	PG&E	SCE	SDG&E
2001	0.07	0.08	0.08
2002	0.32	0.36	0.35
2003	0.07	0.08	0.08
2004	0.09	0.10	0.09
2005	0.10	0.11	0.10
2006	0.09	0.10	0.09
2007	0.09	0.10	0.10
2008	0.08	0.09	0.09
2009	0.08	0.09	0.08
2010	0.08	0.09	0.08
2011	0.04	0.04	0.04

370. Hence, according to Monsen, net rate impacts for all but one year of the Iberdrola contract ranged from $0.04—$0.11 per MWh, or no more than 0.3% of the average rates for residential, commercial and industrial customers of PG&E, SCE and SDG&E.[743]

iii. Staff's Analysis

371. As with the Shell contract, Commission Trial Staff's expert witness, Poffenberger, offers Staff's down-the-line consumer burden analysis of the Iberdrola contract.[744]

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[742] *Id.* at 41:5-11, tbl.16.

[743] *Id.* at 4:4-6.

372. Using the same analysis that he performed on the Shell contract, Poffenberger finds that the Iberdrola contract reflected a burden on the average monthly bill for residential customers of a low of $0.06/month in 2011 to a high of $0.71/month in 2002 (0.071 to 1.483 percent); for commercial customers, a low of $0.45/month in 2011 to a high of $6.52/month in 2008 (0.079 to 1.469 percent); for industrial customers, a low of $4.01/month in 2011 to a high of $1247.07/month in 2008 (0.097 to 1.803 percent); and for street and highway lighting, a low of $0.21/month in 2011 to a high of $3.21/month in 2002 (0.076 to 0.801 percent).[745]

373. Regarding the impact on monthly bills of excess revenues that Iberdrola received over Celebi's forward market price-based revenue, Poffenberger finds as follows: for residential customers, a low of $0.06/month in 2011 to a high of $0.55/month in 2005 (0.07 to 1.06 percent); for commercial customers, a low of $0.44/month in 2011 to a high of $4.37/month in 2005 (0.08 to 1.13 percent); for industrial customers, a low of $3.99/month in 2011 to a high of $448.28/month in 2005 (0.10 to 1.68 percent); and for street and highway lighting, a low of $0.18/month in 2011 to a high of $2.23/month in 2005 (0.08 to 0.49 percent).[746]

374. Finally, Poffenberger's LRMC-based analysis using the levelized cost of building a conventional combined cycle generating unit shows that the amounts CDWR paid to Iberdrola over the life of the long term contract were less than what would have been paid over the same period based on that cost.[747]

375. Based on Poffenberger's analysis, Staff finds that the Iberdrola contract did not result in an excessive burden on consumers down-the-line.[748]

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[744] Ex. S-100R (Poffenberger Answering).

[745] Ex. S-100R at 19:16-20:7 (Poffenberger Answering); Ex. S-103R, tbls.19 & 20.

[746] Ex. S-100R at 23:15-24:2 (Poffenberger Answering); Ex. S-103R, tbls. 22 & 23.

[747] Ex. S-100R at 26:1-3 (Poffenberger Answering).

[748] *Id*. at 24:14-25:2.

b. The Iberdrola Contract's "Down the Line" Burden on Consumers

i. Comparison of the Cost of Substitute Power

376. Like his analysis of the consumer burden of the Shell contract, Celebi's analysis of the consumer burden of the Iberdrola contract reaches the same conclusion, only on a smaller scale. As with his analysis of the Shell contract, Celebi's "fundamentals-based" analysis is a persuasive measure of consumer burden from a qualitative standpoint, regardless of the quantitative result.

377. Complainants and Iberdrola disagree vigorously on whether the Iberdrola contract is a "tolling agreement," which is based mainly on capacity charges rather than energy charges.[749] Even assuming that the Iberdrola contract is indeed a "tolling agreement," however, the Commission measures consumer burden on the basis of the difference between "what *consumers' rates* were" and "what *consumers' rates* would have been down the line in the absence of the contract."[750] Necessarily, consumers' rates are based on the "all-in" costs of electricity, which include both energy *and* capacity costs. Moreover, Celebi's fundamentals-based analysis, which is based closely on LRMC, takes into account the long run fixed costs that are recovered by capacity charges; hence, Celebi's analysis that includes the capacity costs of the Iberdrola tolling contract is appropriate.

378. Iberdrola's expert, Cavicchi, criticizes Celebi's forward prices-based analysis in other respects, for reasons similar to what has already been discussed in connection with the Shell contract. It is unnecessary to address these criticisms, however, because Celebi's fundamentals-based analysis, not his forward prices-based analysis, forms the basis for this conclusion that the Iberdrola contract imposes an excessive burden on consumers.

ii. Impact on a Ratepayer's Bill

379. As with Shell, Poffenberger for Staff calculated his customer-specific overcharge attributable to the Iberdrola contract on the basis of the forward price-based analysis that

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[749] Iberdrola Post-hearing Initial Br. at 45-48; Iberdrola Post-hearing Reply Br. at 23-25; Complainants Post-hearing Initial Br. at 68-69; Complainants Post-hearing Reply Br. at 39-40.

[750] *CPUC v. Sellers of Long-Term Contracts*, 149 FERC ¶ 61,127, at P 22 (2014) (emphasis added).

Celebi performed for Complainants.[751] Monsen for Iberdrola performed a somewhat different analysis of the overcharge based on Celebi's estimates of spot market prices in 2001 and 2002 rather than forward prices, and also used Celebi's estimates of capacity charges in the marketplace.[752] This Initial Decision, however, finds that Celebi's fundamentals-based analysis is more appropriate than the forward prices-based analysis. It yields lower overcharges for Shell and Iberdrola than the forward-price based analysis yields. Neither Staff nor Iberdrola present customer-specific overcharge results using that analysis. It is assumed that both would yield similar results to one another.

380. The point made by Monsen and Poffenberger about the small impact of the Iberdrola contract on consumer bills is inadequate and incomplete, as explained above in connection with the Shell contract. An $875 million net consumer burden does not disappear simply because it is diluted across the bills of millions of ratepayers. It must be compared to the trade-off of alternative uses for the funds that could have served the public interest if they had been available, and the socio-economic impacts that the State experienced. As with the Shell contract, the benefit that could have inured to the public, which was instead wasted on overpayments to Iberdrola for electricity, is amply demonstrated.

c. Conclusion on the Iberdrola Contract's "Down the Line" Burden

381. Accordingly, Complainants have carried their burden of proving, by a preponderance of the evidence, that the Iberdrola contract imposed an excessive burden on consumers "down the line" in the nominal-dollar amount of $258.7 million ($371 million when FERC interest to May 2015 is included, plus additional FERC interest from May 2015 to date).[753]

3. Other Serious Harm to the Public Interest

382. The parties raise no other public interest considerations that affect the *Mobile-Sierra Morgan Stanley* Rule in this case. Two points, however, warrant mention at this juncture.

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[751] Ex. S-100R at 21:4-13 (Poffenberger Answering); Ex. S-103R at tbl.21.

[752] Ex. IB-246 at 30:15-31:13 (Monsen Answering).

[753] Ex. CAL-634R at 77:1-5 and tbl.9 (Celebi Direct).

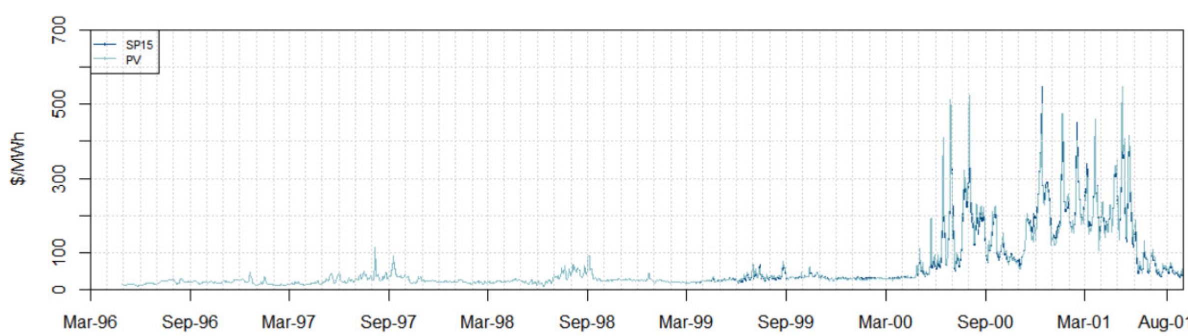
a. **<u>"Extraordinary Circumstances"</u>**

383. The Supreme Court made clear that avoiding or overcoming the *Mobile-Sierra-Morgan Stanley* Rule occurs only in "extraordinary circumstances" involving "unequivocal public necessity" where the contract "seriously harms" the public interest or imposes "an excessive burden on consumers."[754] Remarkably, it is an undisputed fact among all parties that "[t]he Crisis was *unprecedented* in the modern history of the U.S. electric industry in terms of its severity, duration, and consumer impacts."[755] This finding of fact alone suffices to dispose of the *Mobile-Sierra-Morgan Stanley* presumption in its entirety in this case.

384. It must be borne in mind that the *Mobile-Sierra-Morgan Stanley* Rule does not focus alone on the *magnitude* of harm to consumers. It focuses on the *uniqueness* of the harm; on the fact that it is something that has rarely – or never – happened before.

385. The Western Energy Crisis easily fits the description of an unparalleled historical event. A mere glance at the following figure presented in Goldberg's testimony proves the point:[756]

PV and SP-15 Spot Prices from May 1996 through August 2001



Source: Power Markets Week WSCC Spot Price Indices.

[754] *Morgan Stanley*, 554 U.S. at 550.

[755] *See* FF 15 (emphasis added); Complainants Post-hearing Initial Br., App. I at PFF49; Shell Post-hearing Reply Br., App. B at Rebuttal to Complainants' PFF49; Iberdrola Post-hearing Reply Br., Rebuttal to Complainants' PFF49. Staff did not respond to Complainants' PFF49, which constitutes an admission. *See Revised Order Adopting Rules for the Conduct of the Hearing*, at P 23 (October 22, 2015) ("Proposed findings of fact and conclusions of law not objected to or specifically rebutted shall be deemed to have been admitted.").

[756] Ex. CAL-604 at 18 (fig.2) (Goldberg Direct).

386. As the figure shows, spot prices in California exceeded $100/MWh only once prior to May 2000, in August of 1997.[757] After the Crisis, the market settled down to its longstanding norm. The Crisis period was unusual even for California, a state that is famously prone to human and natural disasters of every kind—droughts, wildfires, mudslides, earthquakes, floods, economic dislocations, riots, and, of course, traffic jams. None of those disasters ever had the impact on historical energy prices that the manipulative actions of a few energy traders had during the Crisis. As all parties indisputably admit, the sheer uniqueness of the Crisis in history is enough of an "extraordinary circumstance" to warrant the "unequivocal public necessity" of overcoming the *Mobile-Sierra-Morgan Stanley* presumption and scrutinizing the long term contracts made during that period for justness and reasonableness.

b. The Public Interest

387. Finally, *Morgan Stanley* makes a point about what is in the public interest to do in this case. The late Justice Antonin Scalia, writing for the majority, said:

> Markets are not perfect, and one of the reasons that parties enter into wholesale-power contracts is precisely to hedge against the volatility that market imperfections produce. That is why one of the Commission's responses to the energy crisis was to remove regulatory barriers to long term contracts. It would be a perverse rule that rendered contracts less likely to be enforced when there is volatility in the market. … By enabling sophisticated parties who weathered market turmoil by entering long-term contracts to renounce those contracts once the storm has passed, the Ninth Circuit's holding would reduce the incentive to conclude such contracts in the future. Such a rule has no support in our case law and plainly undermines the role of contracts in the FPA's statutory scheme.[758]

388. This encapsulation of the purpose behind the *Mobile-Sierra-Morgan Stanley* doctrine must be kept in mind when determining the fate of these contracts. The State of California's sense of "buyer's remorse,"[759] which set in only seven months after these contracts were signed, must be soberly weighed against the enforceable bond that they represent. Indeed, it is notable that the Shell contract contains a clause that prohibits either contracting party from "exercis[ing] any of its respective rights under Section 205

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[757] *Id*. at 17:4-5.

[758] *Morgan Stanley*, 554 U.S. at 547 (emphasis in original).

[759] *Id*. at 541 ("After the crisis had passed, buyer's remorse set in and [the California Parties] asked FERC to modify the contracts.").

or Section 206 of the Federal Power Act to challenge or seek to modify any of the rates or other terms and conditions of this Agreement," an obvious reason why only state agencies, not contracting-party CDWR itself, are the Complainants in this proceeding.[760] Clearly, the State has taken action here in response to intense public outrage.

389. It is that public outrage, however, that the FPA empowers the Commission to embody in formulating a just remedy for the extraordinary circumstances presented here. The public outrage is precisely why the contracts at issue are not entitled to the *Mobile-Sierra-Morgan Stanley* presumption of justness and reasonableness. As much as the facts show that both CDWR and Shell had at their command armies of advisors and consultants to assist them in arranging these long term contracts, it would be too kind to call either of them "sophisticated parties who weathered market turmoil," to use the late Justice Scalia's words. Neither the State nor the Respondents come to this forum with clean hands. They may have had a lot of sophisticated advice and counsel, but in the end they faced an emergency that they had never seen before and could not cope with. As a result, the public was clearly, palpably, seriously harmed.[761] "[T]he *Mobile-Sierra* doctrine does not overlook" the interests of consumers; indeed, "it is framed with a view to their protection."[762] Hence, these contracts do not deserve a cloak of sanctity *just* because they are contracts.

VI. <u>Conclusion</u>

390. For the reasons set forth above and the findings of fact set forth below, it is the determination of this Initial Decision that (a) Iberdrola is a proper party in this proceeding; and (b) the *Mobile-Sierra-Morgan Stanley* presumption of the justness and reasonableness of a bilateral contract does not apply to the long term contract dated

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[760] Ex. CAL-31 § 10.17 (CDWR-Shell Contract); Tr. 2717:15-2718:10 (Watkiss Closing Arg.). This clause, similar to clauses in other long term contracts that CDWR executed during the Crisis Period, was set aside by the Commission early in this proceeding. *See CPUC v. Sellers of Long-Term Contracts*, 99 FERC ¶ 61,087, at 61,382-83 (2002).

[761] Ex. CAL-241 at 65:1-7 (Florio Direct) ("Table 5 shows that the rates consume[r]s paid for power delivered under the Shell Contract in 2001-2003 were <u>four to six times higher</u> than what competitive rates would have been once the market dysfunction ended. The rates consumers paid for power delivered under the Iberdrola Contract were <u>two to three times higher in almost every year</u> compared to what the competitive rate would have been once the market dysfunction ended (the multiple is 1.9 for 2009)." (emphasis in original)).

[762] *NRG Power Mktg., LLC v. Me. Pub. Utils. Comm'n*, 558 U.S. 165, 175 (2010).

May 24, 2001 between Shell and CDWR, nor does it apply to the long term contract dated July 6, 2001 between Iberdrola and CDWR.

FINDINGS OF FACT

I. <u>Whether Iberdrola Should Be a Party in this Proceeding?</u>

FF 1. PacifiCorp Power Marketing, Inc. was incorporated in 1995 as a power marketer subsidiary of PacifiCorp, a Pacific Northwest load-serving entity. Ex. CAL-285 at n.3; *PacifiCorp Power Marketing, Inc.*, 74 FERC ¶ 61,139 (1996).

FF 2. In 1999, PacifiCorp was acquired by Scottish Power. Ex. CAL-285 at n.3; PacifiCorp, 87 FERC ¶ 61,288 (1999); Ex. CAL-300 at C1-C2.

FF 3. PacifiCorp remained a parent of PacifiCorp Power Marketing, Inc. until, by a FERC order issued June 19, 2001, PacifiCorp became an affiliate of PacifiCorp Power Marketing, Inc. under the common ownership of Scottish Power. Ex. CAL-285 at n.3; *PacifiCorp*, 95 FERC ¶ 61,417 (2001); Tr. 2338:25-2339:6 (Hudgens).

FF 4. In 2007, Iberdrola S.A. acquired Scottish Power. Tr. 2339:6-8 (Hudgens).

FF 5. Since 2007, Iberdrola's ultimate parent has been Iberdrola S.A., a Spanish company with corporate offices in Madrid and Bilboa, Spain. Tr. 2339:7-23 (Hudgens).

FF 6. Negotiations between Iberdrola and CDWR began on January 24, 2001 and ended with execution of the contract on July 6, 2001. Ex. CAL-210 at 16:12-17:1 (Hart Direct); Ex. CAL-41 (Iberdrola Contract).

FF 7. When the negotiations between Ibderdrola and CDWR concluded, the final deal provided, inter alia, for Iberdrola to deliver to CDWR: (i) 150 MW of 7x24 firm energy (that is, delivered seven days per week, 24 hours per day) at $70/MWh from July 1, 2001 through June 30, 2002; and (ii) 200 MW at $70/MWh from July 1, 2002 through December 31, 2002. Ex. IB-200 at 12:1-17 (Harlan Answering); Ex. CAL-210 at 18:10-15 (Hart Direct); Ex. CAL-41 (Iberdrola Contract).

FF 8. Iberdrola was required under the contract to deliver to CDWR 200 MW from January 1, 2003 through June 30, 2004 and 300 MW from July 1, 2004 through the end of the contract term on June 30, 2011, priced according to a "tolling" arrangement. Ex. IB-200 at 12:1-17 (Harlan Answering); Ex. CAL-210 at 18:10-15 (Hart Direct); Ex. CAL-41 (Iberdrola Contract).

FF 9. Iberdrola provided CDWR dispatching rights to its Klamath cogeneration facility. Ex. IB-200 at 13:1-12 (Harlan Answering).

FF 10. As of the date of execution of the contract between Iberdrola and CDWR, forward prices in the CAISO SP-15 zone stood at approximately $50/MWh for 2002 and 2003 deliveries. Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

FF 11. Spot electric prices in the SP-15 zone as of the execution date of the contract between Ibderdrola and CDWR stood at approximately $97/MWh. Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

FF 12. Immediately before the onset of the Western Energy Crisis, the wholesale spot electric price in California averaged $34/MWh, and after it was over, the spot price averaged $32/MWh. Ex. CAL-90 at 15:10-21 (Stoft Direct).

FF 13. Although spot prices declined in June of 2001, the impacts of manipulation by PacifiCorp and other suppliers during the Crisis lingered in forward contracts through the entire negotiation of the Iberdrola Contract. Ex. CAL-717 at 160:1-5.

FF 14. On June 20, 2001, the date that the Commission's West-wide price mitigation plan went into effect, the "non-reserve deficiency" price cap for spot market sales, which was also the maximum price for negotiated bilateral contracts imposed by the Commission's plan, stood at $91.87/MWh, and remained at that level through December 19, 2001. This price cap represented 85 percent of the highest hourly Stage 1 "reserve deficiency" price declared on May 31, 2001 of $108/MWh, as declared by the Commission's plan. Ex. CAL-227 at 16 & n.5 (CAISO, Third Annual Report on Market Issues and Performance (January 2002)).

II. **Whether the *Mobile-Sierra-Morgan Stanley* Rule Applies to the Contracts at Issue?**

FF 15. The California Energy Crisis was unprecedented in the modern history of the U.S. electric industry in terms of its severity, duration, and consumer impacts. Ex. CAL-241 at 4:9-10.

A. **Whether Respondent Sellers Engaged in Unlawful Market Activity That Had a Direct Effect on the Negotiations of the Contracts At Issue, Such That the *Mobile-Sierra-Morgan Stanley* Rule Is Avoided?**

FF 16. The average wholesale price in the spot market in January 2001 reached $320/MWh, with prices in on-peak hours frequently exceeding $400/MWh, and at times exceeding $1,000/MWh. Ex. CAL-200 at 5:5-8 (Nichols Direct).

FF 17. Prior to 1998, California's electricity markets operated under a traditional franchised monopoly system with the three major IOUs providing power, transmission, and distribution to most of the State's electricity consumers. Ex. CAL-285 at 13:13-15.

FF 18. The IOUs owned much of the generation needed to serve their customers, but because of seasonal load and resource diversity in the West, the IOUs also purchased significant amounts of energy from outside California, and the western transmission grid was developed to facilitate large, seasonal, northerly or southerly power flows. Ex. CAL-285 at 13:15-16, 14:1-4.

FF 19. In 1998, for example, California generated 205,246 GWh, of which 6,236 GWh was exported, leaving 199,010 GWh for local consumption. Imports were 51,125 GWh, or approximately 20% of the total consumption of 250,135 GWh. Ex. CAL-285 at n.9; Ex. CAL-291.

FF 20. Utilities in the PNW generally had winter-peaking loads and significant amounts of hydroelectric power that was abundant in the spring and summer. Loads faced by utilities in the Southwest were strongly summer-peaking and hydroelectric resources were scarce. Thus electricity sourced from hydro generally flowed north to south in the summer while fossil-generated power went south to north in winter. Ex. CAL-285 at n.7.

FF 21. In 1998, legislation took effect to restructure California's electric power markets to facilitate competition for the generation and sale of electric power. The legislation required the IOUs to divest most of their generation and to purchase from newly created FERC-regulated PX and ISO auction markets substantially all of the electric energy and certain Ancillary Services that the IOUs needed to serve their retail customers. Ex. CAL-285 at 14:5-17.

FF 22. The PX was created to function as California's principal power market. It operated both Day Ahead and Hour Ahead single-price auction markets that established a single market-clearing price that all sellers received regardless of the prices at which they offered (bid) their power for sale. The PX Day Ahead and Hour Ahead markets were intended to supply virtually all of the electric power needed to meet projected electric power demand. Once the PX had cleared the markets and identified sellers and buyers, it submitted schedules to the ISO reflecting the flow of power from sellers to buyers. Ex. CAL-285 at 19:1–20:6.

FF 23. The ISO was created as the entity responsible for operating and maintaining California's electric transmission grid. This included resolving transmission congestion and purchasing Ancillary Services and imbalance energy to maintain system reliability. The ISO accepted the schedules prepared by the PX and then procured any electric power needed to make adjustments in Real Time to ensure that actual supply and demand "balanced" and the electric grid operated properly and safely. To meet these obligations, the ISO operated wholesale auction markets for Real Time energy purchases and Ancillary Services, which, like the PX, set a single market-clearing price based on seller's bids. Ex. CAL-285 at 20:7-18; *See* Ex. CAL-289 at § 2.5 (formulas for determining market clearing price in ISO auctions) and Appendix A, Master Definitions Supplement ("Market Clearing Price").

FF 24. To the extent the imbalance auction market did not provide sufficient power to balance the grid, the ISO Tariff permitted the ISO to procure emergency electric power in alternative bilateral, OOM transactions. Such supplies were solicited through various methods, such as phone calls to electric power marketers or generators. OOM transactions were contemplated in the ISO Tariff as a backstop to the ISO's auction market. Ex. CAL-285 at 21:6-14 & n.11; Ex. CAL-289 at § 2.3.5.1.5; *Pub. Utils. Comm'n of Cal. v. FERC*, 462 F.3d 1027, 1052-1053 (9th Cir. 2006).

FF 25. The part of the ISO south of a major transmission link called Path 15 was designated SP-15 (south of Path 15), while the zone north of the link was designated NP-15 (north of Path 15). Because the transmission link between southern and northern California was often congested (the lines could not transfer any more power between the two regions), the ISO was effectively separated into two electrical systems or markets, each with its own price. Ex. CAL-285 at 23:5-12, n.14.

FF 26. The first two years of the PX's and ISO's operation in the California electricity markets worked reasonably well. Even during a few episodes when prices were elevated they rarely exceeded $100/MWh, a very high price for the typical gas-fired generating unit on the margin. Ex. CAL-285 at 22:11-16, n.12.

FF 27. The Crisis affecting Spot Market prices began in May 2000 and lasted through June 2001. Its duration and severity is shown in Figure 4 of Mr. Taylor's Direct Testimony Part 1, Ex. CAL-285 at 27. Figure 4 shows peak prices for trades in California (NP-15 and SP-15) along with peak prices in nearby market trading hubs in the PNW (COB) and in the Southwest (PV). Prices in all western power markets both before May 2000 and after the June 2001 were well below $100/MWh. Ex. CAL-285 at 27.

FF 28. During the Crisis the spot price averaged $201/MWh. Ex. CAL-90 at 15:10-21 (Stoft Direct); Ex. CAL-604 at 17, fig.1 (Goldberg Direct).

FF 29. During the 2000-2001 Crisis, Spot Market prices rose to nearly $600 per MWh. Ex. CAL-241 at 7:19-8:1, fig.2; Ex. CAL-246.

FF 30. Figure 4 of Ex. CAL-285 shows that prices in the western markets moved together, and during the Crisis, all of the western markets experienced the same periods of escalating prices. This is so because the transmission system in the West allows suppliers to choose to sell anywhere in the region, so that western power markets are closely linked. In the absence of transmission constraints, power flows from low priced areas to those with higher prices until prices equalize net of transmission costs. Ex. CAL-285 at 25:7-26:10, 28:1-5, fig.4.

FF 31. During the first week of May 2000, Real Time prices in the southern zone of the ISO rose in some hours to the then-applicable price cap of $750/MWh. Ex. CAL-285 at 23:5-8, fig.2.

FF 32. In late May 2000 prices in the southern zone of the ISO again hit the $750 cap, and did so again in mid-June and in late June 2000, with increasing frequency of pricing at the cap. Ex. CAL-285 at 23:12-24:2, fig.2.

FF 33. The prices in the northern zone of the ISO also spiked to the price cap in late May and mid and late June 2000. Ex. CAL-285 at 24:3-5, fig.3.

FF 34. In early July 2000, the ISO lowered the price cap from $750/MWh to $500/MWh, and prices fell, with peaks generally below $100/MWh. Prices spiked again in both the north and south in the third week in July 2000, however, and remained high until the end of the month, regularly hitting the cap. The ISO again lowered the ISO price cap to $250/MWh on August 7, 2000. From this point through the beginning of October 2000, prices regularly hit the cap in both regions. Ex. CAL-285 at 24:5-25:5 & fig.3.

FF 35. In August 2000 San Diego Gas & Electric Company, one of the California IOUs, filed a complaint with the Commission seeking an investigation into the causes of the extraordinarily high prices in the ISO and PX markets and imposition of a price cap; the Commission instituted its own investigation during the same time period. Ex. CAL-285 at 29:4-10; Ex. CAL-292 at 11.

FF 36. Following the May through early October 2000 period in which price increases reached $400/MWh to over $600/MWh, prices in all of the western markets fell briefly in mid-October and the first part of November 2000. Ex. CAL-285 at 28:6-9, fig.4.

FF 37. At the time it issued the November 1, 2000 order the Commission did not then have the evidence of market manipulation that later surfaced in the Enron Memos. Ex. CAL-285 at 30:12-13; Ex. CAL-302 at 2-22 (Enron Memos).

FF 38. The Commission lifted the hard price cap in the ISO markets in an order issued December 8, 2000, and put into place a soft cap, under which bids below the cap were considered in determining the market clearing price, but bids above the cap were taken as necessary to satisfy demand and paid as bid but did not raise the market clearing price that all sellers would be paid. Ex. CAL-285 at 30:16-22, n.23; Ex. CAL-294.

FF 39. On December 15, 2000, the Commission issued another order adopting other remedies it had proposed in the November 1, 2000 order, including elimination of the requirement that the IOUs make all of their purchases and sales in the PX. Ex. CAL-285 at 33:14-16; Ex. CAL-293.

FF 40. Through late December 2000 prices surged again, approaching an average of $600/MWh. Ex. CAL-285 at 28:9-11, fig.4.

FF 41. After a brief decline in late December 2000, prices began to rise again in early January, 2001 and continued throughout the Negotiation Period at extraordinarily high levels through June 2001. Ex. CAL-285 at 28:11-29:3, fig.4.

FF 42. The squeeze created by frozen retail rates and the huge run-up in wholesale prices drove PG&E and SCE to the brink of bankruptcy and ruined their credit ratings, leaving them with dwindling ability to pay for purchases from the PX and ISO. PG&E, in fact, did declare bankruptcy. Ex. CAL-285 at 34:3-6, n.28.

FF 43. Because PG&E and SCE, the PX's major purchasers, were unable to pay their bills, and because PX sales volumes plummeted as a result of the Commission's December 15, 2000 Order relieving the IOUs of their obligation to make all of their purchases and sales in the PX, the PX was unable to function effectively and ceased operations by the end of January 2001. Ex. CAL-285 at 34:6-9; Ex. CAL-293 at 84 (elimination of mandatory PX Buy-Sell requirement).

FF 44. It was the collapse of the PX market and the IOU's insolvency that necessitated the State's creation of CDWR's CERS division as the buyer of last resort, so that California's consumers could continue to have access to electric power. Ex. CAL-285 at 70:3-16.

FF 45. CDWR assumed its role as purchaser of last resort for the ISO on January 17, 2001 in the midst of two days of rolling blackouts. Ex. CAL-285 at 8:7-8, 72:11-12, n.75.

FF 46. CDWR's initial procurement efforts were financed by advances from California's General Fund to the Electric Power Fund created by Senate Bill 7X, which passed on January 19, 2001. Ex. IB-246 at 14:15-15:8; Tr. 621:6-623:2; Ex. CAL-688 at 24.

FF 47. CDWR was tasked at the height of the Western Energy Crisis, by a Proclamation of a State of Emergency issued by Governor Gray Davis on January 17, 2001, to "enter into contracts and arrangements for the purchase and sale of electric power . . . as expeditiously as possible" in order to meet the "Net Short" energy requirements of the then failing California IOUs, PG&E, SCE, and SDG&E. Ex. CAL-12 at 4:4-16 (Hart Direct); Ex. CAL-13; Ex. CAL-200 at 4:3-7 (Nichols Direct); Ex. CAL-12 at 4:4-6:1 (Hart Direct); Ex. CAL-13.

FF 48. The "Net Short" energy requirements of the IOUs consisted of the difference between (1) the total energy requirements of the IOUs' retail and end use customers, and (2) the sum of the energy generated by IOU-owned electric generating plants, qualifying facilities (QFs) under contract with the IOUs, and existing bilateral contracts between the IOUs and other suppliers. Ex. CAL-200 at 4:15-20 (Nichols Direct).

FF 49. Initially, CDWR had no long-term supply contracts, so the entire Net Short of the IOUs had to be procured on a short-term, largely Spot Market basis, much of it in Real Time. This meant racing the clock each hour to procure the energy that was needed only an hour or two later to prevent the system from blacking out. Ex. CAL-285 at 73:1-7.

FF 50. In purchasing so much of the Net Short so close to the hour of delivery, CDWR was forced to rely heavily upon the PNW for supply, particularly in Real Time as the time for dispatch approached and CDWR sought additional supply from outside the ISO at COB, because most of the generation in the ISO was located in the southern zone but congestion often isolated the northern zone of the California grid from the southern zone. Real Time purchases in the north, virtually all at COB, were at consistently higher prices than in the south, and at consistently higher volumes than in the south. Ex. CAL-285 at 74:10-78:7, tbl.3 (Frequency of Congestion), fig.7 (NP-15/SP-15 Price Differential), fig.8 (NP-15/SP-15 Volume Differential).

FF 51. Following an order issued by the Commission on June 19, 2001, Spot Market prices declined and returned to more normal levels. Ex. CAL-285 at 85:12-86:13, fig.4.

FF 52. The Commission's June 19, 2001 order: (a) imposed a maximum price based upon the marginal cost of the least efficient gas-fired generation that was dispatched in the ISO, and covered all Spot Market transactions in the entire western power grid (not just those in the ISO Real Time market as had been proposed in an April 26, 2001 order) for all hours (not just those in which there were reserve deficiencies, as proposed in the April 26, 2001 order); and (b) imposed a west-wide "must offer" obligation. Ex. CAL-285 at 85:12-86:13; Ex. CAL-745 (June 19 Order).

FF 53. Widespread market manipulation occurred during the Summer Period and contributed to the extraordinary increase in prices in the ISO and PX markets, as the Commission has concluded in Opinion No. 536 issued in 2014, and in other orders issued after the Crisis ended. Ex. CAL-285 at 89:3-17; *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange*, 149 FERC ¶ 61,116 (2014) (Opinion No. 536), *order on reh'g*, 153 FERC ¶ 61,144 (2015).

FF 54. Iberdrola's parent PacifiCorp facilitated market manipulators who engaged in False Export and Circular Scheduling by providing fraudulent Parking services and buy/sell arrangements. Ex. CAL-285 at 89:14-17; Ex. CAL-319 at 90:4-92:6, 153:7-161:9; Ex. CAL-374A, B; Ex. CAL-406; Ex. CAL-409; Ex. CAL-411Ai-v, B.

FF 55. Videos and transcripts in exhibits CAL-242A, B, CAL-243A, B, CAL-244A, B from ABC news programs demonstrate the serious impacts of the 2000-2001 Crisis on Californians at that time. Ex. CAL-241 at 4:15-5:7; Ex. CAL-242A, B; Ex. CAL-243A, B; Ex. CAL-244A, B.

FF 56. The skyrocketing wholesale Spot Market prices and blackouts during the Crisis were caused in large part by market manipulation by sellers, including Shell and PacifiCorp. Ex. CAL-241 at 5:11-14.

FF 57. Spiking Spot Market prices inflicted serious personal and economic hardships on SDG&E customers. Ex. CAL-241 at 10:4-11:17; Ex. CAL-247 at 12, 15.

FF 58. Stories from San Diego ratepayers communicated to the CPUC at hearings and through letters demonstrated the human and economic hardships caused by the escalation in retail energy bills in the summer of 2000. Ex. CAL-241 at 10:4-11:17; Ex. CAL-247 at 12-16.

FF 59. The public outcry and stories of hardship of San Diego ratepayers demonstrated to California's policy makers that consumers could not endure a full pass-through of increased wholesale energy prices during the Crisis. Ex. CAL-241 at 12:3-9.

FF 60. In late August 2000, the California Legislature enacted AB 265, rolling back SDG&E rates to pre-Crisis levels for residential, small commercial and street lighting customers. Ex. CAL-241 at 11:21-12:1; Cal. Pub. Util. Code Section 332.1 (added by Stats. 2000, ch. 328).

FF 61. CPUC implemented a rate cap of 6.5 cents per kWh for SDG&E customers retroactive to June 1, 2000. Ex. CAL-241 at 12:2-3; *CPUC Opinion Expanding the Rate Stabilization Plan for San Diego Gas and Electric Co.* (2000) D.00-09-040.

FF 62. In January 2001, the CPUC raised retail rates for Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (SCE) by one cent per kWh to partially offset spiking wholesale energy costs. Ex. CAL-241 at 14:26-27; CPUC Interim Opinion Regarding Emergency Requests for Rate Increases (2001) D.01-01-018, at 1-2.

FF 63. On March 22, 2001, the ISO issued a 2001 Summer Assessment that warned: "California is facing an electricity shortage of unprecedented proportions for the summer of 2001." Ex. CAL-241 at 22:5-7; Ex. CAL-253 at 4.

FF 64. The 2001 ISO Summer Assessment forecast a peak demand deficiency ranging from a high of 3,647 MW in June to a low of 666 MW in September and indicated that California would experience rolling blackouts. Ex. CAL-241 at 22:8-11; Ex. CAL-253 at 4.

FF 65. The danger of ongoing system emergencies and blackouts to the health and economic welfare of Californians put pressure on CDWR to execute long-term contracts in advance of Summer 2001. Ex. CAL-241 at 28:3-14, 29:3-16; Ex. CAL-242A, B; Ex. CAL-243A, B; Ex. CAL-72 at 7; Ex. CAL-251 at 8-9, 13-14.

FF 66. A Stage One Emergency would be declared by the ISO when operating reserves fell below 7% of load. Ex. CAL-513 at 84:12-17.

FF 67. A Stage Two Emergency would be declared by the ISO when operating reserves fell below 5% of load. Ex. CAL-513 at 85:1-4.

FF 68. A Stage Three Emergency would be declared by the ISO when operating reserves were forecast to be less than the single largest resource online. In the ISO's hierarchy of stage emergency conditions, Stage Three was the most serious emergency condition, denoting that the system had curtailed all interruptible loads and was running with reserves insufficient to cover the loss of a large generating unit. Any loss of such generation would cause the system to collapse. Ex. CAL-513 at 85:5-9; Ex. CAL-285 at 72:13-73:7 & n.76.

FF 69. During 2001 there were 38 Stage Three Emergencies declared by the ISO. Ex. CAL-594 at 1.

FF 70. California was in a state of emergency for 31 consecutive days from January 18, 2001 to February 16, 2001. Ex. CAL-241 at 17:3-6.

FF 71. From May 2000 through July 2001, the ISO issued 125 Stage One Emergencies and 101 Stage Two Emergencies, compared to just eleven Stage One Emergencies and six Stage Two Emergencies in 1998 to 1999 combined. Ex. CAL-241 at 7:13-16, 8:2, (Figure 1); Ex. CAL-245 at 1, 3-7.

FF 72. From 2002 through 2014, the ISO issued nine Stage One Emergencies, four Stage Two Emergencies, and zero Stage Three Emergencies. Ex. CAL-245 at 1.

FF 73. All of the thirty-nine Stage Three Emergencies the ISO has issued during sixteen years of operations, from 1998 through 2014, occurred during the 2000-2001 Crisis. Ex. CAL-241 at 7:9-12, 8:2 (Figure 1); Ex. CAL-245 at 1, 3-7.

FF 74. If after implementing other emergency procedures the ISO is unable to procure sufficient power, service is cut to some customers, producing partial or rotating blackouts. Ex. CAL-513 at 85:10-12.

FF 75. By implementing rolling blackouts, the ISO can spread the impact of blackouts among customers and reduce the duration of blackouts for particular groups of customers. Ex. CAL-513 at 85:12-16.

FF 76. Blackouts impose direct and indirect economic costs on consumers. Ex. CAL-513 at 83:8.

FF 77. On March 22, 2001, the ISO predicted that blackouts would continue into the Summer 2001. Ex. CAL-513 at 87:9-14; Ex. CAL-254.

FF 78. On March 24, 2001, California Governor Gray Davis issued a press release announcing a plan to help neighborhoods and businesses better prepare for blackouts. Ex. CAL-241 at 21:14-16; Ex. CAL-252.

FF 79. Demand in California typically peaks during the summer. Ex. CAL-241 at 5:9-11; Ex. CAL-250.

FF 80. California officials and experts were preparing for the potential of widespread blackouts during the summer of 2001. Ex. CAL-241 at 20:5-21:12; Ex. CAL-242A, B; Ex. CAL-243A, B; Ex. CAL-244A, B; Ex. CAL-251; Ex. CAL-252.

FF 81. On May 15, 2001, the North American Electric Reliability Council (NERC) issued a special report predicting 260 hours of rotating blackouts in the ISO during the summer, estimating that "the [ISO] will most likely experience supply deficiencies in the range of about 4,500 and 5,500 MW at the time of peak demand for each summer month (2,000 – 4,000 MW more than the [ISO] projections, depending upon the month selected)." Ex. CAL-241 at 22:16-20; Ex. CAL-254 at 3-4, 11-12; Ex. CAL-255 at 3; Ex. CAL-256 at 3.

FF 82. NERC warned that the interruptible demand program in Northern California was exhausted in early 2001 because ISO operators had to call on interruptible customers to counteract the high unavailability of generating resources during the winter of 2000-2001. Ex. CAL-241 at 24:19-25:2; Ex. CAL-254 at 5.

FF 83. Initially, CDWR obtained almost all of the power it needed by buying in the Spot Market where average wholesale energy costs had reached 32¢/kWh ($320 per MWh) in January 2001, with costs in on-peak hours frequently exceeding 40¢/kWh or $400/MWh, and at times exceeding $1000/MWh. Ex. CAL-51 at 7:19-23, 21:10-13; Ex. CAL-200 at 5:5-8; Ex. CAL-12 at 7:3-9.

FF 84. The average Spot Market price in January 2001 was approximately ten times the Spot Market price of one year earlier. Ex. CAL-51 at 7:23-24; Ex. CAL-56 at 2; Ex. CAL-200 at 5:8-10.

FF 85. In order to keep the lights in in California, CDWR had to procure for each day the Net Short, the 8,000 to 15,000 MWhs of unmet energy that the IOUs were no longer able to purchase to serve their customers. Ex. CAL-222 at 5:4 -5:8; Ex. CAL-78 at 16:4-7.

FF 86. From January through May 2001, CDWR spent $4.89 billion for Spot Market power to meet the IOUs' Net Short. Ex. CAL-200 at 37:15-16.

FF 87. On January 23, 2001, CDWR issued an initial request for bids (RFB) soliciting offers for forward energy purchases. Ex. CAL-66; Tr. 220:3-6 (Nichols); Ex. CAL-200 at 8:14-15; Ex. CAL-66.

FF 88. After California had suffered 16 straight days of Stage 3 Emergencies, on February 1, 2001, the California Legislature enacted Assembly Bill 1 of the 2001-2002 First Extraordinary Session (AB 1X), which authorized and required CDWR to purchase power, including under long term contracts, for sale to retail end-users served by California's electrical corporations. AB 1X directed CDWR to achieve an overall portfolio of contracts for energy resulting in reliable service at the lowest possible price per kilowatt-hour. Ex. CAL-15; Ex. CAL-12 at 5:12-16; Ex. CAL-142.; Ex. CAL-51 at 7:8-8:8.

FF 89. CDWR issued a second RFB on February 2, 2001. Ex. CAL-200 at 8:14-15; Ex. CAL-67.

FF 90. In the Spring of 2001, CDWR created a Contracts Committee to review and make recommendations regarding the long term contract process which included both those dealing with the negotiations directly as well as those in other aspects of the operations, including Spot Market procurement. Ex. CAL-200 at 10:11-14.

FF 91. During the Crisis, CDWR entered a portfolio of over 50 long-term contracts in order to reduce the State's reliance on the Spot Market. Ex. CAL-12 at 10:11-16; Tr. 388:23-389:2 (Hart); Ex. CAL-50.

FF 92. CDWR entered into the Shell and Iberdrola Contracts because of unreliability and high prices in the Spot Market. Ex. CAL-673 at 16:17-17:6.

FF 93. CDWR would not have entered into the Long-Term Contracts had the Spot Market not been dysfunctional. Ex. CAL-12 at 10:21-25.

FF 94. The prices CDWR accepted in the Shell and Iberdrola Contracts were higher than compared to what prices would have been if the market was not dysfunctional. Tr. 397:11-398:20, 526:8-13 (Hart).

FF 95. CDWR retained Navigant on January 20, 2001 to assist it in the process of establishing and running the State of California's power purchase program. Ex. CAL-51 at 3:9-12; Ex. CAL-200 at 2:9-11.

FF 96. Neither the long-term contracts signed by CDWR before June 19, 2001 nor the Commission's June 19, 2001 Order were sure-fire solutions to the problems in the California energy markets. Ex. CAL-717 at 160:5-8.

FF 97. FERC calculated a set of competitive electricity prices, MMCPs, for each hour and 10-minute interval of the Refund Period. Ex. CAL-268 at 22:5-12.

FF 98. The MMCP is based on the actual units dispatched in the California organized electric markets in each hour. Ex. CAL-268 at 22:17-18; Ex. CAL-281; Tr. 1754:10-1757:6 (Pirrong).

FF 99. The MMCP was applied as a cap in each hour and the Commission ordered that amounts charged above the MMCP cap for sales in the ISO and PX markets be refunded to customers. Ex. CAL-268 at 24:2-6; *San Diego Gas & Elec.*, 99 FERC 61,160 (2002).

FF 100. Overall spot prices in western electricity markets were above competitive levels during the Negotiation Period. Ex. CAL-513 at 6:16-18.

FF 101. Shell's market manipulation and tariff violations directly contributed to the uncompetitive Spot Market prices paid by CDWR during the Negotiation Period. Ex. CAL-764 at 10:3-11:12.

FF 102. Market supply and demand fundamentals alone do not explain the pattern of very high prices seen in sales to CDWR during the Negotiation Period. Ex. CAL-764 at 3:16-18, 35:7-36:16, 51:1-7.

1. **Shell Contract**

a. **Unlawful Spot Market Activities**

FF 103. On every day that an audiotape is missing on which Shell made sales to CDWR (i.e., May 18-24 and May 30-31, 2001), Shell engaged in unspecified unlawful activity, and each such unlawful activity had a price effect in Spot Market. *CPUC v Sellers of Long-Term Contracts*, Order Memorializing November 10, 2015 Bench Ruling on Motion to Compel Production of Audio Recordings and Request for Sanctions, November 13, 2015, at P 10.

FF 104. Seller manipulative behavior during the Crisis can be classified into four categories: (1) Anomalous Bidding (including economic withholding); (2) Fraudulent sales into the ISO Real Time energy and Ancillary Services markets, including: (a) False Export, often abetted through illicit Parking, (b) False Load, and (c) Phantom Ancillary Services; (3) Fraudulent collection of congestion revenues; and (4) Other related market manipulation schemes, including manipulation of the natural gas and futures markets. Variants of these behaviors were described in the Enron Memos with names like Ricochet, Fat Boy, Death Star and Get Shorty. Other sellers adopted, adapted and used them. Ex. CAL-285 at 35:1-12.

FF 105. Anomalous Bids are bids that depart from normal competitive patterns. There were three types of anomalous bids that sellers employed during the Crisis in the ISO and PX markets, and all violated provisions of the PX and ISO tariffs. The purpose of all forms of Anomalous Bidding was to elevate prices in the relevant markets. Sellers bid some portion of the supply they offered at prices far in excess of incremental generation costs, thus deviating from the competitive norm. Ex. CAL-285 at 37:10-38:2; Ex. CAL-733 at PP 91-107 (Opinion No. 536).

FF 106. False export, false load, anomalous bidding, phantom ancillary services, and circular scheduling have been determined to be violations of the market monitoring and information protocol (MMIP) of the CAISO organized market tariff. *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 149 FERC ¶ 61,116, at PP 91, 94, 99, 120, 170 (2014) (Opinion No. 536).

FF 107. The Commission has never found that circular scheduling, sales of phantom ancillary services, shorting generation, or submission of uncompliant quarterly reports had any effect on spot market prices in California during the crisis period. Opinion No. 536 at 186.

FF 108. The Commission has never found that Coral engaged in shorting generation. *See* Ex. SNA-230 at 43:1-3.

FF 109. Type 1 Anomalous Bids featured a portion of the bid that was offered at extremely high prices that were well in excess of marginal cost. If accepted, they had the effect of elevating the market clearing price for all sales made in the same bidding hour. Ex. CAL-285 at 38:3-6; Ex. CAL-733 at P 58 (Opinion No. 536).

FF 110. Type 2 Anomalous Bids were bids above marginal cost offered in conjunction with some other manipulative scheme such as False Export or False Load (schemes discussed below), designed to place energy into the Real Time market fraudulently. Such schemes effectively offered energy into the Real Time market on a "price taker" basis. As "price takers," the suppliers engaging in such schemes had an interest in achieving the highest possible Real Time prices, and, hence, had an incentive to elevate these prices through Anomalous Bids. The bidding effectively made the seller a "price-maker" rather than a "price-taker." Ex. CAL-285 at 38:7-15; Ex. CAL-733 at P 60 (Opinion No. 536).

FF 111. Type 3 Anomalous Bids were bids that were priced far above marginal costs that the seller never expected to be accepted, and thus constituted economic withholding. Ex. CAL-285 at 39:1-3; Ex. CAL-733 at P 63 (Opinion No. 536).

FF 112. False Export, False Load, and Phantom Ancillary Services were used to make fraudulent sales into the ISO Real Time energy and Ancillary Services markets because during the Crisis, prices were consistently higher in the Real Time market than they were in the Day Ahead market. Demand was extremely inelastic in the Real Time market, so it was easier for suppliers to elevate prices there through withholding or Anomalous Bidding. Unlike what one would expect in competitive circumstances in which a Day Ahead/Real Time price differential would not persist over a long period, Real Time prices were consistently higher, providing sellers with an incentive to find ways to avoid the reliability-related requirements of the ISO Tariff that limited access to the Real Time market. Ex. CAL-285 at 39:9-40:16, fig.5; Ex. CAL-296.

FF 113. In a False Export, which Enron called Ricochet, a seller purchasing or generating power within the ISO would file with the ISO a Day Ahead or Day Of schedule showing a nominal “export” of power from within the ISO to a recipient with load (that is, a “sink”) outside California, that then returned the energy for sale back to the ISO through bids into the Ancillary Services or Real Time (Supplemental) energy market. Ex. CAL-285 at 43:11-21, 46:13-47:5; Ex. CAL-302 at 7-8.

FF 114. False Export consisted of at least two instances of fraudulent conduct: first, a false representation to the ISO through the filing of a schedule that energy generated in California was being exported, and, second, a false representation to the ISO (or later in the Crisis, during the Negotiation Period, to CDWR acting on behalf of the ISO) that the energy was coming from the PNW or some other trading hub outside of the ISO. Ex. CAL-285 at 44:9-14.

FF 115. False Export schedules created fictitious energy resources outside the ISO that could thus be bid back into the Ancillary Services markets or as Supplemental Energy. Both the export schedule and the subsequent “import” were fraudulent. The energy was sourced in the ISO and sunk in the ISO. Ex. CAL-285 at 45:6-10.

FF 116. False Export was facilitated by Parking or laundering transactions. Parking providers were entities, generally control area operators at the interfaces with the ISO such as PacifiCorp, that agreed for a fee (e.g., $5/MWh) to be reported as the purchasers and designated recipients of a marketer such as Shell’s exports with the understanding that they would resell and return the energy to the original seller so that the original seller could resell the power back into the ISO, as if it came from outside the ISO. Ex. CAL-285 at 45:12-21; Ex. CAL-374; Tr. 1486:7-1490:23.

FF 117. Parking transactions generally had two components. The first part was a pre-scheduled (e.g., Day Ahead or Hour Ahead) “sale” from the Parking customer to the Parking provider (the “delivery”) at a specific location and for certain specified operating hours. The second part was a “re-purchase” of the prescheduled power (the “return”) from the Parking provider to the Parking customer closer to the actual operating hour, in amounts that equaled the pre-scheduled volumes in each hour. In some cases, the return leg also may have been arranged on a pre-scheduled (e.g., Day Ahead or Hour Ahead) basis. Typically, the return was at the same location as the source of the sale. Although purportedly different transactions, the putative flows associated with the sale and repurchase were in fact simultaneous and scheduled for the same point in time. So if the delivery leg associated with the sale were scheduled from the ISO control area and the return leg associated with the repurchase were scheduled back into the ISO control area, they effectively canceled out so that no power actually flowed at the intertie (i.e., the fictitiously scheduled "export" and "import" point), or into or out of the Parking provider's control area. Ex. CAL-285 at 48:5-49:8.

FF 118. Parking activity technically occurred outside the boundaries of the ISO and, although it was clearly fraudulent and meant to facilitate transactions that disrupted California's markets, it was outside the precise letter of the ISO tariff. However, the buy-resale parking transaction that facilitated False Export was fraudulent and thus violated both participants' market based rate authority which carried the implicit obligation not to engage in fraud, deception or misrepresentation. Ex. CAL-285 at 49:13-50:2; Ex. CAL-736 at P 52 (Enron MBR Revocation Order).

FF 119. In False Load, which Enron called "Fat Boy," the seller submitted to the ISO a Day Ahead or Hour Ahead load schedule that intentionally included an amount of load greater than the amount that the seller actually intended to serve. False Load schedules had the effect of increasing scarcity and prices in the PX Day Ahead market and moved the resources illegally to the more easily manipulated ISO Real Time markets, where the seller could cause, and take advantage of, higher prices. Ex. CAL-285 at 51:1-9 Ex. CAL-302 at 2, 7.

FF 120. False Load subverted the ISO's requirement that schedules be balanced (ISO Tariff §2.2.7.2) because in Real Time, the excess MWs that were scheduled to the fictitious load would be delivered and would result in a positive imbalance which was essentially purchased by the ISO and paid the ISO's Real Time ex post price. False Load was a way to fraudulently gain the Real Time price for energy that otherwise could not legitimately have been bid into the Real Time market. Ex. CAL-285 at 51:10-16; Ex. CAL-289 at §2.2.7.2.

FF 121. False Export degraded ISO grid reliability because it reduced operating reserves on a Day Ahead basis and led the ISO to believe mistakenly that the exported energy needed to be replaced through Real Time purchases. Ex. CAL-680 at 18:20-19:11.

FF 122. Executing Enron-style manipulative schemes such as False Export, and False Load, required access to generation, transmission, or load points in the ISO which were not available to pure marketers. Therefore, marketers that employed these schemes sought out and formed alliances with entities that could provide such access. Ex. CAL-285 at 35:13-16.

FF 123. Shell formed alliances with partners that were load serving entities, such as the municipal utilities of the cities of Glendale and Colton, who provided access to load points, transmission and generation and shared in the profits Shell made from manipulative schemes employed using their facilities. Ex. CAL-285 at 35:16-20; Ex. CAL-480.

FF 124. PacifiCorp, Iberdrola's parent, was a load serving entity with access to generation and transmission that used its facilities to engage in manipulation on its own, and that also charged fees for "Parking" or "laundering" services that facilitated schemes such as False Export and Circular Scheduling for Shell and other marketers. Ex. CAL-285 at 35:16-36:1.

FF 125. Ms. Beth Bowman, Shell's General Manager in charge of its San Diego trading operation, and her direct report Mr. Ed Brown, who was in charge of long term transactions, initiated Shell's alliance arrangements with the cities of Glendale and Colton. Ex. CAL-319 at 21:12-17, 120:1-122:5; Ex. CAL-414; Ex. CAL-426.

FF 126. Shell and Glendale started discussions related to entering into an alliance arrangement in March 2000 and were clearly having detailed strategy discussions before the end of May 2000. Ex. CAL-319 at 21:17-22:1; Ex. CAL-321.

FF 127. Carey Morris, an Enron trader, moved to Shell's San Diego trading operation at the beginning of the Crisis and took on a supervisory role, guiding Shell traders in the same sort of schemes that Enron had perpetrated and bringing along Enron's former municipal utility partners, the cities of Glendale and Colton, California, to carry them out. Ex. CAL-285 at 35:16-20, 55:1-6 (Taylor Direct); Ex. CAL-319 at 25:1-6 (Taylor Direct).

FF 128. Shell executed the formal Marketing Services Agreement (MSA) with Glendale in late July 2000. Ex. CAL-319 at 21:12-13; Ex. CAL-320.

FF 129. Under the Glendale MSA, the parties agreed that Shell would market on Glendale's behalf various specified generation, transmission, and gas supply assets. Shell guaranteed certain minimum revenues to Glendale, and then the parties were to split "Alliance Net Gain" above the minimum at specified rates. Ex. CAL-319 at 22:1-18; Ex. CAL-320 at 1-2.

FF 130. Shell was obligated under the Glendale MSA to market Glendale resources according to a written "Marketing Plan" that was to implement specified and mutually agreed "Marketing Strategies." Ex. CAL-319 at 22:5-7; Ex. CAL-320 at P 2.1.

FF 131. A document outlining various marketing strategies that could be implemented jointly by Shell and Glendale was drafted by Shell traders as reflected in an e-mail chain dated September 17-18, 2000, and a document virtually identical to it was produced by Glendale from its business records. Ex. CAL-319 at 22:8-18; Ex. CAL-322; Ex. CAL-323.

FF 132. The Glendale and Shell Marketing Strategies Document describes in detail several Enron-style strategies similar to Ricochet and Fat Boy. Ex. CAL-319 at 22:18-23:2; Ex. CAL-323 at PP 1-3, 7.

FF 133. A strategy similar to Ricochet is described in the Glendale and Shell Marketing Strategies Document as: “Look to utilize park and loans with counterparties such as PNM (PV) and Pueget [sic] (Mid-C) in the DA market, and utilize the energy in the expost and ancillary service markets in the ISO.” Ex. CAL-319 at 23:1 & n.34; Ex. CAL-323 at P 7.

FF 134. A strategy similar to Fat Boy is described in the Glendale and Shell Marketing Strategies Document as: “Decremental Price Plays in ISO: When pricing looks favorable, you can obtain power from Glendale via an SC to SC transfer in South Path and park it on a Coral Load ID in either SP, NP or Zone 26. Glendale will earn the difference between the cost of the power and the Decremental Price in the zone in which the power was scheduled.” Ex. CAL-319 at 23:1 & n.35; Ex. CAL-323 at P 2.

FF 135. A strategy similar to Load Shift is described in the Glendale and Shell Marketing Strategies Document as: “Inside the ISO, you can take Glendale supplied power via an SC to SC transfer in South Path, move it to North Path (against congestion) and park it on a Coral Load ID. Glendale would earn the congestion payment and any gain (or loss) on the power from being paid the Decremental Price in NP15.” Ex. CAL-319 at 23:2 & n.37; Ex. CAL-323 at P 1.

FF 136. Transaction data confirm that Shell and Glendale actually executed the types of strategies outlined in the Glendale and Shell Marketing Strategies Documents. Ex. CAL-319 at 23:2-3; Ex. CAL-324 at 172-181.

FF 137. Shell had an alliance similar to its Glendale alliance with the city of Colton, and similarly used it to pursue Enron-style manipulation schemes in the California markets. Shell also had similar alliances with other generation owners. Ex. CAL-319 at 25:11-26:12; Tr. 1806:25-1807:14,1807:25-1808:9, 1818:1-1819:6.

FF 138. It is evident from both trader communications and transaction data that Shell’s Glendale and Colton Agreements were used for Enron-style gaming. Shell implemented manipulative schemes with the knowledge of these alliance partners. Ex.

CAL-319 at 41:13-45:14; Ex. CAL-717 at 66:18-68:13, 135:1-136:6; Ex. CAL-301 at 12; Ex. CAL-336; Ex. CAL-480; Ex. CAL-741 (Attachment K); Ex. CAL-730.

FF 139. The Commission has found that Shell engaged in market manipulation in the ISO and PX Spot Markets during the Summer Period and that Shell's manipulation raised the prices in those markets. The Commission "examined whether there was a consistent pattern of market activities indicating, due to their sheer volume and frequency, and other simultaneously undertaken activities, that a seller engaged in the behavior that rendered the transactions at issue unjustifiable as a legitimate business practice." *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange*, Order on Rehearing of Opinion No. 536, 153 FERC ¶ 61,144, at P 3 (2015).

FF 140. The Commission found in Opinion No. 536 that Shell "engaged in Types II and III Anomalous Bidding, as well as False Exports and False Load Scheduling, and these tariff violations impacted the market clearing price." Order on Rehearing of Opinion No. 536, 153 FERC ¶ 61,144 at P 4 (2015).

FF 141. Shell engaged in Type II Anomalous Bids (bids above marginal cost offered in conjunction with some other manipulative scheme such as False Export or False Load) during the Summer Period. As the Commission found, its conclusion was "not solely based on the fact that anti-competitive strategies, such as False Load, False Export, and Economic Withholding" were used, but that "the consistency of Coral's Type II bidding activity demonstrates a pattern of market behavior that cannot be justified as a legitimate business practice" such that "a majority of Coral's bids" tripped the California Parties' conservative screens for detecting anomalous behavior. Order on Rehearing of Opinion No. 536, 153 FERC ¶ 61,144 at P 45 (2015).

FF 142. Shell engaged in Type III Anomalous Bids (bids that were priced far above marginal costs that the seller never expected to be accepted, and thus constituted economic withholding) during the Summer Period. As the Commission found, of Shell's 19,643 MWh of total economic withholding during the Summer Period, approximately 98 percent of its bids remained anomalous even when the marginal cost proxy threshold was increased by a 10% sensitivity factor, and 92% remained anomalous when increased by 25%. Ex. CAL-733 at PP 101 (Opinion No. 536); Order on Rehearing of Opinion No. 536, 153 FERC ¶ 61,144 at P 46 (2015).

FF 143. Shell engaged in False Export during 110 hours of the Summer Period for a total of 1,657 MWh of falsely exported energy. Opinion No. 536 at P 127. On rehearing, the Commission expressly rejected Shell's attacks on Mr. Taylor's False Export screen, finding Mr. Taylor's approach to be "a reasonable method to identify signatures of False Export transactions." Order on Rehearing of Opinion No. 536, 153 FERC ¶ 61,144 at P 60 (2015). The Commission also found that "the pattern of behavior, as measured through the transactions captured by Mr. Taylor's False Export screen, was a key indicator of consistent behavior of tariff violations that permeated through the Summer Period." Order on Rehearing of Opinion No. 536, 153 FERC ¶ 61,144 at P 65 (2015).

FF 144. Shell engaged in 2,598 False Load Scheduling violations that involved 167,545 MWh during the Summer Period. *San Diego Gas & Elec. Co.*, Initial Decision, 142 FERC ¶ 63,011, at P 58 (2013); Ex. CAL-733 at PP 138, 170-185 (Opinion No. 536); Order on Rehearing of Opinion No. 536, 153 FERC ¶ 61,144 at PP 95-111 (2015).

FF 145. The Commission also found in Opinion No. 536 that Shell engaged in other manipulative activity that violated controlling tariffs but as to which the California Parties did not present evidence of impact on the market clearing price, including Type I Anomalous bids, Phantom Ancillary Services, and Circular Scheduling. Ex. CAL-733 at PP 91-93, 189-193 (Opinion No. 536).

FF 146. Shell engaged in Type I Anomalous bidding during the Summer Period. Of the 34,850 total bids Shell submitted, 27,513, or 79%, were Type I Anomalous Bids that violated the ISO MMIP because they "were consistently priced too high and used to exploit shortages in supply in the CAISO real-time market." Opinion No. 536 at PP 58, 91-93. As the Commission found on rehearing, "we do not agree Coral was merely acting in accordance with prevailing market conditions when the record evidence shows other parties did not have to engage in similar bidding patterns to competitively participate in the market." Order on Rehearing of Opinion No. 536, 153 FERC ¶ 61,144 at P 44 (2015).

FF 147. Shell Real Time trader Tobin Dreher was recorded on August 4, 2000 explaining the process of selling Phantom Ancillary Services to the ISO to recently hired Shell trader Shokh Zewar, responding to her question of whether the "ISO know[s] all this" by explaining that its like taking "candy from a baby." Ex. CAL-319 at 27:11-29:8; Ex. CAL-328 A, B at 9:22-25.

FF 148. The Interim Period is the period of the Crisis from October 2, 2000 through January 16, 2001. It followed the Summer Period, which was addressed by the

Commission in Opinion No. 536, where the Commission found that widespread market manipulation by Shell and others raised prices in the ISO and PX markets. It came before the Negotiation Period, which began on January 17, 2001 after the IOUs, the ISO and the PX had become insolvent and the State of California, through CDWR, began purchasing short term and long term power in order to prevent rolling blackouts and stabilize California's electric markets. Ex. CAL-319 at 29:9-30:10, n.55.

FF 149. Following a brief drop in prices in October, 2000, prices ran up unexpectedly again in November of 2000. Squeezed between elevated acquisition costs in the PX and ISO and frozen retail rates, SCE and PG&E's financial positions rapidly deteriorated. Ex. CAL-319 at 31:17-20.

FF 150. On December 8th the Commission granted emergency relief requested by the ISO capping prices in the PX and ISO markets at $250 and in its order on December 15th imposed a soft cap of $150 along with other remedial measures. Ex. CAL-285 at 65:2-6; Ex. CAL-294; Ex. CAL-319 at 32:3-7.

FF 151. The price cap had the effect of allowing marketers to buy energy out of the PX at capped prices. This in combination with the exit of suppliers from the PX and ISO forced the ISO to purchase large volumes of OOM at uncapped prices of $1,000 per MWh or more. Ex. CAL-319 at 32:8-11.

FF 152. On December 9, 2000, Shell traders discussed getting things lined up so that they could "start abusing the ISO" by selling OOM and Ancillary Services. Ex. CAL-319 at 54:10-12; Ex. CAL-339A, B at 14.

FF 153. On December 20, 2000, Carey Morris and Shell Real Time trader Chris Giulini talked about how much money they had made on Phantom Ancillary Services and congestion wheels, and Carey commented on the need to be "creative" in dealing with the ISO. Ex. CAL-319 at 57:5-8; Ex. CAL-334A, B at 4.

FF 154. CDWR began purchasing on behalf of the ISO even before California's Governor formally directed CDWR to take over power purchasing for the Net Short on January 17, 2001, because the ISO was unable to acquire the needed supply on its own. Ex. CAL-319 at 58:6-9.

FF 155. Shell was one of the sellers that began selling to CDWR acting on behalf of the ISO before January 17, 2001. Shell would first arrange a sale with the ISO, and then would call CDWR. CDWR would buy the energy at the price agreed by the ISO and turn it over to the ISO. Ex. CAL-319 at 58:9-12; CAL-348A, B.

FF 156. The State of California through CDWR formally stepped into the role of buyer of the supplies needed to keep the ISO grid operating on January 17, 2001. Ex. CAL-319 at 61:5-8.

FF 157. On January 22, 2001, Shell trader Roy Alvarez defended the high margins Shell was collecting on a Shell/Glendale alliance spot transaction with CDWR to his counterpart at Glendale who questioned the ethics of "gouging" California during a system emergency: "It depends on what side you're on, man. Do you still believe there's a Santa Claus? If, if you think there's a Santa Claus then, then I would say, no, it's not ethical, to be getting the best price you can get." Ex. CAL-319 at 59:13-60:8; Ex. CAL-353A, B at 6:4-9.

FF 158. During the Negotiation Period, Shell made 156 separate contractual Spot Market sales to CDWR in 1,703 individual hours. Ex. CAL-319 at 107:1-7; Ex. CAL-490 (Docket No. EL01-10, Ex. CAT-408).

FF 159. These 156 Spot Market contracts were also the subject of the proceeding in Docket No. EL01-10 that culminated in the issuance of *Puget Sound Energy, Inc.*, 151 FERC 61,173 (2015) (Opinion No. 537), in which the issue is whether Shell's sales to CDWR under these contracts should be subject to refund notwithstanding the *Mobile-Sierra* presumption. Ex. CAL-319 at 107:1-7; Ex. CAL-725 at PP 978, 1022 (EL01-10 Initial Decision); Ex. CAL-724 (Opinion No. 537); *Puget Sound Energy, Inc.*, 153 FERC ¶ 61,386 (2015).

FF 160. In addition to new evidence of Shell's False Exports and bad faith exploitation of CDWR in these 156 Spot Market contracts discovered for the first time and admitted into the record of this proceeding, Mr. Taylor submitted, as part of his testimony in this proceeding, relevant portions of his 2012-2013 testimony and exhibits from Docket No. EL01-10 to show that Shell engaged in False Exports and bad faith in certain of the 156 contracts. Ex. CAL-319 at 85:15-1, 107:1-12; Ex. CAL-330 (Taylor Direct Testimony in Docket No. EL01-10); Ex. CAL-761 (Taylor Rebuttal Testimony in Docket No. EL01-10); Ex. CAL-490 (Docket No. EL01-10, Ex. CAT-408).

FF 161. Shell trader Shokh Zewar arranged the April 24, 2001 multi-hour False Export. She purchased energy from Duke in NP-15 within the ISO for $140/MWh, sold it to Dynegy at COB for $300/MWh and immediately bought it back at COB, still as a south to north transaction, for $325/MWh (thus paying Dynegy $25 to export the energy out of the ISO), set up a buy/resale with PacifiCorp for $20/MWh to falsely sink it in the PNW and sell it back to Shell at COB, and then resold the energy to CDWR as energy sourced in the PNW from PacifiCorp for $350. The transaction allowed Shell to buy energy in California within the ISO for $140/MWh and, by using Dynegy as an intermediary and PacifiCorp as a false sink, falsely represent to CDWR that the energy was coming from the PNW at a cost of $350. Shell incurred fees of $45 and netted a profit of $165/MWh. Tr. 1486:12-1490:25; Ex. CAL-319 at 86:4-96:2, tbl.2; Ex. CAL-372A, B; Ex. CAL-373A, B; Ex. CAL-374A, B; Ex. CAL-375A, B; Ex. CAL-377A, B; Ex. CAL-511A, B; Ex. CAL-512A, B; Ex. CAL-717 at 47:29-54:5, 58:3-59:9.

FF 162. PacifiCorp's participation in the April 24, 2001 HE 1 False Export as the false sink is clear from the trader tapes and confirmed by Ex. CAL-816, the CDWR Real Time spreadsheet in which the comment filed for the Coral purchase in HE 1 on April 24, 2001 shows that Shell represented the source of the energy as PAC, the trader shorthand for PacifiCorp. Ex. CAL-816 at Cell D 13; Tr. 1486:12-1490:25; Ex. CAL-372A, B. Ex. CAL-373A, B; Ex. CAL-374A, B; Ex. CAL-375A, B.

FF 163. Oral and written email conversations between and among Shell's traders and their managers reveal that Shell consciously exploited CDWR's and the ISO's must buy circumstances by maximizing profits at CDWR's expense. Ex. CAL-319 at 30:12-31:10, 69:6-81:6; Ex. CAL-340A, B; Ex. CAL-359A, B at 6-8; Ex. CAL-362A, B at 2-4; Ex. CAL-459A, B; Ex. CAL-460A, B; Ex. CAL-363; Ex. CAL-353A, B at 6:4-9; Ex. CAL-452A, B at 9.

FF 164. In an internal conversation on January 18, 2001, as the ISO had just experienced rolling blackouts, Beth Bowman, general manager of Shell's West Region, discussed the millions Shell had made in profits on January 17-18, 2001 by selling to CDWR, and stated that she had no ethical problem with blackouts in California, except to the extent that blackouts could require a cessation of Shell's San Diego trading operations. Ex. CAL-319 at 69:12-71:2; Ex. CAL-359A, B at 6-8.

FF 165. In an internal Shell email on January 26, 2001, Shell trader Chris Giulini kept his boss Carey Morris apprised of hourly laundering transactions Giulini was arranging in order to sell to CDWR at COB at a profit of $225/MWh, noting that the ISO was on the verge of cutting Firm customers, and joking that "I am pretty sure there is a reserved parking space in hell waiting for me." In a response, Mr. Morris commended Giulini for his "craftiness" and "creative thinking." Ex. CAL-319 at 78:18-79:25; Ex. CAL-363.

FF 166. In a February 17, 2001 internal conversation between Hank Harris, head of Shell's Real Time trading and one of his traders, the topic was that a third trader, Travis

Vining, was too timid when the ISO informed him that the trade he planned to do was a ricochet and not permitted, and Hank instructed that Travis should not have "let some chucklehead at the ISO" talk him down. Ex. CAL-319 at 73:18-75:15; Ex. CAL-458A, B; Ex. CAL-459A, B.

FF 167. On March 7, 2001, internal conversations between Carey Morris, Shell's supervisor of Real Time traders who reported to Hank Harris, and Shell trader Travis Vining, and then between Travis Vining and another Shell trader, Vince Velasquez, the topic was how to misrepresent to the ISO in order to make sure that Shell's planned Circular Schedules would not be detected. Ex. CAL-319 at 75:17-77:38; Ex. CAL-460A, B.

FF 168. In an internal conversation late in the Negotiation Period between Hank Harris, head of Shell's Real Time trading and one of his senior traders, Roy Alvarez, the topic was whether an existing Shell employee would be suitable for Shell's trading group. Roy's opinion was that Mike lacked the "killer instinct." Hank disagreed, and observed that Mike was "one of those bright kids that when he figures out how to break the rules he gets a little giggle out of it." Ex. CAL-319 at 72:7-73:17; Ex. CAL-362A, B at 2-4.

FF 169. Manipulation of Spot Market prices inflated forward market prices for electricity. Ex. CAL-604 at 45:13-15.

b. <u>Causal Connection of Unlawful Activities to Contract</u>

FF 170. The State created the California Energy Resources Scheduling (CERS) division of CDWR in January 2001 for the purpose of purchasing power, developing and administering a portfolio of power contracts, and overseeing the reconciliation and recovery of costs associated with both spot market and long-term contract power purchases made on behalf of the IOUs. Ex. CAL-210 at 2:18-3:2.

FF 171. CDWR's goal was to enter into a portfolio of long-term contracts to help reliability in California and to decrease the State's over-reliance on the volatile and high-priced spot market. Ex. CAL-200 at 6:7-14, 8:8-11, 25:8-9; Ex. CAL-210 at 2:18-3:2, 5:13-18; Tr. 202:10-22 (Nichols).

FF 172. To secure contracts with just and reasonable terms, CDWR employed a number of experienced energy and business consultants to assist in its operations, including Deloitte & Touche, McKinsey & Company, Montague DeRose & Associates, Electric Power Group, Blackstone Saber Partners, Navigant, Hardy Energy Consultants, Natsource, and PriceWaterhouse Coopers. Tr. 211:20-214:22 (Nichols); Tr. at 466:5-468:2 (Hart); Tr. at 551:18-554:2 (Lee); *see also* Ex. SNA-228 at 24:1-14.

FF 173. CDWR spent millions of dollars per month on its expert energy consultants. Tr. 470:16-19 (Hart).

FF 174. CDWR was the largest buyer of electricity in the West in 2001. *See* Tr. 183:16-23 (Nichols); Ex. SNA-228 at 7:7-12; Ex. IB-266.

FF 175. Coral's San Diego regional office opened in 1999 with six employees. Tr. 1500:2-5 (Bowman).

FF 176. By 2000-2001, Coral's San Diego office had approximately 20 to 25 employees. Tr. 1588:13-15 (Brown).

FF 177. Shell Energy witness Mr. Ed Brown was the lead negotiator of the Coral Contract on behalf of Coral. Ex. SNA-219 at 5:16-18.

FF 178. Shell's Beth Bowman supervised the activities of those involved in both short-term trading and negotiation of the CDWR long-term contract, with responsibility for maximizing profitability of the office taken as a whole. Tr. 1501:22–1502:5 (Bowman).

FF 179. Hank Harris, Shell's manager of Spot Market trading, advised on the operational aspects of the Shell Contract. Ex. CAL-880 at 3.

FF 180. Shell participated in a Summer Reliability Agreement (SRA) with CAISO to provide reliability generation during the summer months. In return for CAISO's payment of incentive fixed prices in the form of capacity payments to expedite the construction of new generation resources, Shell agreed to build five 43-MW gas turbine generators through Shell's affiliate, Wildflower Energy, L.L.C. (Wildflower). Shell also built a peaking unit in La Rosita, Mexico, for use in the California market. Under the SRA, CAISO could cause the plants to operate for a limited number of hours, but it was Shell's responsibility to arrange for the sale of the plants' power within the CAISO control area. So Shell was building the Wildflower and La Rosita plants without a third-party power purchase agreement—that is, with no assured buyer for this power. Ex. SNA-219 at 5:20-6:1 (Brown Answering); Ex. S-101 (SRA Agreement); Ex. SNA-219 at 6:3-23 (Brown Answering); Ex. S-100R at 11:11 (Poffenberger Answering); Ex. SNA-

219 at 9:14-19 (Brown Answering); Ex. SNA-219 at 6:8-11 (Brown Answering); Ex. SNA-219 at 6:15-17 (Brown Answering).

FF 181. Each of the five Shell SRAs involved the construction and operation of a simple-cycle combustion turbine peaking facility with generating capacity of 43 MWs (45 MWs for Unit 5), for a total generating capacity of 217 MWs, for the summers of 2001-2003, with a commercial operation date of June 15, 2001. Shell referred to the peaking facilities as the Wildflower peaking units. Ex. CAL-834, Schedule A; Ex. CAL-200 at 14:6-9; Ex. COR-1 at 5-6.

FF 182. Assignment of the SRAs from the ISO to CDWR was a critical part of the State's effort to get committed in advance as much power as it could for delivery in Summer 2001. Ex. CAL-156 at 28:21-29:3; Ex. CAL-200 at 14:16-15:1; Ex. CAL-201 at 63; Ex. COR-45.

FF 183. The contract between Shell and CDWR was negotiated between the parties from February 20, 2001 through the day of its signing. It was signed on May 25, 2001, although the writing bears a date of May 24, 2001. Ex. CAL-200 at 15:4-8 (Nichols Direct); Ex. CAL-200 at 20:17-19 (Nichols Direct); Ex. CAL-31 (CDWR-Shell Contract).

FF 184. The contract term ran from May 25, 2001 through June 30, 2012. The base products consisted of Shell's delivery to CDWR of peak 6x16 energy (i.e., at peak hours, on Mondays-Saturdays between 7:00 a.m. and 10:00 p.m.), ranging from 50-400 MW; and 7x24 energy ranging from 50-100 MW. The contract also included options for Shell to increase the peak hour volumes by 175 MW in July 2003, and by another 175 MW commencing in July 2004 through the remainder of the contract term. Ex. CAL-636; Ex. CAL-200 at 13:15-16 (Nichols Direct); Ex. CAL-200 at 21:2-7 (Nichols Direct).

FF 185. The contract's pricing was tiered as follows: $169/MWh through May 31, 2001; $249/MWh from June 1, 2001 through October 31, 2001; $115/MWh from November 1, 2001 through June 30, 2002; $169/MWh from July 1, 2002 through December 31, 2003; $72.87/MWh from January 1, 2004 through December 31, 2005; and $25.16/MWh plus fuel costs from January 1, 2006 through June 30, 2012. A "tolling" structure was included in this latter price tier, in which CDWR had the right to supply its own natural gas fuel at its own cost. CDWR was also obligated to pay capacity payments from July 1, 2002 through December 31, 2005 for each Shell generating facility (the Wildflower Peaking Units) that was online during that time period. Ex. CAL-200 at 21:7-

12 (Nichols Direct); Ex. CAL-200 at 19:15-16 (Nichols Direct); Ex. CAL-200 at 21:12-15 (Nichols Direct).

FF 186. Navigant took the lead for CDWR on the negotiation of the Shell Contract. Ex. CAL-200 at 13:4.

FF 187. On behalf of CDWR, California Parties witness Mr. Ronald Nichols personally participated in the process that led to the Shell contract. His firm, Navigant Consulting, Inc. (Navigant) developed and ran analytical models to assist CDWR with the long-term contract process and participated in the solicitation and evaluation of supply bids for, and the negotiation of, the CDWR long-term contracts. Ex. CAL-200.

FF 188. On behalf of CDWR, California Parties witness Mr. Hart served as Deputy Director of the California Energy Resources Scheduling division of CDWR (CERS) from January 17, 2001, through August 2001. Ex. CAL-210 at 2:14-16.

FF 189. Mr. Hart reviewed and signed the Shell contract and was familiar with the circumstances surrounding the contract negotiation and was apprised of the various milestones in the negotiation of the Shell contract. Mr. Hart notes that Mr. Nichols was more familiar with the specifics of the day-to-day negotiations of the Shell contract. Ex. CAL-210 at 14:15-15:3.

FF 190. Tara Nolan, a Navigant employee who reported to Mr. Nichols, was involved in the day-to-day Shell Contract negotiations. Tr. 247:11 (Nichols).

FF 191. Mr. Nichols explains that CDWR analyzed the pricing in Shell's proposals with the use of a contract and spot market pricing model. This model was used by CDWR and Navigant from February through early June 2001 and was developed as a tool to evaluate multiple combinations of prospective contracts relatively quickly. Ex. CAL-200 at 17:12-15; Ex. CAL-156 at 13:18-14:11; Ex. CAL-201 at 10 (item 34).

FF 192. A contract and spot market pricing model was used by CDWR and Navigant from February through early June 2001. Ex. S-100R at 38.

FF 193. In lieu of relying on forward market prices, CDWR set an internal target to obtain a weighted average cost of $70/MWh for its entire portfolio of long-term power contracts. Ex. CAL-200 at 6:17-7:2; Tr.195:23-197:12 (Nichols).

FF 194. CDWR's portfolio target of \$70/MWh reflected the all-in power generation cost already embedded in the average retail rates of the three California IOUs as of 1998, when the legislature restructured the State's electric power industry. Ex. CAL-200 at 6:17-7:2 (Nichols); Tr. 196:6-20 (Nichols).

FF 195. In evaluating long-term contract proposals, CDWR considered reliability to be an important factor and wanted to bring new generation, such as the Wildflower units of Coral's affiliate (Intergen), online by the summer of 2001. Tr. 206:11-23 (Nichols); *see* Ex. COR-10 (Memorandum regarding Summer Reliability Agreements).

FF 196. CDWR issued two requests for bids (RFBs), one dated January 23, 2001 and one dated February 2, 2001. CDWR sought deals for terms of one to three years, but left open the possibility for longer terms in order to encourage sellers to offer CDWR's average price target of \$70/MWh. Shell did not respond to the first RFB, but did respond to the second. Ex. CAL-200 at 8:14-15 (Nichols Direct); Ex. CAL-51 at 31:1-13 (Nichols Direct); Ex. CAL-66; Ex. CAL-67; Ex. CAL-051 at 31:1-13 (Nichols Direct); Ex. SNA-219 at 7:13-8:4 (Brown Answering).

FF 197. CDWR distributed the RFBs to as many potential sellers as possible. CDWR emailed the RFBs to a number of market participants and publicly posted the RFBs on CDWR's website. Tr. 218:19-219:19 (Nichols).

FF 198. In response to CDWR's second RFB, CDWR received approximately 110 separate bids from 44 bidders, including bids from some of the largest energy companies in the country. Ex. DYN-44 at 3; Tr. 242:4-18 (Nichols).

FF 199. The State's interest in having CDWR take assignment of the SRAs launched the negotiations between CDWR and Shell for a long-term contract. Ex. COR-10; Ex. CAL-200 at 15:1-2.

FF 200. In response to CDWR's second RFB, Shell offered to sell CDWR 100 MW of 7x24 power at a fixed price of \$71.50/MWh for five years commencing January 1, 2002. Ex. CAL-203; Ex. SNA-219 at 8:5-8 (Brown Answering); Ex. COR-1 at 12:7-14 (Brown Answering).

FF 201. On the date of the second RFB, forward prices at SP-15 stood at approximately \$130/MWh for 2002 delivery and \$75/MWh for 2003 delivery. Spot electric prices at SP-15 stood at approximately $200/MWh. Ex. CAL-604 at 25, fig.5 (Goldberg Direct); Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

FF 202. CDWR did not respond back, and when Shell contacted CDWR about it, CDWR informed Shell that it was not interested in the bid. CDWR was more interested at that time in procuring 6x16 energy (that is, delivered at peak hours, on Mondays-Saturdays between 7:00 a.m. and 10:00 p.m.) that began deliveries in 2001, which Shell did not offer in its bid. Ex. SNA-219 at 8:8-9 (Brown Answering); Ex. COR-1 at 12:12-14 (Brown Answering); Ex. CAL-200 at 13:16-17 (Nichols Direct); Tr. 245:7-246:4 (Nichols Cross).

FF 203. Shell was concerned about the impact of CAISO's financial health on its Wildflower and La Rosita construction plans, so its representatives met with CDWR officials on February 23, 2001. Ex. SNA-219 at 9:11-21 (Brown Answering); Ex. CAL-200 at 15:9-14 (Nichols Direct).

FF 204. CDWR informed Shell that the State had a critical need for power deliveries during March and April 2001, before Shell's Wildflower units were scheduled to come online in July 2001. In response, Shell made on February 26, 2001 a 10-year offer to provide capacity and energy, beginning July 1, 2001, of principally 6x16 and 7x24 power for 210 MW for the first two years, with increasing base quantities and additional volumes over time. Ex. CAL-200 at 15:16-16:2 (Nichols Direct); Ex. SNA-219 at 10:5-9 (Brown Answering); Ex. CAL-200 at 16:3-6 (Nichols Direct); Ex. SNA-219 at 10:21-11:3 (Brown Answering); Ex. COR-11.

FF 205. Shell offered CDWR a price for energy of $93.95 per MWh for delivery during the period July 1, 2001 through June 30, 2004, and $58.75/MWh for delivery during the period July 1, 2004 through June 30, 2011. Shell requested capacity payments for four years commencing on July 1, 2002 at a price of $352,000 per month for each of the five Wildflower units, for a total of $1,760,000 per month. Ex. CAL-200 at 16:6-8 (Nichols Direct); Ex. SNA-219 at 11:3 (Brown Answering); Ex. COR-11; Ex. CAL-200 at 16:8-9 (Nichols Direct); Ex. SNA-219 at 11:3 (Brown Answering); Ex. COR-11.

FF 206. CDWR and NCI evaluated Shell's term sheet using its spot market pricing model. On March 12, 2001, Tara Nolan of NCI reported to CDWR the results of the analysis: "Absent another benchmark not sure where to go with the analysis but I think overall the deal looks acceptable." Ex. CAL-200 at 17:13-18:11 (Nichols Direct); Ex.

CAL-51 at 11:10-14:2 (Nichols Direct); Exs. CAL-53, CAL-54, CAL-161, CAL-162; Ex. CAL-205.

FF 207. CDWR and Shell signed a Letter of Intent (LOI) on April 6, 2001 for a power purchase agreement that would span eleven years and three months. The LOI provided for Shell's energy sales to commence in April 2001 for 100 MW at a price of \$169/MWh. Shell purchased this power on the market and sold it to CDWR at a loss to Shell, with the understanding that Shell would be made whole in the event that the agreement was not executed. The LOI provided that if the anticipated long-term contract was not signed by April 30, 2001, the \$169/MWh price would be retroactively revised upward to \$260/MWh. Ex. CAL-200 at 18:12-17 (Nichols Direct); Ex. SNA-219 at 17:8-18:4 (Brown Answering); Ex. COR-16; Ex. SNA-219 at 21:8-11 (Brown Answering); Ex. CAL-200 at 19:1-9 (Nichols Direct); Ex. COR-16.

FF 208. The LOI also provided for Shell's delivery of increasing quantities of power during the summer of 2001, and even greater quantities for 2002 through 2010. Energy pricing was set as \$169/MWh through 2003, and \$72.87/MWh thereafter through 2005. The capacity payment was set at Shell's requested \$1,790,000 per month for the five Wildflower units (\$21,480,000 per year). For 2006-2012, the LOI provided for a gas-indexed price structure under which CDWR paid a \$25.16/MWh fixed charge plus fuel costs. Alternatively, a tolling structure permitted CDWR to provide the volumes of natural gas needed to serve the contract. Ex. COR-19 at 9; Ex. CAL-200 at 19:10-16 (Nichols Direct); Ex. COR-16.

FF 209. On February 20, 2001, CDWR communicated its interest in taking assignment of Shell's five SRAs, including a bilateral contract for capacity and energy from the Wildflower peaking units. Ex. COR-10.

FF 210. On February 23, 2001, Shell's Arlin Travis and Ed Brown travelled from San Diego to Sacramento to meet with CDWR to discuss CDWR's February 20, 2001 proposal. Pete Garris, who was in charge of CDWR's Spot Market purchasing, Richard Ferreira, a CDWR consultant, and Tara Nolan and Mr. Nichols from Navigant, participated on CDWR's behalf. Ex. COR-1 at 14:7-9; Tr. 1653:13-17 (Brown); Ex. CAL-200 at 15:11-14.

FF 211. As part of the initial February 23, 2001 discussion, CDWR made clear to Shell that the State had a critical need for power deliveries that would begin before the

SRAs were scheduled to come online in July 2001. Ex. CAL-200 at 15:16-16:2; Ex. COR-1 at 15.

FF 212. On February 26, 2001, Shell submitted to CDWR a proposal to sell up to 1060 MWs phased in over three years with prices of $93.95/MWh for July 1, 2001 – June 30, 2004 and $58.75/MWh for July 1, 2004 – June 30, 2011. Ex. COR-11; Ex. CAL-200 at 16:6-8.

FF 213. In addition to the price for the sale of energy, Shell's February 26, 2001 proposal required capacity payments commencing July 1, 2002, for four years at a price of $1,760,000 per month. Ex. COR-11; Ex. CAL-200 at 16:8-9.

FF 214. On February 28, 2001, Shell negotiator Arlin Travis advised Mr. Brown, Shell traders Mr. Turrent and Mr. Harris, and their supervisor, Ms. Bowman, of CDWR's request for short-term power in April, May, and June 2001. Mr. Harris, who was responsible for the day-to-day management of all of Shell's short-term power trading in the West replied: "We'll look to throw them April–June power, if we find it." Ex. CAL-204; Ex. CAL-670 at 19:11-16.

FF 215. Shell revised its February 26, 2001 proposal memorialized in a term sheet dated March 16, 2001 under which the contract term started on April 1, 2001 with 100 MWs of power for April-June 2001 in exchange for higher prices and other modifications benefitting Shell and CDWR. Ex. COR-14; Ex. CAL-200 at 16:18-17:1.

FF 216. The March 16, 2001 term sheet significantly increased the price from the February 26, 2001 proposal – from $93.95/MWh to $169/MWh in the early years (2001-2003) – increased Shell's optionality in delivery points, and extended the contract an additional year. Ex. COR-14; Ex. COR-11; Ex. CAL-200 at 17:5-8.

FF 217. The longer-term prices in Shell's March 16, 2001 term sheet changed from $58.75/MWh to $72.87/MWh for January 1, 2004 – December 31, 2005, and to fixed charges of $25.16/MWh plus fuel costs for January 1, 2006 – June 30, 2012. Ex. CAL-200 at 17:8-11; Ex. COR-14.

FF 218. Shell and CDWR negotiated an LOI, which they executed on April 6, 2001, setting forth a non-binding summary of various terms and conditions for a power purchase agreement that would span eleven years and three months. Ex. COR-16; Ex. CAL-200 at 18:14-17.

FF 219. The LOI provided for Shell's energy sales to commence right away under the Western Systems Power Pool (WSPP) Agreement for 100 MW at a price of $169/MWh for April 2001 sales. Ex. CAL-200 at 19:4-7; Ex. COR-16.

FF 220. The LOI provided, however, that if the anticipated long-term contract was not signed by April 30, 2001, the $169/MWh price for April deliveries would be retroactively revised upward to $260/MWh. Ex. CAL-200 at 19:7-9; Ex. COR-16; Tr. 423:1-22 (Hart).

FF 221. In the LOI, energy pricing for all products was set as $169/MWh through 2003 and $72.87/MWh through 2005. Ex. COR-16; Ex. CAL-200 at 19:11-12.

FF 222. For 2006-2012, the LOI provided for a gas-indexed price structure under which CDWR paid a $25.16/MWh fixed charge plus fuel costs, or alternatively, CDWR could provide the equivalent volumes of natural gas needed to serve the contract. Ex. CAL-200 at 19:12-16; Ex. COR-16.

FF 223. The final long term agreement was not completed by the April 30, 2001 LOI expiration date, so the parties agreed to extend the LOI to May 31, 2001, with May deliveries handled the same as April's at the same price of $169/MWh, and a fallback price of $315/MWh if a final deal was not signed in May. Ex. CAL-200 at 20:3-9 (Nichols Direct); Ex. SNA-219 at 20:17-20 (Brown Answering).

FF 224. The price for Shell to deliver power in May 2001 remained at $169/MWh, but it would be retroactively adjusted to $315/MWh for May deliveries if the contract was not executed by May 31, 2001. Ex. CAL-200 at 20:7-9; Ex. COR-18.

FF 225. On May 7, 2001, Beth Bowman informed her supervisor, Debbie Wernet, that Ed Brown, Sarah Wolfe and James Davitt were on their way to Sacramento for two days of "tough negotiations with CDWR." Ex. CAL 496; Tr. 1579:20-1580:13 (Bowman).

FF 226. After CDWR had repeatedly rejected Shell's demands for termination payments if the revenue bonds designed to secure CDWR's creditworthiness were not timely issued, on May 8, 2001, Shell asked CDWR to change the contract pricing such that Shell would sell at market prices, rather than at $169/MWh, and then Shell would refund the difference between market and $169, or hold the difference in an escrow account to be refunded, when the bonds were issued at investment grade. Ex. CAL-855 at 20, Ex. CAL-857 at 22; Ex. COR-1 at 36:14-17.

FF 227. On May 8, 2001, CDWR responded that it had not agreed to Shell's termination payment proposal with any other party, that the Shell demand would trigger the most favored nations status in other contracts, and in the alternative, CDWR proposed a mechanism to take the contract price back to market prices determined after the fact if Shell elected to terminate due to failure to issue revenue bonds. Ex. COR-1 at 36:17-37:5-7; Tr. 1707:1-1708:22 (Brown).

FF 228. On May 9, 2001, Shell declined CDWR's May 8, 2001 proposal concerning termination payment. Ex. COR-1 at 37:3-38:12.

FF 229. On May 24, 2001, the Governor's office requested the removal of the termination payment provision from the Shell Contract. Tr. 520:11-521:3, 524:14-16 (Hart).

FF 230. Near the end of May, CDWR agreed to reimburse Shell for its power purchases on CDWR's behalf by paying for April through September 2001 purchases at monthly forward rates ranging from $245 to $350 per MWh. CDWR estimated that if it did not complete the deal with Shell by May 31, 2001, it would owe Shell about $9.4 million in retroactive payments for the power that Shell had sold to CDWR in April and May 2001. Ex. SNA-219 at 23:4-9 (Brown Answering); Ex. COR-20; Ex. CAL-200 at 20:13-17 (Nichols Direct); Ex. CAL-207.

FF 231. This deal fell apart at the last minute in the office of the Governor of California. According to Hart, "CDWR was told by the administration that the Shell deal as structured on May 24, 2001 would have been a political nightmare because under it CDWR was agreeing as a contingency to retroactively pay Shell astronomical Spot Market prices – the very prices that were the driving force for CDWR getting into long-term contracts." Ex. CAL-673 at 8:8-12 (Hart Rebuttal).

FF 232. Even after the Governor's office refused to allow CDWR to execute the Shell Contract with the termination payment in place, CDWR executed the Shell Contract the next day replacing the termination payment with increased upfront energy pricing. Ex. CAL-673 at 8:1-17; Tr. 444:14-18, 524:2-19 (Hart); Ex. CAL-670 at 12:1-4; Ex. CAL-671; Ex. CAL-674 at 3-4.

FF 233. In place of the original deal, CDWR proposed to Shell a price change for the initial period of the agreement. Instead of $169/MWh through 2003 with retroactive protection as agreed upon, CDWR proposed: (i) $169/MWh for April and May 2001 purchases through May 31, 2001; (ii) $249/MWh for purchases from June 1, 2001 through October 31, 2001; (iii) $115/MWh for purchases from November 1, 2001 through June 30, 2002; and then (iv) $169/MWh for purchases from July 1, 2002 through December 31, 2003. Ex. SNA-219 at 23:14-25:4 (Brown Answering).

FF 234. In the last minute change to the Shell Contract, Shell went from having a provision similar to an insurance policy where Shell could receive additional funds if CDWR could not secure bonds to a provision in which Shell absolutely received these additional funds as part of the price of energy. Ex. CAL-673 at 9:1-5.

FF 235. Shell agreed that the last minute changes to the contract were revenue neutral. Ex. SNA-219 at 35:12-17.

FF 236. Shell did not walk away from the deal on May 24, 2001; it came back and signed the contract on May 25, 2001. Ex. CAL-673 at 9:9-11.

FF 237. The deal was signed; although the contract bears the date May 24, 2001, the parties actually executed it on May 25, 2001. Ex. CAL-200 at 20:17-18 (Nichols Direct); Ex. CAL-31 (executed agreement).

FF 238. By this time, both spot and forward prices had fallen well below the rates set forth in the agreement. As of May 25, 2001, forward market electricity prices at SP-15 stood at approximately $75/MWh for 2002 delivery and $50/MWh for 2003 delivery. Spot electric prices at SP-15 stood at approximately $110/MWh. Ex. CAL-604 at 25, fig.5 (Goldberg Direct).

FF 239. Navigant performed modeling that included the Shell contract and modeling that did not include the Shell Contract so that CDWR could evaluate the impact on the overall portfolio, which included the change in Spot Market purchases. Tr. 290:6-11 (Nichols).

FF 240. CDWR's model included "a 'market adder,' measured as a percent of the assumed base price," to account for the difference between the model's prices and conditions CDWR was seeing in the spot market. Ex. CAL-156 at 17:19-20:17.

FF 241. Beth Bowman admitted that Shell relied on forward prices to evaluate the Shell Contract throughout the negotiations. Tr. 1558:25-1559:2 (Bowman).

FF 242. CDWR and ISO management gave priority to maintaining the electric grid to preserve the safety and well-being of electric consumers. Ex. CAL-680 at 7:19-21.

FF 243. During the period from January through June 2001 the ISO, and CDWR employees acting at its direction, waged an hourly battle to procure enough power to balance the grid and avoid rolling blackouts. Ex. CAL-680 at 8:6-9.

FF 244. Continued reliance on the Spot Market jeopardized the reliability of the system going into the summer of 2001. Ex. CAL-680 at 9:4-6, 10:18-20, 12:4-8.

FF 245. During numerous "peak day" calls when Stage 2 or Stage 3 emergencies were declared, FERC personnel who participated in the calls told Mr. McIntosh that the ISO should not consider cost as a factor in procuring power, even though FERC knew that the ISO often had to pay 5 to 10 times the usual price for energy. Ex. CAL-680 at 9:6-8; Tr. 605:14-607:10 (McIntosh).

FF 246. From the ISO's perspective, long-term contracts were absolutely necessary for CDWR to assure reliability given the continuingly chaotic and dysfunctional Spot Market. Ex. CAL-680 at 12:4-8.

FF 247. A complete copy of the executed Shell Contract is contained in the record of this proceeding as Ex. CAL-31.

FF 248. The Shell Contract was executed on May 25, 2001 and ran for a term of eleven years, ending June 30, 2012. Ex. CAL-634R at 6:15-16; Ex. CAL-31.

FF 249. CDWR paid Shell approximately $2.85 billion for 34.5 million MWh of energy deliveries under the Shell Contract, at an average "all-in" cost of $82.51/MWh. Ex. CAL-634R at 10:3-4, 11, fig.1; Ex. CAL-216.

FF 250. The Shell Contract rates were fixed through 2005, but varied over time as follows. Ex. CAL-634R at 7:2-8; Ex. CAL-636; Ex. CAL-31.

FF 251. Starting January 1, 2006, the Shell Contract converted to an indexed pricing arrangement with a $25.16/MWh fixed charge (applied to fixed energy deliveries) plus fuel costs. Ex. CAL-634R at 7:9-12; Ex. CAL-636; Ex. CAL-31.

FF 252. Starting in 2002, CDWR had the option to schedule dispatch of each of the five Wildflower Peaking Units up to 500 hours each calendar year through 2005. CDWR paid Shell capacity payments of $358,000 per month (or approximately $100/kW-yr) from July 2002 – December 2005 for each Wildflower unit that was online during that period. Ex. CAL-634R at 9:3-18; Ex. CAL-636; Ex. CAL-31.

FF 253. The Shell Contract was not tied to any specific generation source, meaning that Shell could fulfill its delivery obligations solely from the market. Ex. CAL-634R at 9:3-4; Ex. CAL-636; Ex. CAL-31; Ex. CAL-804 at 6:9-12; Tr. 905:25-906:3, 931:22-932:2 (Kito).

FF 254. The Shell Contract included non-price terms related to volume and delivery location flexibility. Ex. CAL-634R at 8:2-14, 27:9-14, 41:14-42:8; Ex. CAL-636.

FF 255. After 2006, CDWR had the option to reduce volumes by 25 MW per quarter for the 7x24 product delivered under the contract. However, CDWR would still have to pay the fixed charge of $25.16/MWh for the reduced quantities "notwithstanding the fact that such [r]educed [quantities] are not to be delivered." Ex. CAL-634R at 41:16-17; Ex. CAL-636; Ex. CAL-31, § 3.6(f).

FF 256. Shell had the option to increase peak hour volumes by 175 MW from July 2003 onward, and another 175 MW from July 2004 onward. Ex. CAL-634R at 8:2-5, 42:1-4; Ex. CAL-636; Ex. CAL-31.

FF 257. Shell had the option to reduce peak-hour (6x16) and clock-hour (7x24) volumes and increase peak-hour volumes by 10% annually. Ex. CAL-634R at 41:21-42:1; Ex. CAL-636; Ex. CAL-31; Ex. CAL-665 at 14:19-15:11.

FF 258. Shell's costs did not drive Shell pricing to CDWR. Shell's price was driven by Shell's quest for the highest margin it could get. Ex. CAL-319 at 103:2-5; Ex. CAL-717 at 62:1-65:25 (Taylor); Ex. CAL-332A, B; Ex. CAL-381A, B; Ex. CAL-384; Ex. CAL-751A, B; Ex. CAL-752A, B.

FF 259. Shell recognized by February of 2001 that the generation it had coming online, La Rosita and the Wildflower Units, gave Shell a long position in the market. Shell expected market prices would decrease or "tank." Ex. CAL-319 at 183:12-15; Ex. CAL-358.

FF 260. Shell recognized that its long position in the market coupled with its expectations that the market would tank created an incentive for Shell to enter into a long-term agreement to lock in high market prices for its excess generation and hedge against its long position. Ex. CAL-319 at 183:12-17; Ex. CAL-358.

FF 261. One of Shell's goals throughout the negotiation was to lock in Crisis Period prices. Ex. CAL-319 at 183:12-17; Ex. CAL-358.

FF 262. Ms. Bowman's contemporaneous evaluation of the Shell Contract estimated Shell's losses in the initial seven months of the Shell Contract at only $5 million, and she observed that because the Shell Contract was frontloaded, Shell would recover 70% of the total value of the Contract, roughly $336 million, in the first three years of the Shell Contract. Ex. CAL-319 at 175:10-17; Ex. CAL-717 at 132:5-10; Ex. CAL-451 at 3, 8-9.

FF 263. Long term contracts were viewed by CDWR as a way to pay off immediate power needs over time, not as a hedge to lock in the cost of future power purchases. Ex. CAL-200 at 5:11-6:17 (Nichols Direct); Ex. CAL-670 at 10:9-14 (Nichols Rebuttal); Tr. 642:20-25 (Pacheco Cross); Tr. 2688:13-20 (Ritchie Closing Arg.) ("PRESIDING JUDGE: … [CDWR] wanted to have those long-term contracts because then they could delay out the payments for the high spot prices they had to pay in the beginning; right? MR. RITCHIE: That was the exchange. That was the cost to keep the lights on … in California. They were forced to take these longer term deals, yes.").

FF 264. There is little evidence that CDWR compared the costs of its long term contract offers (including Shell's offers) to then-prevailing forward prices, which by April 2001 were declining for deliveries in future years. The evidence shows only that CDWR focused on reliability and reducing the size of the Net Short in early 2001. Tr. 2645:2-2647:1 (McKeon Closing Arg.); Tr. 2679:7-21 (Berman Closing Arg.).

FF 265. There is no evidence that CDWR's modeling technology was capable of alerting CDWR about declining spot and forward prices. Its sole purpose was to estimate the cost of the Net Short through 2003 based upon a projection of production costs, after taking into account whatever executed and proposed long term contracts were executed or under consideration when the model was run. Ex. CAL-156 at 14:12-19:16 (Nichols Rebuttal); Ex. CAL-161; Ex. CAL-162; Ex. COR-67 at 181:17-24, 191:8-20, 136:24-137:12 (Nolan Dep).

FF 266. Shell's manipulative actions in the Summer and Interim Periods contributed to the collapse of the California power markets, pushed the IOUs into bankruptcy and drove the State, in the form of CDWR, into the difficult position of purchasing enough power each day in the Spot Markets to keep California's lights on while at the same time negotiating long-term contracts to reduce its exposure to excessive Spot Market prices and to secure enough power to guard against predicted blackouts in the summer of 2001 and beyond. Ex. CAL-319 at 115:9-116:1.

FF 267. At the same time Shell was pursuing a long-term energy deal with CDWR, Shell continued to engage in manipulative trading strategies that contributed both to the stratospheric power acquisition costs CDWR was incurring through Spot Market purchases and to the reliability concerns that forced CDWR to seek relief through long-term contracts in the first place. Ex. CAL-319 at 116:10-15.

FF 268. Shell personnel who were negotiating the long term contract with CDWR enlisted the help of Shell's spot market traders who were engaged in unlawful, manipulative activities to find power for CDWR's summer needs. Tr. 1663:25-1667:2 (Brown); Ex. CAL-204.

FF 269. Shell's spot market traders and long term contract negotiators were well aware of the profitable outcomes of their spot market sales from employing these strategies. The audio tape recordings and e-mails of Shell trader conversations that have been admitted in evidence are replete with references to the traders' knowledge of unlawful activities and how profitable they were. Beth Bowman, the head of Shell's trading office that negotiated the CDWR-Shell contract and conducted Shell's spot market trades, was aware of these activities. Ex. CAL-717 at 57:23-28 (Taylor Rebuttal) (December 7, 2000 e-mails and telephone conversations show "that Ms. Bowman and Mr. Turrent, who were later involved with the long-term-contract negotiations, were fully apprised of the manipulative schemes of Shell's Real Time traders and the profits that Shell was reaping from those activities."); Exs. CAL-727, CAL-543A, B; Ex. CAL-423B at 2:21-5:4 ("Well. Yeah, that… (laughs) It wouldn't be done if there wasn't money involved"); Ex. CAL-328 at 9:12-11:4 ("It's candy from a baby"); Ex. CAL-363 ("I am pretty sure there is a reserved parking space in Hell waiting for me"); Ex. CAL-340-B at 9:2-7 ("TRAVIS: I don't know how honest that is, but, we're not in the honesty game are we? ROY: We're in optimizing. It's not a question of honesty. TRAVIS: Yeah. ROY: It's a question of optimization"); Tr. 1517:18-24, 1523:22-1524:5 (Bowman Cross); Ex. CAL-322 at 2.

FF 270. Internal Shell emails show that it understood that a contract with CDWR committing Shell's new generation resources, La Rosita and the Wildflower Units, to a long-term deal, was a "big bet" that historically high 2001 energy market prices would tank. Shell knew in early 2001 that the California Spot Markets were dysfunctional. Shell knew that regulators could stop the chaos and shut down the extreme profits through market mitigation at any time. Ex. CAL-319 at 117:3-118:14; Ex. CAL-358; Ex. CAL-476; Ex. CAL-378; Ex. CAL-387A, B at 5-6.

FF 271. Shell traders discussed the possibility that regulators might catch on to their manipulating ways, corroborating that Shell and its San Diego trading operation understood that regulatory action could be taken to lower the excessive Spot Market prices. Ex. CAL-319 at 118:14-119:15; Ex. CAL-463; Ex. CAL-361A, B; Ex. CAL-469.

FF 272. Shell personnel working on the long-term deal with CDWR knew about Shell's manipulative trading strategies in the Spot Market. Ms. Bowman oversaw all of Shell's western operations, including the spot traders, resided in the same office as the traders, and was kept abreast of both their manipulative trading strategies and excessive profits. At the same time, she was providing strategic direction regarding the CDWR deal, initiated the long-term contract approval process at Shell, and was heavily involved in all internal decisions concerning the agreement through its execution. Ex. CAL-319 at 120:1-5, 120:18-121:12; Ex. CAL-717 at 55:12-57:25; Ex. CAL-396; Ex. CAL-407; Ex. CAL-410; Ex. CAL-428; Ex. CAL-435; Ex. CAL-481; Ex. CAL-543A, B; Ex. CAL-727.

FF 273. Mr. Brown, who initiated Shell's lucrative arrangements with Glendale and Colton that Shell traders exploited throughout the Negotiation Period, was Shell's lead negotiator on the long term contract with CDWR. Mr. Brown maintained oversight of the Glendale and Colton relationships and was regularly copied on correspondence regarding the manipulative activities in the Spot Market undertaken with these municipalities and the profitability of manipulative schemes implemented through Shell's alliances. Ex. CAL-319 at 120:6-8, 121:12-122:1; Ex. CAL-414; Ex. CAL-426.

FF 274. Mr. Brown was kept informed of issues regarding the alliance agreements. Mr. Brown was copied on discussion of Shorting Generation and similar schemes with Glendale to bid Ancillary Services that they did not have and cover them by drawing on the inadvertent deviation leeway with LADWP. Ex. CAL-319 at 121:14-122:1; Ex. CAL-717 at 137:5-12; Ex. CAL-426; Ex. CAL-443i at 1; Ex. CAL-742.

FF 275. Mr. Harris, Shell's Real Time Manager, provided operational support and guidance regarding the Shell Contract. Shell Spot traders knew about the potential long-term deal with CDWR. Shell's term traders implemented the purchases of third quarter 2001 positions needed to hedge the early months of the contract because the generation to back the sale would not yet be on line. Ex. CAL-319 at 120:6-8, 122:6-123:16; Ex. CAL-618A, B; Ex. CAL-432; Ex. CAL-494; Ex. CAL-356; Ex. CAL-204.

FF 276. Mr. Morris, Shell's Real Time Supervisor, emphasized to his traders the need to keep one another, and especially the San Diego trading operation personnel outside the Real Time group, informed of all relevant market information acquired by the Real Time desk traders. The Real Time traders were a very close-knit group. Ex. CAL-319 at 122:13-123:2; Ex. CAL-618A, B; Ex. CAL-432; Ex. CAL-494; Ex. CAL-356.

FF 277. Shell Spot traders likewise knew about the potential long-term deal with CDWR. Mr. Harris, the Real Time Manager, was consulted in the contract negotiations. Shell's term traders implemented the purchases of third quarter 2001 positions needed to hedge the early months of the contract because the generation to back the sale would not yet be on line. Ex. CAL-319 at 122:6-123:16; Ex. CAL-618A, B; Ex. CAL-432; Ex. CAL-494; Ex. CAL-356.

FF 278. Mr. Harris supported the long-term contract negotiations. Following Shell's first meeting with CDWR regarding the long-term contract, Arlin Travis reached out to Mr. Harris and Ms. Bowman among others to inform them that as part of any long-term deal, CDWR wanted deliveries prior to July 2001 when Shell's new generation units were expected to come online. Mr. Travis stated that Pete Garris, who attended the meeting and was in charge of CDWR's Spot Market purchasing, was looking for power in April, May and June. Mr. Travis requested of Mr. Harris and Ms. Bowman: "Anything you can do, even if we only make a buck or two would be good for getting the larger deal done." Mr. Harris responded "We've done about $55 million in RT [Real Time sales] since January. We'll look to throw them April – June power, if we find it." Ex. CAL-319 at 123:3-16; Ex. CAL-204.

FF 279. Shell's manipulative trading strategies spanned the entire period of key negotiation dates, including: Shell's written proposal to CDWR on February 26, 2001, the parties' verbal agreement to a term sheet on March 16, 2001; execution of the previously discussed LOI on April 6, 2001, and execution of the Shell Contract on May 25, 2001. Figure 2 in Mr. Taylor's Direct Testimony Part 2 displays in graphic form the False Export and bad faith manipulation Mr. Taylor found in the 156 Spot Market contracts between Shell and CDWR against key long term contract milestones. The red diamonds identify the spot transactions affected by manipulation or bad faith, and the prices associated with those transactions. The blue and green lines plot Day-Ahead spot prices at COB and in the ISO. The black line tracks forward prices for the third quarter of 2001, the coming June, July and August period. Along the top of the picture, colored triangles indicate any emergency condition declared by the ISO. The key dates in the negotiation of the Shell Contract referenced above are shown with vertical dotted lines. Ex. CAL-319 at 125:11-126:6, fig.2.

FF 280. Shell's missing audio has created an evidentiary gap at the critical time when the Shell Contract was being finalized. Audio recordings provide contemporaneous evidence of the unguarded views regarding the motives behind the actions of traders and their supervisors. This information often provides the insights necessary to interpret the complicated mosaic of data on supplier transactions. Shell did not provide audio recording for 30 days during the Crisis period. By far, the largest single group of missing recordings is from May 13-27, 2001, or roughly the two weeks immediately before the Shell Contract was executed. Conversations that occurred during the final days leading to and immediately after execution of the Shell Contract would have been highly relevant to Mr. Taylor's review and the issues set for hearing in this case; the loss of this audio unquestionably impaired evaluation Shell's actions during this critical period. Ex. CAL-319 at 113:6-114:4; Ex. CAL-453.

FF 281. Forward contracts are agreements to buy or sell a specified amount of a commodity over a future period at a certain price generally at a particular location. For electricity there are well established bilateral markets at various trading hubs for forward contracts for future months, calendar quarters or years. Ex. CAL-319 at 132:18-133:3.

FF 282. Traded forward contracts have standardized terms, generally offered in increments of 25 MW for peak, off-peak or all hours for delivery at recognized locations such as COB/Malin and Mid-C in the PNW or Palo Verde near the California/Arizona border. Brokers continually quote and publish bid and ask prices for such contracts. Ex. CAL-319 at 133:5-9.

FF 283. Shell's behavior in short-term trading with CDWR affected forward prices. Forward prices reflect expectations about future spot prices. Shell's manipulative activity and that of other suppliers in Spot Markets elevated Spot Market prices and made them much more volatile. High and volatile spot prices over the winter of 2000-2001 raised concerns about future market dysfunction and thus expectations about future spot prices that elevated forward contract prices. Ex. CAL-319 at 135:7-137:1, fig.5.

FF 284. Dr. Goldberg contended that "during the crisis the spot prices were elevated far beyond historical experience. That changed what people thought might happen in the future, and we see the forward prices reacting to that, and all the parties were evaluating the overall value of the contract relative to those forward prices. So therefore, that rolled into contract prices." Tr. 1182:1-7; Ex. CAL-604 at 2:13-3:12.

FF 285. Manipulation by Shell and other suppliers impacted Spot Market prices. If energy can be transferred from one market to another, prices across the markets will tend to equilibrate. A buyer paying high prices draws supply away from other purchasers and tends to elevate the prices paid by all buyers. This is true in bilateral markets as well as auction markets particularly if the buyer's behavior persists over time as was the case with CDWR. Ex. CAL-319 at 137: 4-11, n.204.

FF 286. Expectations of the level of Spot Market prices that will exist at a future time of delivery are the primary factor that determines forward prices for that delivery date. Changes in expected Spot Market prices result in changes in corresponding forward prices. Ex. CAL-604, at 11:12-13:2; Ex. CAL-784, at 8:1-6, 46:11-13; *see* Ex. SNA-230, at 71; Ex. IB-242, at 10; Tr. 1220:4-1222:1 (Goldberg); Tr. 1989:7-12 (Pirrong); Tr. 2011:21-2012:2 (Pirrong).

FF 287. Spot Market prices for electricity in California affect forward prices for electricity in California. Ex. CAL-604, at 34:5-42:16; Ex. CAL-784 at 33:6-17; Ex. CAL-291 at 189-207 (V-1 – V-19); Tr. 1211:23-1212:1 (Goldberg); Tr. 1214:1-5 (Goldberg); Tr. 1988:12-14 (Pirrong); Tr. 2471:20-2472:4 (Cavanagh).

FF 288. Persistent increases in California Spot Market prices for electricity during the Crisis led to significant increases in forward prices for electricity. Ex. CAL-604 at 26:1-4, 42:10-16; Ex. CAL-784 at 9:5-7; Tr. 1211:23-1212:1, 1214:1-5 (Goldberg).

FF 289. Complainants' witness Dr. Goldberg offers a regression analysis based on forward contracts for delivery at SP-15 for 6x16 electricity for one-year calendar blocks. Ex. CAL-604 at 19:17-20:3, 37:1-3; Ex. CAL-607.

FF 290. The regression of Spot Market prices (adjusted for natural gas prices) against forward prices demonstrates that spot prices in California electricity markets affected forward prices in California electricity markets during the Crisis in a statistically significant manner. Ex. CAL-604 at 34:5-42:16; Ex. CAL-784 at 33:6-17; Ex. CAL-291 at 189-207 (V-1 – V-19); Tr. 2471:20-2473:4 (Cavanagh).

FF 291. Market participants derive expectations of future Spot Market prices from current and past market prices. Current Spot Market prices influence expectations of future Spot Market prices. Ex. CAL-604 at 13:1-15:4.

FF 292. West-wide price caps that FERC imposed in June 19, 2001 were the first effective measure to mitigate spot price increases. After FERC imposed west-wide price caps, spot electricity prices returned to levels seen prior to the Crisis Period. Ex. CAL-604 at 28:16-29:4, 17 fig.1, 18 fig.2.

FF 293. All four analyses completed by the proceeding participants support the fact that that spot electric prices correlated closely with forward electric prices within a period of two to three years following the end of the Crisis. Ex. CAL-291 at 391 (FERC Staff, Final Report on Price Manipulation in Western Markets, Docket No. PA02-2-000 (March 2003)) (tbl.V-C1); Ex. CAL-604 at 48 (Goldberg Direct); Ex. SNA-230 at 84:11 (tbl.8); Ex. SNA-237 at 2; Ex. IB-242 at 18 (tbl.3) (Cavanagh Answering); Ex. IB-244 (Column 5).

FF 294. Forward market participants during 2000-2001 expected the dysfunctions present in the spot electric market of that time to have an impact on future spot prices, as reflected in 2000-2001 forward prices, for at least two years into the future; that is, on deliveries during 2002 and 2003. Ex. CAL-90 at 24:18-30:11 (Stoft Direct); Ex. CAL-604 at 26:1-8 (Goldberg Direct).

FF 295. Shell's own witness, Dr. Pirrong, has studied the relation between spot prices and forward prices in California. While he predicted from theory that spot prices should have little influence on forward prices, he found that electric markets did not behave consistently with that theory in that spikes caused by short term increases in electric load tended to raise forward electric prices. He also found that generally volatile conditions in the Spot Markets tend to inflate forward prices, and he found that when sellers had market power and thus were able to cause price spikes in the Spot Markets, that they increased forward prices because they knew that a forward sale would mean forgoing the opportunity to benefit from such spikes. These results are consistent with Prof. Pindyck's conclusions and those of the California Parties' experts. Ex. CAL-910 at 11-21; Ex. CAL-911 at 117-118; Ex. CAL- 912 at 2, 24-34.

FF 296. Both Shell and Iberdrola evaluated their CDWR contracts with reference to the forward price curves, and used forward prices as a justification for their pricing levels. Ex. CAL-604 at 43:5-44:11.

FF 297. Current electricity spot prices affect forward contract prices through their impact upon expectations. Changes in spot prices may provide information that causes market participants to revise what they expect in terms of future spot prices. Forward contract prices reflect risk-adjusted expectations of future spot prices. Ex. CAL-319 at 140:11-14.

FF 298. Traders' expectations of forward prices were influenced by what was going on in the Spot Markets. Ex. CAL-319 at 143:1-144:11; Ex. CAL-717 at 118:14-119:4; Ex. CAL-401; Ex. CAL-402; Ex. CAL-762.

FF 299. Shell evaluated proposed long-term contract prices against forward prices. Ex. CAL-319 at 144:19; Ex. CAL-403; Ex. CAL-404.

FF 300. Electricity that uses natural gas is typically "on the margin," meaning it is the most expensive unit setting the market price for electricity in Western North America. Ex. CAL-268 at 5:18-21, 13:12-14; Tr. 1054:25-1055:21 (Berry); Tr. 1772:16-1773:1 (Pirrong).

FF 301. Forward market price curves dropped precipitously from March to May 2001. Ex. CAL-604 at 23:9-11.

FF 302. The record shows that CDWR did not rely upon forward price curves in its negotiation of long-term forward contracts. Ex. S-7.

FF 303. It is undisputed that both Coral and later Shell Energy fully performed all of their obligations to CDWR under the Coral Contract, delivering 34,507,002 MWh to CDWR over the 11-year term of the Contract. *See* Ex. CAL-216.

FF 304. The Coral Contract provided grid reliability. Tr. 602:12-18 (McIntosh).

FF 305. In 2001 there was a significant transmission constraint between SP-15 in southern California and NP-15 in northern California. Tr. at 281:20-23 (Nichols).

FF 306. California Governor Gray Davis made contemporaneous statements praising the Coral Contract, saying it would "keep supplying California with power . . . at reasonable rates." Ex. COR-4; *see* Ex. COR-5; Ex. SNA-219 at 47:1-15.

FF 307. On May 24, 2001, the day before the Coral Contract was executed, Complainants' witness Mr. Hart said that the Coral Contract was "a good deal." Ex. CAL-809 at 5.

FF 308. From shortly after execution of the CDWR long term contract through year-end bonus time in 2001, Bowman was reporting to her superiors at Shell that the value of the long term contract with CDWR had reached nearly $500 million, "reflect[ing] the outcome in today's lower power and gas market." Tr. 1573:5-16 (Bowman); Ex. CAL-888 at 2; Ex. CAL-319 at 185:4-6 (Taylor Direct); Ex. CAL-451 at 3; Complainants Post-hearing Initial. Br. at 70.

FF 309. The evidence of record, however, does not support the notion advanced by Complainants that Shell was in a more advantageous bargaining position than CDWR. Tr. 209:4-214:22 (Nichols Cross); Tr. 182:2-7 (Nichols Cross); Ex. MSC-17 at 3 ("As more and more of the energy supply to meet the net short obligation is placed under contract by CDWR, the more the CDWR purchases set the market."); Ex. S-100R at 42:17-43:17 (Poffenberger Answering); Ex. S-105 at 3 (originally AYE-51; CDWR memo reviewing progress of negotiations and noting that "sellers had to concede numerous points to obtain the terms and provisions they ultimately ended up with in the agreements").

FF 310. Both Shell and CDWR exhibited relatively equal bargaining power during negotiations for the long-term contract. Tr. 182:2-7, 209:4-214:22 (Nichols Cross); Ex. MSC-17 at 3; Ex. S-100R at 42:17-43:17 (Poffenberger Answering); Ex. S-105 at 3.

FF 311. Unlike the southern end of California, the northern end was a constrained market during the Crisis Period that relied heavily on imports of electricity from a small, highly concentrated group of suppliers at the California-Oregon Border, or "COB," particularly as the time for dispatch approached in any given supply hour. Ex. CAL-717 at 88:3-5 (Taylor Rebuttal).

FF 312. Shell was particularly active at COB, and because of its large credit line was able to command high prices from CDWR in Real Time sales by reselling power that other suppliers were unwilling to sell directly to CDWR because of its credit problems.

As a result, Shell's prices to CDWR were consistently higher at COB than the prices of other sellers to CDWR at COB. Ex. CAL-717 at 91:2-6, 101:1-102:20 (Taylor Rebuttal); Ex. CAL-717 at 91:6-94:16 (Taylor Rebuttal).

FF 313. Shell's opportunity for high margins with its strong credit position came when other parties, who had exhausted their credit lines, were willing to "sleeve" their sales of power to CDWR through Shell by selling to Shell for resale to CDWR. Ex. CAL-717 at 102:18-20 (Taylor Rebuttal).

FF 314. By its own terms, the Shell-CDWR contract is "governed by and construed and enforced and performed in accordance with the laws of the State of California." Ex. CAL-31 (amended section 10.6).

FF 315. CDWR received many bids that it did not choose to pursue because it deemed them unfavorable, mostly for economic reasons. CDWR turned down offers from large energy suppliers in the region, including Dynegy, PG&E, Williams Power, and LADWP. Tr. 227:18–231:3 (Nichols); 459:1–12 (Hart); Ex. COR-24; Ex. COR-42; Tr. 228:8–231:3, 232:13–20 (Nichols); 459:1–15 (Hart).

FF 316. CDWR was able to assemble a portfolio of contracts at prices that met its $70/MWh target average price and reduced the Net Short that it inherited from the IOUs from about 40 percent during the Crisis to about 33 percent by July 2001. Tr. 235:26-236:9 (Nichols); Tr. 393:18-22, 489:16-20 (Hart); Ex. CAL-210 at 8:8-12 (Hart Direct); Tr. 500:16-501:7 (Hart); Ex. IB-266.

FF 317. As a result of CDWR's demand for Shell to purchase power for CDWR beginning in April 2001 and throughout the summer, Shell demanded a price increase for 2001 through 2003 deliveries from $93.95/MWh to $169/MWh. Shell demanded in the April 6, 2001 LOI a fallback power price, in case the long term deal was not signed by April 30, in the amount of $260/MWh. This fallback price was increased to $315/MWh when the LOI was extended to May 31, 2001. Ex. CAL-200 at 17:5-9 (Nichols Direct); Ex. COR-14; Ex. CAL-200 at 19:1-9 (Nichols Direct); Ex. COR-16; Ex. CAL-200 at 20:3-9 (Nichols Direct); Ex. SNA-219 at 20:17-20 (Brown Answering).

FF 318. Shell's demand for these prices, made at a time when the spot price for April and May 2001 deliveries hovered near $300/MWh, was based on an untrue assertion of fact that Shell made to CDWR – that Shell was being "forced" to purchase power for CDWR in these months "at a loss." Ex. CAL-604 at 25, fig.5 (Goldberg

Direct); Ex. SNA-219 at 18:5-21, 21:3-17 (Brown Answering); Tr. 2734:25-2739:3 (Watkiss Closing Arg.).

FF 319. CDWR was unaware of the extent to which Shell, Enron, and other traders were using the manipulative strategies already described here in their dealings in the California spot markets while CDWR's negotiations with Shell were being conducted. Ex. CAL-200 at 29:7-12 (Nichols Direct); Ex. CAL-680 at 14:5-14 (McIntosh Rebuttal) ("I strongly suspected that sellers, particularly Enron, were playing unlawful games in the Spot Market in 2000 and 2001. However, it was not until after the Crisis, including through recent revelations, that I learned how widespread the wrongful practices were or the specific nature of such practices.").

FF 320. The Enron memos that detailed the strategies did not come to light until May 2002, after Enron went bankrupt and well after the Shell-CDWR contract was signed. Ex. CAL-291 at 209 (FERC Staff, Final Report on Price Manipulation in Western Markets, Docket No. PA02-2-000 (March 2003)); *See Public Utilities Comm'n of State of Cal. v. FERC*, 462 F.3d 1027, 1044 (9th Cir. 2006) (Enron filed for bankruptcy on December 2, 2001).

FF 321. Shell's Margin Reports to the WSPP show that Shell profited from its combined spot and LOI sales by nearly $1 million in April and May 2001. Ex. CAL-717 at 132:13-133:2 (Taylor Rebuttal); Ex. CAL-313 at 71-74, 95-99.

FF 322. When Shell reported the financial results of its California energy trading office to its corporate parent, it stated that "US power margins generated US$20 million in January [2001], compared to a plan of US$2.2 million, reflecting the positive margins generated from West Coast real-time power trading (positive US$19.0 million)." In the month of January 2001 alone, Shell's spot market traders made over nine times the amount of profit that Shell expected to make in that month and double the purported $10 million "loss" it told CDWR that it would take. Ex. CAL-461 at 4; Tr. 1679:11-1680:16 (Brown Cross); Tr. 1680:9-13 (Brown Cross).

FF 323. The prices that Shell and CDWR settled upon in May 2001 were far above the "benchmark" price of $74/MWh that the Commission ruled in December 2000 was a just and reasonable target price for long-term contracts to have in order to solve the Crisis. It was well over CDWR's own target average price of $70/MWh that it had set for all of its long term contracts. *SDG&E v. Sellers*, 93 FERC ¶ 61,294, at 61,994-95 (2000) ("[I]t is our view that five-year contracts for supply around-the-clock executed at or below $74/MWh can be deemed prudent."); Ex. CAL-200 at 6:17-7:2 (Nichols Direct).

2. <u>Iberdrola Contract</u>

a. <u>Unlawful Spot Market Activities</u>

FF 324. PacifiCorp's unlawful activities in the Spot Market during the Western Energy Crisis are attributable to Iberdrola. *CPUC v Sellers of Long-Term Contracts*, Order Memorializing November 10, 2015 Bench Ruling on Motion to Compel Production of Audio Recordings and Request for Sanctions, November 13, 2015, at P 11.

FF 325. One working group within PacifiCorp worked on power purchasing and selling on behalf of the PacifiCorp public utility on the one hand, while another working group within PacifiCorp worked on power marketing with third parties. Both groups shared many organizational activities. Ex. IB-200 at 14:3-7, 11-22 (Harlan Answering); Ex. IB-211 at 3:4-10:2 (Hudgens Answering); *See, e.g.*, Ex. CAL-319 at 160:12-163:13 (Taylor Direct).

FF 326. Iberdrola and PacifiCorp operated as one entity during the Crisis Period. Iberdrola's president and chief executive officer from May 2001 through November 2008, Terry Hudgens, served previously for PacifiCorp as Senior Vice President for Power Supply. Hudgens testifies that "certain corporate functions were shared" between PacifiCorp and PacifiCorp Power Marketing. Although PacifiCorp Power Marketing's offices were located several blocks away from the PacifiCorp offices and its employees' badges were locked out from accessing the latter's power trading floor, both entities shared a single U.S. chief risk officer and shared mid-office personnel. The chief financial officers of PacifiCorp and Scottish Power had access to the accounting personnel of both entities. Among the corporate functions that PacifiCorp and PacifiCorp Power Marketing shared were legal, credit, human resources, public relations, risk management, and information technology. John Fryer of PacifiCorp's credit department participated in analyzing the credit issues that arose between CDWR and PacifiCorp Power Marketing during the contract negotiations. Even PacifiCorp Power Marketing's now-missing tapes of conversations between its traders and counterparties in the California spot market during the Crisis period were routed through PacifiCorp's legal department when a legal hold was placed on them pursuant to the advent of litigation in this case. Ex. IB-211 at 1:20-21 (Hudgens Answering); Ex. IB-211 at 3:6-7 (Hudgens Answering); Ex. IB-211 at 3:17-20 (Hudgens Answering); Ex. IB-211 at 5:1 and 6

(Hudgens Answering); Ex. IB-211 at 5:19-6:2 (Hudgens Answering); Ex. IB-211 at 6:8-10 (Hudgens Answering); Ex. IB-211 at 6:11-14 (Hudgens Answering).

FF 327. PacifiCorp was one of many market participants that engaged in or facilitated manipulation of the California markets during the Crisis and such manipulation elevated prices in those markets and throughout the West. Ex. CAL-717 at 158:6-9; Ex. CAL-364 at 38-47; Ex. CAL-365 at 19, 79; Ex. CAL-736 (Enron MBR Revocation Order).

FF 328. PacifiCorp manipulation in the Summer and Interim Periods contributed to the demise of the California markets. Ex. CAL-717 at 158:9-10 & n.288; Ex. CAL-746.

FF 329. PacifiCorp manipulation and its facilitation of manipulation in the Negotiation Period undercut reliability in the ISO and caused CDWR to pay excessive prices in order to meet California's electricity needs. Ex. CAL-717 at 158:9-13.

FF 330. Prior to the Summer Period, PacifiCorp engaged in False Export transactions. Ex. CAL-319 at 153:8-154:15; Ex. CAL-408 at 191.

FF 331. PacifiCorp knew as of August 2000 that it was facilitating False Exports. PacifiCorp purchased energy from Sempra for resale back to Sempra, knowing that Sempra purchased the energy from within the ISO and was reselling that energy back to the ISO. Ex. CAL-411Ai-iv, B.

FF 332. During the Summer Period, PacifiCorp engaged in False Export transactions. Ex. CAL-319 at 153:8-154:15; Ex. CAL-408 at 191.

FF 333. During the Summer Period, PacifiCorp purchased energy from Enron for resale back to Enron, knowing that Enron purchased the energy from the PX and planned to resell that energy to the ISO. PacifiCorp engaged in similar transactions with Sempra and Dynegy during the Summer Period. Ex. CAL-408 at 125-26.

FF 334. During the Summer Period the Replacement Reserves acquisition policy of the ISO made use of this strategy to collect high prices for both capacity and energy very attractive. During the early part of the Crisis PacifiCorp was among the most frequent users of the False Export scheme. Ex. CAL-319 at 153:17-154:2; Ex. CAL-408 at 191.

FF 335. During the Interim Period, PacifiCorp engaged in False Export Transactions. Ex. CAL-319 at 153:12-154:9; Ex. CAL-408 at 191.

FF 336. PacifiCorp not only engaged in False Export transactions, but also facilitated False Exports prior to and during the Negotiation Period. Ex. CAL-319 at 151:15-152:3,153:8-158:7, n.231; Ex. CAL-406; Ex. CAL-408 at 191; Ex. CAL-409; Ex. CAL-411 Ai-Av, B; Ex. CAL-489_PAC_Multiparty False Exp_Public.xls.

FF 337. PacifiCorp provided Parking and laundering services all through the Crisis to Enron and Powerex and in the Negotiation Period with Shell and Sempra. Transcripts of recorded conversations between PacifiCorp's traders and their counterparts at Enron, Sempra and Powerex, and in recordings of trader conversations obtained from Shell, show PacifiCorp knowingly and willingly engaged in these transactions. Ex. CAL-319 at 155:1-158:7; Ex. CAL-406; Ex. CAL-409; Ex. CAL-411Ai-Av, B.

FF 338. During the Negotiation Period, PacifiCorp facilitated two different types of False Exports, multi-party and two-party. In both transactions, PacifiCorp served as the entity through which California sourced energy was laundered through the PNW in order for the energy to be sold to CDWR as OOM. In the first type of transaction, Sempra purchased power in NP-15 and sold it to Dynegy, Dynegy exported the power to COB where it sold it back to Sempra for a $20/MWH fee, and then Sempra resold is to CDWR as power generated in the PNW. Ex. CAL-319 at 155:1-158:7; Tr. 1481:13-1483:7; Ex. CAL-406; Ex. CAL-411Ai-Av, B; Ex. CAL-409; Tr. 1488:6-19, 1480:18-22; Ex. CAL-816 at Cell D 13.

FF 339. Iberdrola was active throughout the Negotiation Period in Spot Markets in the Pacific Northwest and made numerous sales to entities, such as Enron, known to have manipulated markets during this period. Ex. CAL-319 at 151:14-152:3.

FF 340. The only Spot Market sales by Iberdrola to CDWR during the Negotiation Period occurred on July 4 through 6, immediately before and during execution of the Iberdrola Contract. On these days, Iberdrola made the following spot sales:

7/4-5/2001 6,950 MWh at $67.01 per MWh at COB
7/4/2001 690 MWh at $75.51 at CKF
7/5-6/2001 1,530 MWh at $86.50 at COB
7/6-7/2001 225 MWh at $62.57 at COB

The total cost of these sales to CDWR was $664,244.65. Ex. CAL-319 at 168:5-13; Ex. CAL-506.

FF 341. During the Negotiation Period Iberdrola and PacifiCorp both used an e-mail address with the suffix "pacificorp.com." PacifiCorp and Iberdrola were on a common e-mail platform that made no distinction between the PacifiCorp and Iberdrola entities. Ex. CAL-319 at 161:14-19; Ex. CAL-499.

FF 342. Both Iberdrola and PacifiCorp employees were included on e-mails relating to the negotiation of the Iberdrola Contract. For example, e-mails dated February 28, April 2, April 11, and May 9, 2001, included both the Iberdrola and CDWR negotiation teams and related directly to the ongoing negotiations and potential resolution of various outstanding issues, including issues relating to credit. Ex. CAL-319 at 162:1-9; Ex. CAL-499.

FF 343. Emails regarding the Iberdrola contract included Nathalie Wessling who was a PacifiCorp employee. Ex. CAL-319 at 162:3-18; Ex. CAL-498; Ex. CAL-499.

FF 344. Andrew Haller was General Counsel and Secretary of PacifiCorp and Secretary of Iberdrola, and Bruce Williams served as Treasurer of both companies. Ex. CAL-319 at 163:6-9; Ex. CAL-300 at 32-33.

FF 345. PacifiCorp and Iberdrola coordinated efforts to manage the audio trader recordings and shared counsel. Ex. CAL-319 at 166:1-28; Ex. CAL-505 at Response CA-IB-56.

FF 346. In 2007, both PacifiCorp and Iberdrola reached settlements of all claims relating to market manipulation in the California and Pacific Northwest electricity markets during the Crisis with the California Parties. However, both settlements explicitly excluded the EL02-60 and EL02-62 proceedings from the releases contained in those otherwise global settlements. Ex. CAL-319 at 152:12-153:1; Order Approving Settlement, *San Diego Gas & Elec. Co. v. Sellers*, 119 FERC 61,296 (2007) (approving and modifying settlement with PacifiCorp as filed on April 11, 2007); Order Approving and Modifying Settlement, *San Diego Gas & Elec. Co. v. Sellers*, 121 FERC 61,014 (2007) (approving and modifying settlement with Iberdrola as filed on June 22, 2007).

FF 347. Iberdrola's predecessor, PacifiCorp Power Marketing, was incorporated as a subsidiary of PacifiCorp in 1995. In 1996, Iberdrola's predecessor applied to the Commission for market-based rate authority. As a condition for granting market-based rate authority, the Commission required the adoption of the "Statement of Policy and

Code of Conduct with Respect to the Relationship Between PacifiCorp Power Marketing, Inc. and PacifiCorp," (hereafter, "Code of Conduct"). The Code of Conduct required that, "[t]o the maximum extent practicable, the operating employees of [Iberdrola] and the operating employees of PacifiCorp shall operate independently of each other." It also prohibited the sharing of non-public market information between the two companies "including, but not limited to, transaction specific data or information concerning any opportunity to purchase or sell electricity at wholesale." "The purpose of the code of conduct was to prevent PacifiCorp Power Marketing from gaining any advantage due to its affiliation with PacifiCorp, either in power transactions or in obtaining access to transmission services." Ex. CAL-285 at 4 n.3; Ex. IB-212; Ex. IB-211 at 8:3-10; Ex. CAL-285 at 4 n.3.

FF 348. In 1999 PacifiCorp was acquired by Scottish Power. On April 27, 2001, PacifiCorp filed a request for authorization from the Commission to engage in a corporate reorganization, including a plan that would place Iberdrola's predecessor under the direct ownership of Scottish Power. The authorization was approved by the Commission on June 19, 2001. Ex. CAL-285 at 4 n.3.

b. <u>Causal Connection of Unlawful Activities to Contract</u>

FF 349. Iberdrola witness Mr. Jim Harlan was the lead negotiator for PPM (Iberdrola's predecessor) in the long-term contract negotiations with CDWR. Ex. IB-200 at 3:1-4.

FF 350. Iberdrola responded to the January 23, 2001 RFB on January 24, 2001. Ex. IB-202.

FF 351. Iberdrola responded to CDWR's RFB with a proposal to provide a 7x24 fixed priced power supply for 10 years from a cogeneration plant in Klamath Falls, Oregon which was expected to come on line on October 1, 2001. Ex. CAL-210 at 16:14-17, 17:9-11.

FF 352. On February 8, 2001, John Fryer of PacifiCorp, sent an email to PacifiCorp and Iberdrola employees identified in the email regarding potential credit issues relating to the CDWR deal. Ex. IB-205.

FF 353. On March 1, 2001, CDWR and Iberdrola executed a First MOU, with a termination date of March 31, 2001 for reaching an agreement. Ex. IB-204; Ex. CAL-245.

FF 354. On March 1, 2001, Iberdrola and CDWR entered into a Memorandum of Understanding (the "First MOU") for the purchase and sale of firm energy on a 7x24 basis for 10 years. Energy deliveries were to ramp up from 100 MW during the first contract year (July 1, 2001 to June 30, 2002) to 400 MW in the final years of the 10-year term. Prices declined over the 10-year term beginning at $95/MWh for the first contract year, with interim reductions and a final price of $60/MWh for the period from July 1, 2005 through the end of the contract term. Ex. CAL-212 at 1-3.

FF 355. The First MOU was to expire by its own terms in the event that a Power Purchase Agreement was not executed by the parties by close of business on March 31, 2001. No agreement was reached, and the First MOU expired. Ex. IB-200 at 8; Ex. CAL-201 at 20, 64.

FF 356. Forward price curves began to decline in late March 2001. By late June 2001, the 18-month forward prices had returned to pre-crisis levels, as had forward price curves for all deliveries beyond 2002. Tr. 1162:3-13; Tr. 1226:14-1227:22; Tr. 1219:16-1220:3; Ex. CAL-76; Tr. 304:7-22; Ex. CAL-606; Tr. 1389:20-1390:4; Tr. 1162:3-13; Tr. 1226:14-1227:22; Tr. 1219:16-1220:3; Ex. CAL-76; Tr. 304:7-22; Ex. CAL-606; Tr. 1389:20-1390:4.

FF 357. March 31, 2001 passed without an executed contract and the March 1, 2001 MOU between CDWR and Iberdrola terminated. Tr. 2205:25-2206:3 (Harlan).

FF 358. On April 2, 2001, Jim Harlan sent an email to Dan Herdocia and others representing CDWR that, inter alia, revised proposed contract prices to reflect corrected forward price curves. Ex. IB-207.

FF 359. Mr. Harlan testifies that by June 21, 2001, it was anticipated that CDWR would issue bonds to finance repayment of its spot market purchases and a portion of its long-term contracts.

FF 360. CDWR and Iberdrola did not reach an agreement on the basis of the changes proposed by Iberdrola in Mr. Harlan's June 21 letter to Mr. Ferreira. Ex. IB-200 at 12. Ex. IB-200 at 12.

FF 361. On June 22, 2001, CDWR and Iberdrola agreed to a second extension of the execution date to July 1, 2001. Ex. CAL-936.

FF 362. On July 3, 2001, the PacifiCorp Power Marketing, Inc. board approved proceeding with the contract between CDWR and Iberdrola. Ex. CAL-213; Tr. 2369:3-2373:4 (Hudgens).

FF 363. The July 3, 2001 presentation to the PacifiCorp Power Marketing, Inc. board explained in a section titled "Pricing Structure and Gas Hedging Strategy" that: The last 8.5 years pricing is tied to a fixed capacity price, an escalating operating and maintenance charge, and a floating energy price based on a heat rate and gas index. CDWR is responsible for the gas cost during this period. This passes the largest risk element and operating cost to CDWR. Ex. CAL-213 at 3.

FF 364. The contract between Iberdrola and CDWR was negotiated between the parties from January 24, 2001 through the day of its signing. It was signed on July 6, 2001. Ex. CAL-604 at 5:3-6 (Goldberg Direct); Ex. CAL-200 at 23:1-2 (Nichols Direct); CAL-041 (CDWR-Iberdrola Contract).

FF 365. Copies of the Iberdrola Contract, as executed on July 6, 2001, are contained in the record of this proceeding at Exs. CAL-41 and IB-208.

FF 366. The contract term ran from July 29, 2001 through June 30, 2011. Iberdrola was to deliver 7x24 energy in the following amounts: from July 29, 2001 through June 30, 2002, 150 MW; from July 1, 2002 through June 30, 2004, 200 MW; from July 1, 2004 through June 30, 2011, up to 300 MW. For deliveries from July 2001 through December 2002, the contract price was fixed at $70/MWh. For deliveries from January 1, 2003 through June 30, 2011, the price was calculated according to fixed and variable charges and a natural gas cost index, and included a tolling arrangement by which CDWR controlled the dispatch of energy from the Klamath generating plant. Ex. CAL-637; Ex. CAL-604 at 4:14-15 (Goldberg Direct); Ex. CAL-637; Ex. CAL-210 at 18:10-15 (Hart Direct); Ex. CAL-604 at 4:14-5:2 (Goldberg Direct); Ex. CAL-637; Ex. IB-200 at 12:1-17 (Harlan Answering).

FF 367. The price set for the initial year and a half of the Iberdrola-CDWR contract met the target average price of $70/MWh that CDWR had set as the goal for its portfolio of long-term contracts. Tr. 197:4-12, 199:18-201:6 (Nichols); 489:16-20 (Hart).

FF 368. At the time the Iberdrola Contract was signed, California had just experienced staged alerts. Tr. 498:15-22, 518:14-21 (Hart); Ex. CAL-41.

FF 369. The Iberdrola Contract was executed on July 6, 2001. The delivery term ran from July 29, 2001 through June 30, 2011. Ex. CAL-634R at 11:3-4; Ex. CAL-41.

FF 370. The Iberdrola Contract rates were fixed at $70/MWh through December 2002. Ex. CAL-634R at 12:2; Ex. CAL-637; Ex. CAL-41.

FF 371. Starting January 2003, the Iberdrola Contract converted to a dispatchable arrangement with various fixed charges, as well as fuel and other variable costs dependent on the energy volumes CDWR scheduled for delivery. As part of this arrangement, CDWR paid a fixed "capacity charge" of $15/kW-month (or $180/kW-yr) at the "Contract Delivery Rate," as defined in the contract, regardless of the quantity of power actually delivered. Ex. CAL-634R at 12:2-8; Ex. CAL-637; Ex. CAL-41.

FF 372. CDWR's ability to dispatch the Iberdrola Contract was subject to various restrictions, as well as additional cycling, start-up and fuel costs. Ex. CAL-634R at 43:13-15; Ex. CAL-789 at 58:8-15; Ex. CAL-637; Ex. CAL-41.

FF 373. The Iberdrola Contract specified COB as the primary delivery point; however, Iberdrola had discretion to deliver up to 50 MW of energy to NP-15 on a monthly scheduled basis, and another 50MW on a daily pre-scheduled basis. Ex. CAL-634R at 13:9-13; Ex. CAL-789 at 58:16-18; Ex. CAL-637; Ex. CAL-41.

FF 374. Iberdrola could curtail up to 12% of delivery volumes annually due to outages or scheduled maintenance without a reduction in CDWR's capacity payments. Ex. CAL-634R at 43:16-44:2; Ex. CAL-789 at 59:1-4 & n.122; Ex. CAL-637; Ex. CAL-41.

FF 375. Iberdrola could curtail an additional 3% of annual delivery volumes for any reason except during the period June 15 through October 15. Ex. CAL-634R at 43:16-44:2; Ex. CAL-789 at 59:1-60:13; Ex. CAL-637; Ex. CAL-41.

FF 376. Capacity charges are costs paid by a buyer to have a specific unit owned by the seller available to meet the buyer's energy requirements, and are associated with contracts tied to a specific generation unit which allow the buyer control over the unit providing the generation. Ex. 634R at 12:8-17; Ex. CAL-789 at 57:12-59:12.

FF 377. Iberdrola used NPV to evaluate the Iberdrola Contract during the Negotiation Period. Ex. CAL-319 at 189: 15-190:17; Ex. CAL-405.

FF 378. Iberdrola calculated NPVs both on a market basis, using forward contract prices, and a cost basis, relying upon the projected generation costs of the Klamath units. Ex. CAL-319 at 190:1-3.

FF 379. Development of the Klamath generating units was already under way prior to the contract negotiations and the Iberdrola's financing of the units took advantage of tax exempt municipal bonds. Iberdrola sought to hedge the long position created by the generating units against declines in market prices. Ex. CAL-717 at 148:10-15; Ex. IB-211 at 10-11.

FF 380. Iberdrola's pricing strategy was to get CDWR to accept a higher price up front by offering a lower price in the out years of the contract. In the stage of price negotiations for the Iberdrola Contract, when the price for energy during the first year and one/half was reduced, the price for capacity during the final seven years of the contract was increased. Ex. CAL-319 at 175:1-9; Ex. CAL-415; Ex. CAL-717 at 149:6-8.

FF 381. The lower front end prices in the Iberdrola Contract meant greater up-front losses that required out year prices well above market levels to recover shortfalls in the earlier years. Ex. CAL-319 at 176:8-11; Ex. CAL-717 at 149:3-8.

FF 382. Iberdrola was successful in achieving its pricing strategy in negotiations. Ex. CAL-319 at 176:8-11; Ex. CAL-717 at 149:6-8.

FF 383. PacifiCorp was one of many market participants that engaged in or facilitated manipulation of the California markets during the Crisis. Such manipulation elevated prices in those markets and throughout the West. Ex. CAL-717 at 158:6-913; Ex. CAL-736 (Enron MBR Revocation Order).

FF 384. PacifiCorp activity in the Summer and Interim Periods contributed to the demise of the California markets and its facilitation of manipulation in the Negotiation Period undercut reliability in the ISO and caused CDWR to pay excessive prices in order to meet California's electricity needs. Ex. CAL-717 at 158:9-13.

FF 385. PacifiCorp continued its facilitation of market manipulation throughout the Negotiation Period by providing Parking and buy/resell laundering services to Shell and other market manipulators, knowing the illicit purpose of the transactions and their effect on the price paid by CDWR. Ex. CAL-319 at 158:1-7, 159:6–160:16; Ex. CAL-411Ai, B at 1; Ex. CAL-411Av, B at 5; Ex. CAL-411Ai, B at 1; Ex. CAL-411Aiii, B at 3.

FF 386. During the Negotiation Period when its Spot Market traders were engaged in Spot Market manipulation and the facilitation of manipulation, PacifiCorp was aware that its subsidiary Iberdrola was in the process of negotiating a long term contract with CDWR. Ex. CAL-319 at 163:15-164:13; Ex. CAL-500.

FF 387. CDWR had "specific reasons" for entering into the Klamath Contract that "had little bearing on pricing." In spring 2001, CDWR experienced significant transmission constraints on Path 15 between Southern and Northern California and was seeking deliveries north of Path 15. CDWR considered Northern California to be "particularly vulnerable to spot market price volatility due to its typical reliance upon short-term and seasonal imports from the Pacific Northwest and due to the well-known 'Path 15' constraints in transmission between northern and southern California." With deliveries in Northern California, the Klamath Contract was considered to be a "valuable" asset for CDWR, a fact that "would go into the terms of the price that the department was willing to enter into for the transaction." Ex. CAL-156 at 23; Tr. 367:13-23; Tr. 368:2-3; Ex. CAL-156 at 24-25; Ex. CAL-156 at 23; Tr. 281:20-23; Tr. 364:22-23.

FF 388. There are no records of CDWR modeling Klamath Contract pricing against forward price curves and no testimony from any witness for the Complainants that the evaluation was done. During the period it was negotiating long-term contracts, CDWR believed that forward price curves were an unreliable basis for setting prices for its long-term contract portfolio. Mr. Harlan testified that the forward price curves were "not relevant to that discussion. I don't know where [CDWR] got their price from." Tr. 2249:16-18; Tr. 744:22-24; *see also* Tr. 2595:11-24; Ex. MSC-17 at 3; Tr. 2249:16-18.

FF 389. Generally, CDWR's evaluation of contract pricing was based on a target set in January 2001 of an average weighted cost of $70/MWh for its entire long-term contract portfolio. The $70/MWh target was based on the "all-in power generation average cost embedded in the average retail rates of the three investor-owned utilities in California." Tr. 195:23-196:1; Tr. 235:16-21; Tr. 391:14-17; Tr. 196:13-20; Ex. CAL-201 at 18; Tr. 196:13-20; Ex. CAL-201 at 18, 55; Ex. CAL-201 at 17-18.

B. Whether the Contracts at Issue Imposed an Excessive Burden on Consumers Relative to the Rates They Could Have Obtained After Elimination of the Dysfunctional Spot Market, or Otherwise Seriously Harmed the Public Interest, Such That the *Mobile-Sierra Morgan Stanley* Rule is Overcome?

1. Shell Contract

FF 390. The Shell contract imposed an excessive burden on consumers "down the line" in the nominal-dollar amount of $384.8 million ($779 million when FERC interest to May 2015 is included, plus additional FERC interest from May 2015 to date). Ex. CAL-634R at 76:1-6 and tbl.8 (Celebi Direct).

FF 391. The rates charged by Shell between 2001 and 2003 for generation alone exceeded the average all-in retail rate charged to California customers at the time, and still exceed rates charged throughout the United States today. In 2001, California customers paid average retail rates of $118/MWh and average retail rates for all customers nationwide was only $104.50/MWh in 2014. Ex. CAL-665 at 12:11-13:5.

FF 392. Average retail rates include a component for generation, transmission and distribution services; the generation component generally comprises between 50 and 65% of the total retail rate. Shell's rates of $169/MWh and $249/MWh therefore were multiples higher than the average generation component. Ex. CAL-665 at 12:14-13:3; *see also* Tr. 932:17-24 (Kito).

FF 393. At the time of the Crisis, energy prices were at an all-time high. After the market recovered and returned to normal in the late summer of 2001, California energy prices moderated considerably, declining to below $50/MWh on average beginning in October 2001. Ex. CAL-665 at 8:3-6.

FF 394. In the second quarter of 2001, CDWR paid for its power purchasing costs by means of ratepayer remittances, loans/advances from the State general fund, and interim loan funding. Tr. 623:3-624:9 (Pacheco).

FF 395. In order to pay the debt service and interest on the long-term bonds, California retail ratepayers pay a surcharge on their monthly bills known as the "Bond Charge." Ex. SNA-256 at 6:12-13.

FF 396. Reserves required for the bond issuance referenced by Mr. Pacheco have been kept in an interest-bearing account. Tr. at 649:16-19 (Pacheco).

FF 397. Reserves required for the bond issuance referenced by Mr. Pacheco have been and will continue to be returned to ratepayers with interest as the bonds have matured. Tr. 626:12-14, 649:20-650:1 (Pacheco).

FF 398. The State decided to spread out its excess costs from 2001 in order to protect consumers from “rate shock.” Tr. 642:20-644:8 (Pacheco); Tr. at 963:2-964:3 (Berck).

FF 399. After 2002, the costs of CDWR’s long-term contracts were collected from ratepayers by means of a surcharge on their monthly bills known as the “Power Charge.” Ex. SNA-256 at 6:13-15.

FF 400. Complainants’ witness Ms. Kito confirmed that “the period of the energy crisis was unique and that the post-crisis period was different.” Tr. 905:1-5 (Kito).

FF 401. Long-run marginal cost (LRMC) is equal to CONE plus variable operating expenses. Ex. SNA-244 at 8:9-11.

FF 402. LRMC is a measure of long-term, competitive pricing independent of any short-term market dysfunction. Ex. SNA-244 at 11:9-12.

FF 403. The Commission has recognized LRMC is a reasonable benchmark for long-run competitive pricing and has in multiple contexts found that just and reasonable market designs should produce prices that allow recovery of LRMC over time. Ex. SNA-244 at 16:3-17:15.

FF 404. Long-run marginal cost, or "LRMC," is independent of the vagaries of the marketplace and represents a constant cost of power to society over the long haul. It is typically represented in economic thought (with the agreement of economics experts on both sides of this case) by the total yearly levelized fixed and variable cost of installing, running, and maintaining a new combined-cycle gas-fired generating plant, expressed as a constant rate in dollars per kilowatt-year. Ex. SNA-244 at 13:11-12, 33:3-6 (Niemann Answering); *see also* Paul A. Samuelson and William D. Nordhaus, Economics 464 n.1 (12th ed. 1985); Ex. CAL-634R at 48:17-49:2 (Celebi Direct); Ex. SNA-244 at 19:14-15 (Niemann Answering).

FF 405. Complainants' witness Dr. Celebi uses September 2001 forward market prices as a benchmark to evaluate the pricing in the Coral Contract. Ex. CAL-634 at 25:10-26:2.

FF 406. Dr. Celebi's calculation of down-the-line burden is based on the cost of substitute power as calculated from forward prices reported by two brokers—TFS Energy and Natsource—during trading days in September 2001. Ex. CAL-634R at 25:10-26:2.

FF 407. As of September 2001, TFS and Natsource reported forward power prices only through the year 2005. Ex. CAL-634R at 34:3-4.

FF 408. To demonstrate that market fundamentals cannot explain the prices in the Shell and Iberdrola Contacts, Dr. Celebi derived expected prices for the products delivered under the contracts based on the underlying cost elements of producing electric power as of the contract execution dates (May 25, 2001 for Shell and July 6, 2001 for Iberdrola). Dr. Celebi referred to these prices as "Fundamentals-Based Prices." Ex. CAL-634R at 46:9-77; Ex. CAL-789 at 10:13-11:15.

FF 409. Dr. Celebi employed a two-step process to determine Fundamentals-Based Prices for the Shell and Iberdrola Contracts' terms. For near-term deliveries (2001-2004), he utilized market simulation software (DAYZER) to estimate locational marginal prices for the products delivered under the contracts. For later-year deliveries (2005-2012), Dr. Celebi developed prices consistent with the costs to build and operate a new gas-fired combined-cycle plant (also known as long-run marginal cost or LRMC) as of the contracts' execution dates. Ex. CAL-634R at 47:6-49:2.

FF 410. In a functioning competitive market, expected energy prices in the near-term should reflect the short-run marginal cost of generation, i.e., the marginal production cost of available, existing units on the margin. Short-run marginal costs are routinely estimated by market simulation software such as DAYZER. Ex. CAL-634R at 47:18-48:4, 60:3-7.

FF 411. In the long-run, and under equilibrium conditions, competitive energy prices should be consistent with LRMC. The expected time to reach long-run equilibrium conditions depends on how quickly new units can be built to meet the increased need for generation. Ex. CAL-634R at 48:4-14.

FF 412. Dr. Celebi assumed the transition to prices based on LRMC in 2005 because in the early 2000s, it took approximately four years to develop a new gas-fired combined-cycle power plant in California. Therefore, near-term contract deliveries (2001-2004) would have had to have been sourced from units actually available during those years and not from the hypothetical new plant. Ex. CAL-634R at 48:14-17; Ex. CAL-789 at 12:7-13; Tr.810:17-19 (Celebi).

FF 413. Shell witness Dr. Niemann agreed that as of early 2001, the process to develop a new gas-fired combined-cycle power plant in California would take three to five years. Tr. 2142:17-20; 2144:2-3 (Niemann).

FF 414. The DAYZER software utilized by Dr. Celebi simulates the operation of the WECC system, and calculates the hourly marginal cost of energy at each pricing location within the system. Dr. Celebi used the DAYZER software to replicate WECC system conditions and expectations as of the contract execution dates (May 25, 2001 for Shell and July 6, 2001 for Iberdrola). Ex. CAL-634R at 49:3-51:2; Ex. CAL-643.

FF 415. Market simulations are routinely used to forecast future power prices as a function of expected market fundamentals. Ex. CAL-634R at 60:3-7.

FF 416. For years 2005-2012, Dr. Celebi derived Fundamentals-Based Prices consistent with long-run equilibrium conditions. Specifically, he estimated prices based on the expected costs to build and operate a new gas-fired combined-cycle power plant (LRMC) as of the contract execution dates, and translated those costs to a \$/MWh figure for each product delivered under the contracts. Ex. CAL-634R at 63:10-72.

FF 417. The Shell Contract rates were substantially higher than Fundamentals-Based Prices during the initial years of the contract, but close to Fundamentals-Based Prices in the later years. Ex. CAL-634R at 73:5-74:3, fig.22.

FF 418. The Iberdrola Contract rates exceeded Fundamentals-Based Prices in all years except 2011. Ex. CAL-634R at 74:4-11, 75, fig.23.

FF 419. In addition to the Shell and Iberdrola Contracts, CDWR executed approximately 50 additional long-term contracts in 2001. Ex. CAL-634R at 78:3-6.

FF 420. CDWR paid \$36.41 billion, at an average "all-in" price of \$75.79/MWh, for approximately 480 million MWh of energy delivered under the CDWR Long-Term

Contracts, from October 2001 through December 2014. Ex. CAL-634R at 78:7-15; Ex. CAL-218.

FF 421. Trial Staff's witness Mr. Poffenberger admitted that charging every electric ratepayer in California a few pennies a month on their electric bill is a very powerful way to raise a lot of revenue because there are many customers. Tr. 2601:3-7 (Poffenberger).

FF 422. Trial Staff's witness Mr. Poffenberger admitted that rates collected from retail customers to pay for the Shell Contract could have been used for alternatives uses; these alternatives are an opportunity cost of the contract. Tr. 2599:18-2560:7 (Poffenberger); *see also* Ex. CAL-699 at 15:19-16:1.

FF 423. Trial Staff's witness Mr. Poffenberger admitted that opportunity costs can be viewed in the aggregate for all ratepayers as for society as a whole, or on an individual basis for each ratepayer. Tr. 2560:11-15 (Poffenberger).

FF 424. The Excess Charges California consumers paid to Shell and Iberdrola could have been used to fund California's public purpose programs for low income ratepayer assistance and energy efficiency for two years based on the nominal amount of overcharges, or up to three years factoring in interest. Ex. CAL-699 at 16:2-12.

FF 425. The Excess Charges California consumers paid to Shell and Iberdrola could have been used to fund significant additions of new generating capacity within California such as four to five new 550-MW Combined Cycle Gas Turbine plants or between fifteen and twenty-three 100-MW Combustion Turbine peaking power plants, as shown in Table 2 from CAL-699. Ex. CAL-699 at 16:13-17:5, tbl.2.

FF 426. The Excess Charges California consumers paid to Shell and Iberdrola could have been used to fund the construction of fifty new schools within the State. Ex. CAL-319 at 193:8-10.

FF 427. California's IOUs are authorized to collect through retail rates many large and legitimate cost components necessary to provide safe and reliable electric service that meets California's policy mandates in addition to power generation costs. Ex. CAL-699 at 12:4-9, 3:1-6; Tr. 2041:3-11 (Fulmer)

FF 428. The CPUC had to impose significant rate increases in 2001 and 2002 as a result of the Crisis and the significant economic hardship to California consumers from those rate increases are evidenced by the complaints of residential customers made to the CPUC included in the record as Exs. CAL-262 and CAL-263. Ex. CAL-241 at 47:13-53:24; Ex. CAL-262; Ex. CAL-263.

FF 429. The significant rate increases in 2001 and 2002 imposed as a result of the Crisis impacted industrial and commercial consumers including, for example, causing businesses to close facilities, lay off workers, or consider scaling back operations in California. Ex. CAL-241 at 54:8-55:17; Ex. CAL-264 at 4, 13-30; Ex. CAL-242B at 2.

FF 430. The significant rate increases in 2001 and 2002 imposed as a result of the Crisis strained California agricultural businesses and challenged their ability to remain competitive against agricultural businesses located outside the State. Ex. CAL-241 at 55:18-56:13; Ex. CAL-265 at 4-5.

FF 431. The CPUC received complaints from California ratepayers regarding the impact they suffered from CDWR Power Charges and CDWR Bond Charges assessed on their utility bills long after the Crisis ended. Ex. CAL-241 at 59:13-60:9; 60:14-22; Ex. CAL-266 at 1; 267 at 1.

FF 432. Large industrial energy users – including Anheuser-Busch, BOC Gases, and others – complained to the CPUC in September 2001 expressing concern that rising engery costs could force them to leave or reduce their presence in the State. Ex. CAL-241 at 54:8-56:3; Ex. 264.

FF 433. Shell's witness Mr. Fulmer estimated an average retail rate increase to an average industrial or commercial customer due to the Shell Contract, but did not examine impacts to specific industrial or commercial customers. Tr. 2085:18-20 (Fulmer).

FF 434. Iberdrola's witness Mr. Monsen presented no evidence that he examined actual impacts on any specific industrial or commercial customers resulting from the average retail rate increases attributable to the Iberdrola net or gross contract costs. Ex. IB-246.

FF 435. The Environmental-Dynamic Revenue Analysis Model (EDRAM) created by Dr. Berck uses the relationships between 185 distinct sectors of the California economy to estimate the overall financial and economic impact of various events on the State and its citizens. Ex. CAL-666 at 9:19-21, 11:17-20.

FF 436. State Personal Income is the sum of income received by all persons in California, including wages and benefits, property income, proprietors' income and public and private transfer payments less contributions for government and social insurance. Ex. CAL-666 at 2:17-3:2.

FF 437. Real State Personal Income is State Personal Income divided by the consumer price index. Ex. CAL-666 at 3:3-5.

FF 438. The $4.8 billion reduction to Real State Personal Income caused by the Shell and Iberdrola Contracts is on the same order of magnitude as some of California's largest ever infrastructure projects, including building the new span of the Bay Bridge ($6.4 billion) and the bond to fix California's water system ($7.5 billion). Ex. CAL-666 at 7:14-18.

FF 439. EDRAM is used regularly by the State of California to determine the impacts on the economy from new regulations or taxes. Ex. CAL-666 at 9:19-10:2 (Berck Direct Testimony); Ex. CAL-805 at 2:9-13.

FF 440. EDRAM has been peer reviewed. Tr. 954:15-17 (Berck); Ex. CAL-805 at 5:3-8.

FF 441. Consumers paid for the costs of the Shell and Iberdrola Contracts through retail rates increases in 2001-2002, the CDWR Power Charge from January 2003 through contract termination, and the Bond Charges. Ex. CAL-241 at 31:8-32:2; Ex. SNA-26 at 18:20-19:2; Ex. IB-246 at 13:3-12.

FF 442. Every penny of excess contract rates that Shell and Iberdrola charged CDWR has been or will be paid for by California ratepayers. Ex. CAL-241 at 32:3-5, 65:8-17.

FF 443. The public, consisting of all of California's retail ratepayers within the service territories of the three IOUs, have paid and will continue to pay rates resulting from the contracts at issue until the Bond Charges end in 2022. Ca. Water Code § 80104; Ex. CAL-241 at 30:17-32:10.

FF 444. On February 2, 2001, the legislature enacted permanent emergency purchasing legislation in the form of AB1X (Ex. CAL-15), which transferred an additional $495,755,000 into the Electric Power Fund. AB1X also provided ongoing authority for further General Fund transfers into the Electric Power Fund, with the proviso that the total amount transferred would be paid back at the earliest possible time. Tr. 622:7-14 (Pacheco); Ex. CAL-214 at 4:2-7.

FF 445. From January through June 2001, $6.1 billion was transferred from the General Fund to the Electric Power Fund. CDWR paid for both Spot Market purchases and payments under the CDWR Long-Term Contracts from the funds transferred into the Electric Power Fund. Ex. CAL-214 at 4:11-14; Ex. CAL-684 at 11:3-17; Ex. CAL-687A, B.

FF 446. In 2001, the CPUC authorized rate increases for the IOUs, which helped the IOUs pay for about half of the energy CDWR purchased. Tr. 622:18-623:2 (Pacheco); Ex. CAL-214 at 5:1-4; Ex. CAL-241 at 14:26-27; CPUC Decision 01-01-018, at 1-2.

FF 447. The CPUC raised PG&E and SCE's retail electric rates by a total of four-cents per kWh in 2001 in response to the increase in the wholesale electricity prices during the Crisis, through a one-cent increase approved on January 4, 2001 and three-cent increase approved on March 27, 2001. Ex. CAL-241 at 32:13-34:9; Tr. 2096:4-9 (Fulmer).

FF 448. The CPUC increased system-average retail rates for SDG&E customers in September, 2001, of 1.46 cents/kWh or 12.1 percent to implement a CDWR charge for SDG&E's customers. Ex. CAL-241 at 36:11-14.

FF 449. CDWR received an interim or bridge loan of $4.3 billion on June 26, 2001. Tr. 623:7-18 (Pacheco).

FF 450. From January 2001 through December 2002, CDWR paid for Spot Market and Long-Term Contract purchases with funds from the State's General Fund, third party loans, and IOU remittances. Ex. CAL-214 at 4:17-5:4.

FF 451. The State of California issued bonds to pay for CDWR's power procurement expenses incurred in 2001-2002 that could not be repaid in full with revenues collected from the IOU's customers and remitted to CDWR. Ex. CAL-241 at 57:6-10.

FF 452. At the end of 2002, CDWR received $11.3 billion from Power Supply Revenue Bonds. Tr. 624:16-17 (Pacheco); Ex. CAL-689.

FF 453. The bond funds were needed to avoid rate shock to consumers, disruption to people's lives, avoid blackouts, and avoid disruption to California businesses from blackouts and high prices. Tr. 643:4-7 (Pacheco).

FF 454. CDWR carried an $8.152 billion debt as result of its energy procurement responsibilities until it received bond funds at the end of 2002. Tr. 667:7-15 (Pacheco).

FF 455. CDWR's receipt of IOU remittances was insufficient to pay down its $8.152 debt. Tr. 667:16-18 (Pacheco).

FF 456. CDWR paid almost $16 billion in energy costs from the beginning of 2001 through the end of 2002. Tr. 667:23-25 (Pacheco).

FF 457. Of the $16 billion in energy costs that CDWR incurred from January 2001 through December 2002, the IOU remittances only covered about half, or $8.2 billion. Tr. 668:14-17 (Pacheco).

FF 458. Since January, 2003 California ratepayers have paid for electricity supplied by CDWR under the Long Term Contracts through the Power Charge assessed on their utility bills. Ex. CAL-241 at 39:11-14; 40:7-10; 42:17-43:5; Ex. SNA-256 at 8:15-16; 19:1-2; Ex. IB-246 at 22:15-23:2.

FF 459. The Power Charge is a fixed per-kWh rate assigned to each IOU that the IOUs then charge their customers for all CDWR power they consume; it is passed-through directly to CDWR. Ex. CAL-241 at 40:7-10; 41:12-42:13; Ex. 214 at 11:18-12:3; Tr. 2062:3-14 (Fulmer); Ex. IB-246 at 24:16-25:3.

FF 460. The Power Charge is established without regard to the rates or charges for electric power sold by the IOUs. Ex. CAL-241 at 41:12-42:13 (explaining CPUC Decision 02-02-052 at 90).

FF 461. The Power Charges and Bond Charges appear as a separate rate on electric utility bills of customers of the California IOUs. Ex. CAL-241 at 45:2-46:19; Ex. CAL-260 at 2; Ex. CAL-261 at 2, Ex. CAL-266 at 7.

FF 462. California ratepayers will be paying for the Bond Charge until 2022 and for the Power Charge until all costs CDWR incurred related to the Long-Term Contracts are recovered. Tr. 669:23-670:1 (Pacheco); Ex. CAL-214 at 12:1-3.

FF 463. CDWR paid $2.8 billion for energy under the Shell Contract. Ex. CAL-214 at 16:15-17.

FF 464. The state of California experienced socio-economic trade-offs due to the excessive burden of the Shell Contract. Ex. CAL-699 at 16:2-12 (Florio Rebuttal).

FF 465. During the Crisis there were many instances of hardship that citizens endured and wrote to the CPUC about because of high electric bills and rolling blackouts—the inability of people on fixed incomes to buy necessities because they must pay electric bills that increased by $100 a month, the disruption of normal routines in order to conserve electricity, the need to reduce home heating to minimal levels during cold winters in order to reduce the bill, the fear of losing one's home, the increased cost of operating medical equipment. Businesses suffered as well, threatening to abort an economic revival in California that had just gotten started. Ex. CAL-241 at 47:13-48:18 (Florio Direct); Ex. CAL-241 at 50:20-36 (Florio Direct); Ex. CAL-241 at 51:18-23 (Florio Direct); Ex. CAL-241 at 51:24-52:4 (Florio Direct); Ex. CAL-241 at 52:24-53:2 (Florio Direct); Ex. CAL-241 at 54:8-56:13 (Florio Direct).

2. Iberdrola Contract

FF 466. Iberdrola contract imposed an excessive burden on consumers "down the line" in the nominal-dollar amount of $258.7 million ($371 million when FERC interest to May 2015 is included, plus additional FERC interest from May 2015 to date). Ex. CAL-634R at 77:1-5 & tbl.9 (Celebi Direct).

FF 467. CDWR paid $1.1 billion for the energy under the Iberdrola Contract. Ex. CAL-214 at 16:18-20.

FF 468. Because a portion of the payments under the Shell and Iberdrola Contracts were paid from bond funds, in addition to the $2.8 billion and $1.1 billion paid for energy, CDWR also incurred interest charges. Ex. CAL-214 at 17:15-18.

3. Other Serious Harms to the Public Interest

FF 469. Spot prices in California exceeded $100/MWh only once prior to May 2000, in August of 1997. Ex. CAL-604 at 17:4-5 (Goldberg Direct).

FF 470. The public was clearly, palpably, seriously harmed by the energy crisis. Ex. CAL-241 at 65:1-7 (Florio Direct) ("Table 5 shows that the rates consume[r]s paid for power delivered under the Shell Contract in 2001-2003 were four to six times higher than what competitive rates would have been once the market dysfunction ended. The rates consumers paid for power delivered under the Iberdrola Contract were two to three times higher in almost every year compared to what the competitive rate would have been once the market dysfunction ended (the multiple is 1.9 for 2009)." (emphasis in original)).

CONCLUSIONS OF LAW

CL 1. Iberdrola Renewables, LLC is a proper party in this proceeding.

CL 2. The *Mobile-Sierra-Morgan Stanley* presumption of the justness and reasonableness of a bilateral contract is avoided in connection with the long term contract dated May 24, 2001 between Shell Energy North America (US), L.P. and the California Department of Water Resources, by reason of Shell's unlawful activity comprising fraud in the formation of the contract.

CL 3. The *Mobile-Sierra-Morgan Stanley* presumption of the justness and reasonableness of a bilateral contract is not avoided in connection with the long term contract dated July 6, 2001 between Iberdrola Renewables, LLC and the California Department of Water Resources, by reason of any unlawful activity on Iberdrola's part.

CL 4. The *Mobile-Sierra-Morgan Stanley* presumption of the justness and reasonableness of a bilateral contract is overcome in connection with the long term contract dated May 24, 2001 between Shell Energy North America (US), L.P. and the California Department of Water Resources, by reason of its excessive burden on consumers and because it is contrary to the public interest.

CL 5. The *Mobile-Sierra-Morgan Stanley* presumption of the justness and reasonableness of a bilateral contract is overcome in connection with the long term contract dated July 6, 2001 between Iberdrola Renewables, LLC and the California Department of Water Resources, by reason of its excessive burden on consumers and because it is contrary to the public interest.

CL 6. Accordingly, the *Mobile-Sierra-Morgan Stanley* presumption of the justness and reasonableness of a bilateral contract does not apply to the long term contract dated May 24, 2001 between Shell Energy North America (US), L.P. and the California Department of Water Resources.

CL 7. Accordingly, the *Mobile-Sierra-Morgan Stanley* presumption of the justness and reasonableness of a bilateral contract does not apply to the long term contract dated July 6, 2001 between Iberdrola Renewables, LLC and the California Department of Water Resources.

ORDER

391. IT IS ORDERED, that this case is returned to the Commission for further action, with the record supplemented and findings made as set forth herein. This Initial Decision is subject to review by the Commission on exceptions or on its own motion, as provided by the Commission Rules of Practice and Procedure.[763] Within thirty (30) days of the issuance of the final Commission order in this proceeding, the participants shall comply with the findings and conclusions reflected in this Initial Decision, as adopted or modified by the Commission.

Steven A. Glazer
Presiding Administrative Law Judge

[763] *See generally* 18 C.F.R. §§ 385.708(d), 711(a).

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

THE PEOPLE OF THE STATE OF CALIFORNIA, ex rel. Kamala D. Harris, Attorney General; PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA; PACIFIC GAS & ELECTRIC COMPANY; SOUTHERN CALIFORNIA EDISON; *Petitioners*, v. FEDERAL ENERGY REGULATORY COMMISSION, *Respondent*, SHELL ENERGY NORTH AMERICA (US), L.P.; TRANSCANADA ENERGY LTD.; MPS MERCHANT SERVICES, INC.; MIECO, INC.; HAFSLUND ENERGY TRADING LLC; MERRILL LYNCH CAPITAL SERVICES, INC.; KOCH ENERGY TRADING, INC.; ILLINOVA CORPORATION; COMMERCE ENERGY INC.; ALLEGHENY ENERGY SUPPLY COMPANY LLC; *Respondents-Intervenors*.	No. 12-71958 FERC No. EL02-71-036 OPINION

On Petition for Review of an Order of the
Federal Energy Regulatory Commission

Argued and Submitted
February 11, 2015—San Francisco, California

Filed April 29, 2015

Before: Sidney R. Thomas, Chief Judge and M. Margaret McKeown and Richard R. Clifton, Circuit Judges.

Opinion by Chief Judge Thomas

SUMMARY*

Federal Energy Regulatory Commission

The panel granted a petition for review brought by the people of the state of California and related parties challenging a series of orders issued by the Federal Energy Regulatory Commission on remand following the panel's decision in *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), concerning market-based energy tariffs.

In *Lockyer*, the panel held that FERC could authorize market-based energy tariffs, so long as that regulatory framework incorporated both an ex ante marker power analysis and enforceable post-approval transaction reporting.

* This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

The panel remanded because FERC had not appropriately implemented the market-based tariff.

The panel held that FERC structured the remand proceedings in a manner contrary to the terms of the *Lockyer* decision. The panel further held that FERC omitted a necessary component of the market-based tariff approved in *Lockyer* by insisting on proof of market concentration under its hub-and-spoke test as a precondition to any relief for reporting deficiencies. The panel held that reliance on the hub-and-spoke market share measure alone immunized sellers from any consequence for failure to report market transactions and ignored the agency's statutory charge under § 205 of the Federal Power Act: to determine whether sellers charged a "just and reasonable" rate. The panel remanded for further proceedings.

COUNSEL

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William E. Schroeder and Aliya M. McLendon, Sullivan & Cromwell, LLP, New York, New York, for Respondent-Intervenor Koch Energy Trading, Inc.

Gordon A. Coffee and Steffen N. Johnson, Winston & Strawn LLP, Washington, D.C., for Respondent-Intervenor Allegheny Energy Supply Company LLC.

OPINION

THOMAS, Chief Judge:

Petitioners, the people of the state of California through their Attorney General Kamala D. Harris, the California Public Utilities Commission, Pacific Gas & Electric Company, and Southern California Edison ("the California Parties"), seek review of a series of orders issued by the Federal Energy Regulatory Commission ("FERC" or "the Commission") on remand following our decision in *California ex rel. Lockyer v. FERC* ("*Lockyer*"), 383 F.3d 1006 (9th Cir. 2004). There, we held that FERC may authorize market-based energy tariffs, so long as that regulatory framework incorporates both an ex ante market power analysis and enforceable post-approval transaction reporting. *Id*. at 1014. We remanded the case because FERC had not appropriately implemented the market-based tariff. *Id*. at 1015.

In this case, the California Parties petition for review of FERC's actions after our remand, claiming that FERC failed to follow *Lockyer* and violated the Federal Power Act ("FPA") by requiring proof of excessive market share as a necessary condition for relief for transaction reporting violations.

We conclude that FERC structured the remand proceedings in a manner contrary to the terms of our *Lockyer* decision. Enforceable transaction reporting is a necessary ingredient of a lawful market-based tariff. *Id*. By insisting on proof of market concentration under its hub-and-spoke test as a precondition to any relief for reporting deficiencies, FERC omitted a necessary component of the market-based tariff approved in *Lockyer*. Reliance on the hub-and-spoke market share measure alone immunizes sellers from any consequence for failure to report market transactions and ignores the agency's statutory charge under § 205 of the FPA: to determine whether sellers charged a "just and reasonable" rate. 16 U.S.C. § 824d(a). We therefore grant the petition for judicial review and remand to the agency for further proceedings.

I

The essence of the California Parties' complaint is presented in some detail at the outset of our *Lockyer* decision. *See* 383 F.3d at 1008–11. A summary of our *Lockyer* decision and an exposition of events that transpired before FERC on remand follows.

A

In *Lockyer*, we denied the California Parties' facial challenge to market-based ratemaking. *Id*. at 1013. We held that the agency's segmented approach, which requires an ex ante finding of an absence of market power coupled with regular transaction reports, does not *per se* violate the FPA. *Id*. at 1012–13. However, we granted the California Parties' as-applied challenge, holding that FERC's enforcement and review of market-based rates during the 2000–01 California energy crisis was unlawful. *Id*. at 1014. We held that FERC abdicated its regulatory responsibility by summarily dismissing electricity wholesalers' failure to comply with reporting requirements. *Id*. at 1014–15. "[B]ecause the reporting requirements [are] an integral part of a market-based tariff that . . . pass[es] legal muster, FERC cannot dismiss the requirements as mere punctilio." *Id*. at 1015. We remanded to FERC to reconsider the California Parties' claim for a refund of the amount sellers charged in excess of just and reasonable rates during the crisis. *Id.* at 1018.

B

On remand, FERC ordered

> a trial-type hearing before an ALJ to make findings of fact regarding whether, based on the facts and circumstances associated with each individual seller, that seller's improper or untimely filing of its quarterly transaction reports masked an accumulation of market power such that the market rates were unjust and unreasonable, during the relevant period . . . .

California ex rel. Lockyer v. B.C. Power Exch. Corp.[1] ("Mar. 21, 2008 Order"), 122 FERC ¶ 61,260, 62,504–05 (Mar. 21, 2008). FERC defined the threshold issue for the ALJ proceeding as whether sellers accumulated market power and set parameters for the ALJ to use in conducting that inquiry. *Id.* at 62,505–06. Specifically, FERC limited the market power assessment to whether a seller, under the hub-and-spoke test, "did or did not gain an increased generation market share sufficient to give it the ability to exercise market power and cause market-based rates to be unjust and

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[1] Because all remand proceedings are captioned thusly before the agency, to avoid confusion, *hereinafter* each is denominated by reference to the date and title of the document.

unreasonable as a result."[2] *Id*. at 62,505. Other claims of tariff violations, such as gaming and anomalous bidding behavior, were off the table. *Id*. at 62,505 n.65. The Commission reserved determination of the remedy for violations by each particular seller, if any. *Id*. at 62,505.

The California Parties urged FERC to reconsider its definition of the objective of the ALJ proceeding, claiming that the Commission's decision to focus on identifying sellers' market power based on market share levels stood contrary to the FPA, our remand instructions in *Lockyer*, and agency precedent. *See* Oct. 6, 2008 Order, 125 FERC ¶ 61,016, 61,040. The state claimed that FERC's initial order on remand unjustifiably collapsed the two-tiered approach approved in *Lockyer* by conflating the ex ante market power determination and the ex post reporting requirement. *Id*. It identified FERC decisions holding that the purpose of market-based rate quarterly transaction reporting is to meet the filed rate requirements of the FPA, evaluate the reasonableness of rates, and monitor sellers' market power on an ongoing basis. *Id*. Furthermore, the California Parties argued that the hub-and-spoke test prescribed by the agency was an inadequate screen for market power. *Id*.

FERC denied rehearing. *Id*. The Commission declared the state's claims an impermissible collateral attack on the market power analysis FERC used at the time of the transactions and explained that the purpose of market-based

[2] The hub-and-spoke test considers a seller's market share of installed and uncommitted generation capacity in its control area market and each control area market to which it is directly interconnected and finds the potential for market power where the seller holds a market share of 20 percent or more in each relevant market. *Id*. at 62,505 n.70.

quarterly reports "is not to re-run the Commission's market power screens, but rather . . . to monitor and evaluate market concentration on an ongoing basis." *Id.* at 61,040–41. FERC rejected the state's suggestion that the hub-and-spoke test was an inappropriate screen for market power, claiming that it must use only those standards in effect at the time of the reviewed transactions. *Id.* at 61,041–42.

The California Parties also argued that FERC erred in its March 21, 2008 Order by excluding evidence of other tariff violations and market manipulation from the ALJ proceeding. *Id.* at 61,042. The California Parties sought to introduce evidence of alternative analyses of market power and market function, based on information presented in sellers' reports, to show a nexus between deficient reporting, market function, and market power. *Id.* FERC denied rehearing on this issue because other potential seller misconduct, such as gaming and anomalous bidding, was the subject of another proceeding before the agency, which it determined should remain distinct and separate. *Id.*

Shortly thereafter, the California Parties again requested rehearing regarding the evidentiary basis for its reporting allegations. Dec. 28, 2009 Order, 129 FERC ¶ 61,276, 62,530. The California Parties again sought to introduce evidence of market manipulation and tariff violations, explaining that these concerns were not adequately addressed by other proceedings before FERC. *Id.* FERC denied the request as an impermissible request for rehearing of an order denying rehearing. *Id.* The Commission also reasoned that the California Parties' argument about the scope of evidence in the remand proceeding was incongruous with evidence of deficient reporting presented in the original complaint. *Id.* at 62,531. The Commission definitively limited the allegations to be considered in the ALJ proceedings to the California Parties' reporting and hub-and-spoke market power claims, not allegations of market manipulation or other measures of market power. *Id.*

C

After briefing and submission of written testimony, but without hearing argument, the ALJ granted sellers' motions for summary disposition in an Initial Decision issued March 18, 2010. 130 FERC ¶ 63,017, 66,159–62. After crediting the California Parties' evidence of reporting violations, the ALJ ruled in the sellers' favor because the state did not demonstrate that sellers accumulated market power under the hub-and-spoke test. *Id.* at 66,162. The ALJ reasoned that "[a]bsent a showing by the California Parties in their direct testimony that each [seller] possessed generation market power under the Commission's hub-and-spoke test, no material factual issues remain for hearing on the central issue in this proceeding." *Id.* at 66,195. The ALJ set aside the California Parties' seller misconduct and alternative market power analyses as outside the scope of the proceeding and contrary to sellers' due process right to notice. *Id.* at 66,194.

In a May 4, 2011 Order, the Commission affirmed the ALJ decision. 135 FERC ¶ 61,113. The Commission rested on its previous rulings on the California Parties' exceptions and objections. *Id.* at 61,655–56. FERC reasoned, "[g]iven that the issue of whether suppliers accumulated market power was the threshold issue in this proceeding, and given the California Parties' failure to offer any evidence to demonstrate the accumulation of market power under the hub-and-spoke standard, summary disposition was appropriate." *Id.* at 61,655. The Commission later denied the

California Parties' request for rehearing. June 13, 2012 Order, 139 FERC ¶ 61,211. This petition followed shortly thereafter.

II

We have jurisdiction to hear this petition for judicial review pursuant to § 313(b) of the FPA. 16 U.S.C. § 825*l*(b). The California Parties timely filed this petition on June 20, 2012. *See id*. "Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part." *Id*.

We review FERC decisions to determine whether they are "arbitrary, capricious, an abuse of discretion, unsupported by substantial evidence, or not in accordance with the law." *Cal. Dep't of Water Res. v. FERC*, 341 F.3d 906, 910 (9th Cir. 2003). "The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." 16 U.S.C. § 825*l*(b). Questions of law are subject to de novo review. *Am. Rivers v. FERC*, 201 F.3d 1186, 1194 (9th Cir. 1999). FERC's interpretation of the FPA is reviewed under the deferential framework in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984). *Port of Seattle, Wash. v. FERC*, 499 F.3d 1016, 1026 (9th Cir. 2007). However, "*Chevron* does not require blind deference; the Supreme Court has articulated a more thorough and nuanced approach." *Lockyer*, 383 F.3d at 1016. When considering "whether Congress has directly spoken to the precise question at issue," *Chevron*, 467 U.S. at 842, this court is guided by statutory context and "common sense as to the manner in which Congress is likely to delegate a policy decision." *Lockyer*, 383 F.3d at 1016–17 (citation and internal quotation marks omitted).

III

Adjudication of the petition turns on interpretation of § 205 of the FPA, which commands that "any . . . rate or charge that is not just and reasonable is hereby declared to be unlawful." 16 U.S.C. § 824d(a). Although "[o]ur role in determining whether rates are just and reasonable is limited," *Mont. Consumer Counsel v. FERC*, 659 F.3d 910, 918 (9th Cir. 2011), in *Lockyer*, we held that § 205 authorizes FERC to order retroactive refunds for seller reporting failures, based on the "integral nature" of reporting requirements to a lawful, i.e., "just and reasonable," market-based tariff, 383 F.3d at 1014–16. The structure of the remand proceedings is not square with this conclusion. We remanded the matter to FERC "to reconsider its remedial options in the first instance," *id.* at 1018, observing that "FERC may elect not to exercise its remedial discretion by requiring refunds, but it unquestionably has the power to do so," *id.* at 1016. FERC abdicated its discretion by structuring the remand proceedings in a manner that prevented any meaningful review of sellers' failure to file transaction reports during the crisis.

FERC held that the California Parties' "failure to offer any evidence to demonstrate the accumulation of market power under the hub-and-spoke standard" foreclosed relief. May 4, 2011 Order, 135 FERC ¶ 61,113, 61,655. By granting summary disposition to the sellers, the Commission denied the California Parties' claims that reporting deficiencies violated the FPA and justified refunds of amounts sellers charged in excess of the just and reasonable rates. By structuring the remand proceedings in this manner, predicating the "just and reasonable" inquiry required under § 205 on accumulation of market power under the hub-and-spoke test, FERC insulated sellers from liability for reporting violations and thereby ran afoul of the FPA. FERC casts market power identified solely through excessive market share as a necessary condition to conclude that a seller's rate is unjust or unreasonable. This view undercuts the essential importance of transaction reporting and the distinct purpose of each prong of a viable market-based tariff system. In *Lockyer*, when we deemed FERC's market-based ratemaking approach a viable extension of the agency's authority under the FPA, we went to great lengths to distinguish market-based regulatory schemes rejected by the Supreme Court in *MCI Telecommunications Corp. v. AT&T*, 512 U.S. 218 (1994), and *Maislin Industries U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116 (1990). *See Lockyer*, 383 F.3d at 1013. "The structure of the tariff complied with the FPA, so long as it was coupled with enforceable post-approval reporting that would enable FERC to determine whether the rates were 'just and reasonable' and whether market forces were truly determining the price." *Id*. at 1014. "[T]he crucial difference between *MCI*/*Maislin* and the present circumstances is the dual requirement of an ex ante finding of the absence of market power *and* sufficient post-approval reporting requirements." *Id*. at 1013 (emphasis in original).

Our discussion of the California Parties' as-applied challenge in *Lockyer* underscores the independence and import of each prong of the analysis. In testing FERC's claim that reporting violations were mere compliance issues, we observed that each prong of the framework serves a different purpose. Enforceable post-approval reporting is necessary to enable FERC to determine whether sellers' rates complied with § 205 and to investigate whether market forces truly determined the rate charged. *Id.* at 1014. Without "active ongoing review" brought about by an enforceable transaction reporting requirement, "the only arguably serious regulatory screening that exists is FERC's initial determination with respect to a seller's market power—a determination that may bear little or no relation to the realities of subsequent circumstances." *Id.* at 1017. We went on to observe that the FPA remedial scheme comports only with a dual-track regulatory framework because market-based ratemaking premised solely on an initial analysis of market power would eliminate retrospective refund relief under the Act. *Id.*

FERC erred by structuring the remand proceedings to focus exclusively on market-share evidence of market power. By doing so, FERC unlawfully administered the market-based tariff. "If the ability to monitor the market, or gauge the 'just and reasonable' nature of the rates is eliminated, then effective federal regulation is removed altogether. Without the required filings, neither FERC nor any affected party may challenge the rate. Pragmatically, under such circumstances, there is no filed tariff in place at all." *Id.* at 1015–16.

In addition to ignoring our remand instructions, FERC's interpretation is at odds with the position it took in the initial appeal. There, "FERC . . . affirmed . . . that it is not contending that approval of a market-based tariff based on market forces alone would comply with the FPA or the filed rate doctrine." *Id.* at 1013. FERC argued that the presence of reporting requirements differentiated its market-based tariffs from those rejected by the Court in *MCI* and *Maislin*, and this court agreed. *Id.* In fact, even before *Lockyer*, in its initial order on the complaint FERC stated that "[a]fter-the-fact quarterly reports provide a means for spotting price trends, discriminatory patterns, or other indicia of the exercise of market power." May 31, 2002 Order, 99 FERC ¶ 61,247, 62,063. As we said once before, "FERC cannot have it both ways." *Lockyer*, 383 F.3d at 1016. "If the tariff is interpreted as FERC urges here, then the tariff runs afoul of *Maislin*, the filed rate doctrine, and the FPA." *Id.*

FERC argues that the reasonableness of market-based rates charged by sellers without market power, as measured by market share, cannot be challenged. It therefore claims that following an alleged reporting violation, analysis of a seller's market share alone is sufficient. For this proposition the Commission cites a paragraph in *Lockyer* that describes two D.C. Circuit decisions approving market-based ratemaking in the market for natural gas and wholesale electricity. *See id.* at 1012–13. However, FERC takes that passage out of context. Those cases involve a traditional bilateral transaction, that is, a bargained-for exchange between an interested buyer and willing seller. *Id.* That is not directly analogous to the factual circumstances here involving clearinghouse sales during the energy crisis. *See id.* at 1008–10.

FERC also cites *Blumenthal v. FERC*, 552 F.3d 875, 882 (D.C. Cir. 2009), but makes no effort to explain its relevance to its claim that the rate charged by sellers without hub-and-spoke market power is *per se* "just and reasonable." *Blumenthal* concerns a different factual circumstance: Connecticut's challenge to FERC's approval of a "'hybrid' market, in which some electricity generators sell power at regulated rates and others at market rates." *Id.* at 878. Even so, the D.C. Circuit relied on FERC's requirement of "quarterly and annual reports assessing the competitiveness of the market based on transactional data reflecting the behavior of each market participant." *Id.* at 882. The court explained that its holding approving of the "hybrid" market structure comports with *Lockyer* by requiring "[r]egular reports based on 'transaction-specific data[.]'" *Id.* "FERC violates its oversight duty when it imposes no reporting requirements on generators and instead resorts to 'largely undocumented reliance on market forces as the principal means of rate regulation.'" *Id.* (quoting *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1508 (D.C. Cir. 1984) (footnote omitted)). Because it recognizes the necessity and intrinsic value of transactional reporting, *Blumenthal* does not support the proposition FERC presents.

The record on remand demonstrates that FERC did not "examine the relevant data and articulate a satisfactory explanation for its action" and thereby did not meet its burden to engage in reasoned decisionmaking. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). The manner in which FERC structured the proceedings on remand is arbitrary, capricious, and otherwise not in accordance with law. The agency collapsed a lawful two-step market-based tariff to an impermissible one-step inquiry focused solely on whether a seller controlled 20 percent of the generation market in its hub-and-spoke area. FERC may not limit its review of the reporting deficiencies to the hub-and-spoke market power screen. To fully consider whether a reported rate was just and reasonable, the agency must consider claims and evidence beyond the hub-and-spoke analysis.

FERC attempts to justify its position by claiming that the California Parties' claims have been addressed in other proceedings. For example, FERC stated that "this proceeding focuses solely on violations of our quarterly transaction reports as a basis for potential refund liability . . . this is not a proceeding to address other potential tariff violations (such as gaming and anomalous bidding behavior), which is the subject of the *CPUC* proceeding."[3] Oct. 6, 2008 Order, 125 FERC ¶ 61,016, 61,042; *see also* Mar. 18, 2010 Initial Decision, 130 FERC ¶ 63,017, 66,194; Mar. 21, 2008 Order, 122 FERC ¶ 61,260, 62,505 n.65. The California Parties counter that the agency is playing a shell game, artificially limiting the scope of these proceedings and promising that excluded claims will be addressed elsewhere. They argue that this limitation excluded their evidence that sellers exercised market power in ways not detected by the 20-percent hub-and-spoke test. Specifically, the California Parties argue that evidence of sellers' actual market positions, gaming, anomalous bidding behavior, and other market manipulation is relevant to determining whether rates were "just and reasonable" and whether "market forces were truly determining the price."

An agency errs when it "entirely fail[s] to consider an important aspect of the problem." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43. FERC framed the issue in this appeal as whether deficient reporting masked an accumulation of market power such that the market rates charged were unjust and unreasonable. By requiring the California Parties to demonstrate that a seller exercised market power solely by reference to the hub-and-spoke test, FERC ignored other important aspects of the problem of market power masked by

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[3] *Pub. Utils. Comm'n of the State of Cal. v. FERC* ("*CPUC*"), 462 F.3d 1027 (9th Cir. 2006). Before the agency, *CPUC* is denominated *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange* ("*SDG&E*"). *SDG&E*, 149 FERC ¶ 61,116, 2014 WL 5860025 (Nov. 10, 2014).

deficient reporting. This is so regardless of the Commission's consideration of manipulation claims in *CPUC*. FERC entered a final order authorizing refunds for manipulative tariff violations in the *CPUC* remand proceedings on November 10, 2014. *SDG&E*, 149 FERC ¶ 61,116. These proceedings did not concern the nexus between manipulative conduct and reporting violations, however. *SDG&E*, 135 FERC ¶ 61,183, 62,088 (May 26, 2011). The existence of widespread reporting violations and market manipulation by sellers during the 2000–01 crisis has been established. *See Lockyer*, 383 F.3d at 1014 ("[N]on-compliance with FERC's reporting requirements was rampant throughout California's energy crisis. FERC itself has acknowledged that during the height of the energy crisis the quarterly reports of several major wholesalers failed to include the transaction-specific data through which the agency at least theoretically could have monitored the California energy market[.]"); *SDG&E*, 149 FERC ¶ 61,116, 2014 WL 5860025 at *13 (finding "34,020 . . . transactions that constituted tariff violations, more than 20,000 affected the market clearing prices"). While the nexus of these findings may be unclear at this juncture, the merits of that issue are not now before the court. FERC granted summary disposition without considering this argument or any evidence in support. We therefore remand to the agency with instructions to evaluate reporting deficiencies and related market-based rates to determine whether they were unjust and unreasonable in light of the California Parties' nexus claims. The California Parties' manipulation claims are integral to their allegation that reporting deficiencies fostered the subtle accumulation of market power and resulted in an excessive rate. This claim has not yet been tested by FERC and it is most appropriate for the agency to resolve the question in the first instance. *See SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943).[4]

Whether the California Parties' claims have been resolved in other proceedings is also a merits question that must be resolved by the agency. The Commission has recognized its capacity to "be cognizant of the factual scope of each proceeding and the ramifications of [its] actions here on other, related proceedings." Oct. 6, 2008 Order, 125 FERC ¶ 61,016, 61,042. That awareness does not translate into authority to sidestep due process and reasoned analysis for claims the agency believes have been litigated and decided in other proceedings. Obviously, parties are not entitled to double recovery, but that is an analysis that the agency can undertake on remand. This opinion does not address the question of potential refunds from sellers who were not themselves responsible for any manipulation that FERC may determine occurred, but who may have benefitted from it. This issue is appropriately within FERC's province in the first instance.

In summary, FERC's response to *Lockyer*, that refunds are unavailable because no seller exercised market power under the hub-and-spoke test, falls short. When we approved market-based ratemaking in *Lockyer* we repeatedly emphasized the importance of "the dual requirement of an ex ante finding of the absence of market power *and* sufficient post-approval reporting requirements." *Lockyer*, 383 F.3d at

[4] We are aware of Respondents-Intervenors' claim that *Morgan Stanley Capital Group Inc. v. Public Utility District No. 1 of Snohomish County*, 554 U.S. 527 (2008), bars relief for reporting deficiencies in the context of bilateral CERS transactions. This merits argument is also most appropriately addressed by FERC in the first instance.

1013. After FERC dismissed sellers' widespread reporting deficiencies as a mere compliance issue, we granted the state's petition for judicial review and remanded this case to correct the oversight. On remand, FERC structured the proceedings so as to again deny the intrinsic import of transaction reporting.

We therefore remand to the agency once again for adjudication of the complaint in a manner that respects the *Lockyer* mandate and the FPA. To remedy reporting violations, FERC must review the transaction reports to determine whether a just and reasonable price was charged by each seller, with specific attention to whether reporting deficiencies masked manipulation or accumulation of market power. If so, FERC may then elect to exercise its remedial discretion as appropriate. "The FPA cannot be construed to immunize those who overcharge and manipulate markets in violation of the FPA." *Id.* at 1017.

PETITION GRANTED; REMANDED.

[J-79-2013]
IN THE SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

CASTILLE, C.J., SAYLOR, EAKIN, BAER, TODD, McCAFFERY, STEVENS, JJ.

GREENWOOD GAMING AND ENTERTAINMENT, INC.,	: No. 50 MAP 2012
Appellant	: Appeal from the Order of the Commonwealth Court dated May 16, 2012 at No. 617 FR 2009, which Overruled the Exceptions and Entered Judgment in favor of the Commonwealth of PA, affirming the decision of the Board of Finance and Review dated October 21, 2009 at No. 0904037.
v.	
COMMONWEALTH OF PENNSYLVANIA, DEPARTMENT OF REVENUE,	: ARGUED: October 15, 2013
Appellee	:

OPINION

MR. JUSTICE BAER **DECIDED: April 28, 2014**

In this case involving calculation of slot machine tax, Greenwood Gaming and Entertainment ("Greenwood") appeals as of right from the Commonwealth Court's en banc decision overruling exceptions and affirming a panel decision of that court, which likewise affirmed the order of the Board of Finance and Review. 42 Pa.C.S. § 723 (b).[1] Greenwood asks this Court to reverse the decision below and hold that the relevant section of the Gaming Act, 4 Pa.C.S. §§ 1101-1904, allows for the cost of promotional awards given away by the gaming facility to be subtracted prior to calculation of the "gross terminal revenue" for purposes of slot machine taxes. 4 Pa.C.S. § 1103 (Gross

[1] 42 Pa.C.S. § 723(b) provides, "Any final order of the Commonwealth Court entered in any appeal from a decision of the Board of Finance and Revenue shall be appealable to the Supreme Court, as of right, under this section."

Terminal Revenue). After review, we reverse the order of the Commonwealth Court and remand for further proceedings.

Greenwood operates slot machines at the Parx Casino (formerly Philadelphia Park Casino and Racetrack) in Bensalem, Pennsylvania. It is seeking a tax credit against the slot machine tax due and paid for years 2007 and 2008 for approximately $1.1 million in cash and non-cash awards given away as promotions. The promotional giveaways included vehicles, concert tickets, sporting event tickets, and gift cards, and thus were not a result of "winning" a slot machine game, as could be dramatized by coins spilling out when the spinning reels stop on three of a kind. The slot machine tax is based upon the gross terminal revenue ("GTR").[2] During the relevant time period of 2007 and 2008, GTR was defined as the total of the "wagers received by a slot machine" minus specified reductions:

> "Gross terminal revenue." The total of cash or cash equivalent wagers received by a slot machine minus the total of:
>
> (1) Cash or cash equivalents paid out to patrons as a result of playing a slot machine which are paid to patrons either manually or paid out by the slot machine.
>
> (2) Cash paid to purchase annuities to fund prizes payable to patrons over a period of time as a result of playing a slot machine.
>
> (3) Any personal property distributed to a patron as the result of playing a slot machine. This does not include travel expenses, food, refreshments, lodging or services.

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[2] The parties and the tribunals appear to assume that the tax is calculated at a combined rate of 55% of the "gross terminal revenue." Section 1403 provides for a "slot machine tax" of 34%, but also includes various local assessments. 4 Pa.C.S. § 1403. As there is no dispute regarding the tax percentage, this Court need not delve into this detail.

> The term does not include counterfeit money or tokens, coins or currency of other countries which are received in slot machines, except to the extent that they are readily convertible to United States currency, cash taken in fraudulent acts perpetrated against a slot machine licensee for which the licensee is not reimbursed or cash received as entry fees for contests or tournaments in which the patrons compete for prizes.

4 Pa.C.S. § 1103 (GTR) (effective prior to Jan. 7, 2010).[3]

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[3] Effective in January 2010, the legislature amended the definition of GTR. As noted by the parties at oral argument, the Commonwealth Court and both parties in their briefs to this Court utilized the amended statute, which, for purposes of this case, is not substantially different from the prior version applicable to the case at bar. Nonetheless, we observe that the prior version provided for the subtraction of "[a]ny personal property distributed to a patron as <u>the</u> result of playing a slot machine" whereas the amended statute allows for the deduction of personal property distributed as "a" result of playing a slot machine. 4 Pa.C.S. § 1103 (emphasis added). In full, the amended statute defines GTR as follows:

> "Gross terminal revenue." The total of:
>
> (1) cash or cash equivalent wagers received by a slot machine minus the total of:
>
> (i) Cash or cash equivalents paid out to players as a result of playing a slot machine, whether paid manually or paid out by the slot machine.
>
> (ii) Cash or cash equivalents paid to purchase annuities to fund prizes payable to players over a period of time as a result of playing a slot machine.
>
> (iii) Any personal property distributed to a player as a result of playing a slot machine. This does not include travel expenses, food, refreshments, lodging or services.
>
> (2) cash received as entry fees for slot machine contests or slot machine tournaments.

(continued…)

The Department of Revenue utilizes the "central control computer system" ("CCS"),[4] to calculate the daily slot machine tax. The Board of Finance and Review described the process as follows: "Each day, the Department determines Petitioner's gross terminal revenue, taxes and other assessments based on actual calculations by the central control computer system. The Department notifies Petitioner of the amounts due and transfers such amounts from Petitioner's revenues to various Gaming Act funds." Board of Finance and Review Opinion, Oct. 23, 2009, at 1-2. While the CCS tracks various financial events on each slot machine including wagers and payouts, it is

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(…continued)

> The term does not include counterfeit cash or tokens; coins or currency of other countries received in slot machines, except to the extent that the coins or currency are readily convertible to cash; or cash taken in a fraudulent act perpetrated against a slot machine licensee for which the licensee is not reimbursed.

4 Pa.C.S. § 1103 (GTR).

[4] In relevant part, "Central control computer system" is described as follows:

> (a) General rule.--To facilitate the auditing and security programs critical to the integrity of slot machine gaming in this Commonwealth, the department shall have overall control of slot machines, and all slot machine terminals shall be linked, at an appropriate time to be determined by the department, to a central control computer under the control of the department and accessible by the board to provide auditing program capacity and individual terminal information as approved by the department and shall include real-time information retrieval and terminal activation and disabling programs . . . .

4 Pa.C.S. § 1323(a); see also 4 Pa.C.S. § 1103 (defining "[c]entral control computer").

not technologically capable of accounting for the promotional giveaways at issue in this case.

In February 2009, Greenwood filed an appeal with the Department of Revenue's Board of Appeals, seeking a tax credit of approximately $600,000.[5] The crux of Greenwood's argument was that these awards were distributed "as a result of playing a slot machine" such that they could be subtracted from the total wagers received in determining GTR for purposes of calculating the slot machine tax. 4 Pa.C.S. § 1103 (GTR)(1)-(3). The Board of Appeals rejected Greenwood's claim, finding that the promotional awards "were distributed to winners drawn from a pool of players, and not the direct result of a metered win of playing a slot machine." Decision of Bd. of Appeals, July 13, 2009, at 4. Therefore, the Board of Appeals concluded that the promotional giveaways could not be subtracted from the total wagers pursuant to the GTR calculation. Greenwood appealed to the Board of Finance and Review, asserting that the Board of Appeals erroneously interpreted the GTR statute to require that the payouts be "a direct result of a metered win of playing a slot machine." Id.

The Board of Finance and Review similarly denied Greenwood relief. While Greenwood's interpretation essentially allowed credit for awards paid as a result of playing "any" slot machine, the Board concluded that that interpretation was flawed because the "Legislature did not intend to allow gross terminal revenue deductions untied to a specific machine." Decision of Bd. of Fin. and Rev., Oct. 21, 2009, at 6. The Board further concluded that awards could not be subtracted from total wagers unless they were trackable by the CCS: "Providing trackable and verifiable receipt and payout data tied to a specific machine is consistent with the Legislative intent to protect the

5 The $600,000 credit is calculated as 55% (the tax rate on GTR) of the $1.1 million of the awards given to patrons of the gaming facility.

public, police gaming activities and maintain the integrity of regulatory control over the operation of slot machines in Pennsylvania." Id. (citing 4 Pa.C.S. § 1102(1) which provides that a primary objective of the Gaming Act is "to protect the public through the regulation and policing of all activities involving gaming"). Because the promotional awards could not be tracked by the CCS through the individual slot machines, the Board denied Greenwood relief.

Greenwood appealed to the Commonwealth Court, and the parties submitted a stipulation of facts which detailed all the 2007 and 2008 promotional awards ("Stipulation"). Initially, a three-judge panel of the Commonwealth Court affirmed the decisions below. Greenwood Gaming and Entertainment, Inc. v. Commonwealth, 29 A.3d 1215 (Pa. Cmwlth. 2011). After Greenwood filed exceptions, the Commonwealth Court, en banc, adopted the panel decision without additional analysis.[6] Greenwood Gaming and Entertainment, Inc. v. Commonwealth, 45 A.3d 455 (Pa. Cmwlth. 2012). Accordingly, our review is of the reasoning of the original panel decision.

The Commonwealth Court stated that the Gaming Act provides for the subtraction[7] of the three categories of awards set forth in the GTR definition, specifically "cash or cash equivalents paid out to patrons, cash paid to purchase annuities to fund prizes, and any personal property," but the court controversially found that all three categories of awards were measured by the CCS. Greenwood Gaming, 29 A.3d at 1217. In regard to the CCS, the court observed that the Gaming Act requires "that each

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[6] Judge Brobson concurred in the result of the en banc opinion.

[7] The Commonwealth Court used the term deduction to refer to the items being subtracted from the total wagers to calculate GTR. As our resolution of this case turns on whether subsections (1)-(3) are exclusions, which are interpreted in favor of Greenwood, or exemptions which are interpreted in favor of the Commonwealth, we prefer to use the more neutral term "subtraction" to the extent possible.

slot machine directly provides or communicates all required activities and financial details to the central control computer." 4 Pa.C.S. § 1322(b)(3). The court also noted that Section 1322(b)(6) requires that a gaming facility "[e]nsure that any financial event that occurs in the operation of a slot machine is recorded adequately to permit proper and timely reporting of gross revenue and the calculation thereof and of fees and taxes and to maintain accountability for assets." Greenwood Gaming, 29 A.3d at 1219 (quoting 4 Pa.C.S. § 1322(b)(6)).

The court emphasized that the awards Greenwood sought to subtract were not measured by the CCS, finding that the CCS only recorded payments "made within the algorithm of the slot machine, which results from a patron's physical operation of the slot machine." Id. at 1217. It further defined the phrase "within the algorithm of the slot machine" as referring to "a computer-established payout formula and methodology which provides awards to players as a result of physically operating a slot machine." Id. at 1217 n.3.

To determine whether the promotional giveaways could be subtracted from total wagers under the GTR definition, the Commonwealth Court considered the phrase "as a result of playing a slot machine" and concluded that it was ambiguous, a determination which both parties now contest on appeal. To resolve the ambiguity, the court looked to the definition of a "slot machine," which it viewed as tied to the physical operation of the apparatus.[8] Id. at 1219. It concluded that the phrase, "as a result of playing a slot

[8] Slot machine is defined as follows:

> Any mechanical, electrical or computerized contrivance, terminal, machine or other device approved by the Pennsylvania Gaming Control Board which, upon insertion of a coin, bill, ticket, token or similar object therein or upon payment of any consideration whatsoever, including the use of any electronic payment system except a credit card or

(continued…)

machine," should therefore be interpreted to mean "as a direct and immediate result of physically operating a slot machine." Id. at 1220.

It further opined that "[t]he actual winning of a prize from the physical operation of a slot machine would be recorded by the CCS regardless of how the prize was actually distributed," which would encompass the "personal property" provision in subsection (3) of the GTR definition. Id. at 1219. In contrast to winnings directly resulting from the physical operation of a slot machine, the majority concluded that the promotional awards in this case were awarded to patrons who merely had Players Cards,[9] and thus,

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(…continued)

> debit card, is available to play or operate, the play or operation of which, whether by reason of skill or application of the element of chance or both, may deliver or entitle the person or persons playing or operating the contrivance, terminal, machine or other device to receive cash, billets, tickets, tokens or electronic credits to be exchanged for cash or to receive merchandise or anything of value whatsoever, whether the payoff is made automatically from the machine or manually. A slot machine:
>
> (1) May utilize spinning reels or video displays or both.
>
> (2) May or may not dispense coins, tickets or tokens to winning patrons.
>
> (3) May use an electronic credit system for receiving wagers and making payouts.
>
> The term shall include associated equipment necessary to conduct the operation of the contrivance, terminal, machine or other device.

4 Pa.C.S. § 1103 (slot machine)(effective Jan. 7, 2010). Although this section was amended in January 2010, the amendments are not relevant to the issues at bar.

[9] Players Cards "look like credit or debit cards" and are provided to patrons who sign up for the cards. Stipulation at 3, ¶15. "The Players Cards identify the patron to (continued…)

were not tracked by the CCS, nor necessarily awarded "as a result of playing a slot machine." Id. at 1220. Rather than being tied directly to the physical operation of a slot machine, the promotions were awarded, for example, to patrons who had their Players Card inserted into a slot machine at a designated time or who presented a postcard at a specific time, where the postcard was sent as a result of their past slot machine usage. Concluding that Greenwood's promotional awards resulted not from "playing a slot machine" but from having a Players Card and that the awards were not measurable with the CCS, the court held that the awards could not be subtracted from total wagers in determining GTR.

Judge Simpson dissented. Like the majority, he concluded that the language "as a result of playing a slot machine" is ambiguous. However, the dissent noted that when construing an ambiguity in a taxing statute, the conflict must be resolved in favor of the taxpayer, pursuant to Pennsylvania's Rules of Statutory Construction, 1 Pa.C.S. § 1928(b)(3). The dissent emphasized that the panel majority did not address Section 1928(b)(3), even though Greenwood had proffered this argument.

Additionally, the dissent noted that the definition of GTR contemplated the subtraction of values not accounted for by the CCS, specifically cash or cash equivalents "paid manually" and for non-cash personal property awards. 4 Pa.C.S. § 1103 (GTR)(1). The dissent concluded, "The existence of express deductions for these distributions renders the statute ambiguous. Their existence also supports the reasonable interpretation urged by the Taxpayer." Greenwood Gaming, 29 A.3d at 1220-1221 (Simpson, J., dissenting).

Greenwood appeals raising the following issue:

(…continued)
the casino's computer system, which stores data on the patron, including his/her complete gaming activity." Id.

> Are cash and non-cash awards paid out and distributed to casino patrons as promotions based on a patron's slot machine activity, but paid outside the payout algorithms of a slot machine, properly deductible from taxable "gross terminal revenue" as defined in 4 Pa.C.S. §1103?

Greenwood Brief at 4.

Greenwood urges this Court to reverse the Commonwealth Court's holding that the only payments that may be subtracted from the taxable GTR are those made pursuant to the payout algorithms of the slot machines and measured by the CCS. Instead, Greenwood argues that the plain language of the statute's definition of GTR allows subtraction of cash or cash equivalents, annuity payments, or personal property paid or distributed to patrons, with the only limitation being that the awards are "as a result of playing a slot machine." 4 Pa.C.S. § 1103 (GTR)(1)-(3). It argues that the awards in this case fall within the statute's requirements.

Initially, Greenwood argues that the awards in this case may be subtracted under the plain language of the definition of GTR because they were distributed "as a result of playing a slot machine." Id. Greenwood contends that there is a "direct, discernible nexus between the qualifying slot machine play and the award." Greenwood Brief at 8. Greenwood explains that all the awards at issue were distributed to patrons who held Players Cards. The Players Cards, which are classified as Regular, Premium, and Elite, are akin to customer loyalty cards and track patrons' gaming activity. It argues that the Players Cards are a "reliable proxy for prior slot machine play." Greenwood Brief at 16.

Greenwood categorizes the method of awarding prizes into four groups: (1) "from among patrons who had their Players Cards inserted into a slot machine during a designated period or at a designated time;" (2) "from among entries deposited in and selected from a drawing drum or by a computer using a random number generator;"

where entries were based on prior slot machine play, (3) "by bringing to a specific place at the casino . . . a postcard or other mailer the casino had sent to a patron;" or (4) other awards provided "directly to a specific patron as part of 'Player Development.'" Greenwood Brief at 8-9, quoting Stipulation at 5 ¶ 26. Greenwood distributed the postcard and player development awards using prior gaming activity as eligibility criteria, with higher value promotions awarded to the higher tiers of Players Card holders. Greenwood argues that each of these award categories has a palpable connection to slot machine play such that each category satisfies the plain language of Section 1103's provision allowing for the subtraction of "[c]ash or cash equivalents paid out to players as a result of playing a slot machine" or "personal property distributed to a player as the result of playing a slot machine." 4 Pa.C.S. § 1103 (GTR)(1-3).

Next, Greenwood criticizes the Commonwealth Court's requirement that all awards be recordable by the CCS in order to be subtracted from total wagers pursuant to Section 1103's calculation of GTR. Greenwood acknowledges that the Gaming Act provides for the CCS to track various financial data, including payouts made pursuant to the algorithm of the slot machine. It emphasizes, however, that the Gaming Act does not require that GTR be based on CCS data or reference the CCS in the definition of GTR.

In a footnote, Greenwood confronts the Commonwealth Court's suggestion that awards not tracked by the CCS are unmonitored transactions that cannot be audited. Greenwood Brief at 20 n.11. It asserts that the transactions will still be monitored even if not specifically tracked by the CCS since the taxpayer must file a petition for a refund supported by documentation. Greenwood further emphasizes that nothing in the Gaming Act provides that the CCS is the only method for monitoring and accounting for slot machines. Greenwood acknowledges that subsection (3) of Section 1322(b)'s minimum requirements for slot machine accounting controls requires that each slot machine directly communicate all required financial details to the CCS. However, Greenwood observes that several other subsections addressing financial reporting do not mention the CCS, thus suggesting that not all reporting must be processed through the CCS but could instead be provided by supporting documentation for a refund, as in this case. 4 Pa.C.S. § 1322(b).

Assuming arguendo we hold that the language is not plain, Greenwood alternatively argues that, if the GTR definition is ambiguous, the promotional awards at issue still fit within the statutory language based on our rules of statutory construction. Greenwood emphasizes that any ambiguity in provisions imposing a tax must be construed in favor of the taxpayer and against the taxing authority. See 1 Pa.C.S. § 1928(b)(3) ("[p]rovisions imposing taxes"). Greenwood acknowledges that exemptions from taxation are strictly construed against the taxpayer under 1 Pa.C.S. § 1928(b)(5) ("[p]rovisions exempting persons and property from taxation"). Greenwood, however, asserts that the provisions at issue do not constitute exemptions, but rather exclusions, because the language defines the property upon which taxes are imposed, citing BFC Hardwoods, Inc. v. Bd. of Assessment Appeals of Crawford Co., 771 A.2d 759, 763 n.5 (Pa. 2001) (observing that exemptions are strictly construed in favor of taxation whereas "doubts are resolved in favor of the taxpayer in assessing the reach of the taxing statute in the first instance."). See also; Lehigh-Northampton Airport Auth. v. Lehigh Co. Bd. of Assessment Appeals, 889 A.2d 1168, 1177-78 (Pa. 2005). Accordingly, Greenwood argues that any ambiguity in these exemptions should be construed in its favor as the taxpayer.

Greenwood also asserts an argument regarding the so-called "comp exclusion." As noted, the definition of GTR allows for the subtraction of "[a]ny personal property distributed to a player as the result of playing a slot machine" but provides that "[t]his does not include travel expenses, food, refreshments, lodging or services," colloquially known as "comps." 4 Pa.C.S. § 1103 (GTR)(3). Emphasizing that courts must construe statutes to give effect to all provisions, 1 Pa.C.S. § 1921, 1922, Greenwood contends that the comp exclusion would be superfluous if items not traceable via the CCS could not be subtracted from total wagers because comps are also not traceable by the CCS. Greenwood emphasizes that comps function in a similar way to the awards at issue in this case which are given to selected patrons to encourage their continued gaming and not as a result of winning a specific slot machine game. Thus, Greenwood contends that the "comp exclusion" implies that items may be included in subsection (3) "personal property" even if they cannot be measured by the CCS.

Additionally, Greenwood discusses the exclusion of comp items from the personal property category in regard to the maxim expressio unius est exclusio alterius: the express inclusion of one thing implies the exclusion of another. It contends that the personal property awards at issue in this case, such as concert tickets, cars, jewelry, and gift certificates, are indistinguishable from the specified types of comp awards (travel, food, lodging). Greenwood asserts, "Applying that maxim here, the legislature's express exclusion of comps from the personal property deduction signals the availability of the deduction for all other forms of personal property not expressly excluded, including the non-cash awards at issue." Greenwood Brief at 25.

Greenwood further asserts that the Commonwealth Court improperly relied upon the Department's regulation regarding State Gaming Fund Transfers. The relevant subsection provides:

> Determinations of gross terminal revenue and the calculations of taxes and other assessments due will be determined by the Department based on the actual

> calculations by the CCS and the certificate holders' weekly reports of table game revenue made to the Department.

61 Pa. Code § 1001.8(c)(1). Greenwood contends that this regulation merely establishes a mechanism for measuring and paying daily taxes and does not purport to forbid other methods of measuring GTR. Moreover, it argues that even if the regulation did apply as the Commonwealth Court interpreted, it would be invalid as contrary to the statutory language, which Greenwood views as allowing the reductions not accounted for by the CCS.

Given the preceding arguments, Greenwood asks the Court to overturn the decisions below and allow for the subtraction of the promotional awards from the calculation of GTR.

While agreeing with Greenwood that the result is dictated by the plain language, and not ambiguous as the Commonwealth Court held, the Commonwealth asserts that the plain language of GTR definition only allows for the subtraction of those awards that are a direct result of playing a particular slot machine. It acknowledges that the language, "as a result of playing a slot machine" might be ambiguous if viewed in isolation, but contends that it is appropriate to look to legislatively defined terms, before deeming the phrase ambiguous.

Specifically, the Commonwealth focuses on the defined term "slot machine," which is referenced in the definition of GTR. As did the Commonwealth Court, the Commonwealth emphasizes a portion of the definition of slot machine:

> the play or operation of which, whether by reason of skill or application of the element of chance or both, may deliver or entitle the person or persons playing or operating the contrivance, terminal, machine or other device to receive cash, billets, tickets, tokens or electronic credits to be exchanged for cash or to receive merchandise or anything of

> value whatsoever, whether the payoff is made automatically from the machine or manually.

4 Pa.C.S. § 1103 (Slot Machine). It argues that this language indicates that the General Assembly intended that a patron "playing" a slot machine "would have [to] be engaged in the actual physical operation of a slot machine." Commonwealth Brief at 13. In contrast, it maintains that the promotional giveaways awarded to Players Card holders, who merely have a general history of playing slot machines, are not a result of physically playing a slot machine.

The Commonwealth also finds support in the statutorily mandated use of the CCS, which is intended to promote the integrity of slot machine gaming through an auditing and security program. It claims that the CCS is the only mechanism under the Gaming Act for determining GTR for purposes of imposing tax. As did the Commonwealth Court, the Commonwealth contends that the security purposes of the CCS would be undermined by allowing gaming facilities to subtract awards that are not monitored by the CCS.

Assuming arguendo that the language is not plain, the Commonwealth maintains that its interpretation of the GTR definition is consistent with the underlying purpose of the section, which is to tax the net revenue generated by slot machines. It argues that the promotional awards at issue are unrelated to the calculation of slot machine revenue. In contrast, the Commonwealth asserts that standard slot machine winnings are clearly relevant to the calculation of the net revenue, as one must subtract winnings from the total wagers to determine revenue:

> While it makes perfect sense to deduct the cost of prizes which are awarded as a part of, and as a result of, playing slot machines from the total revenue taxed, it does not make sense to deduct the cost of promotional prizes where the "winners" of those prizes did not make any wagers at slot

> machines (i.e. directly contribute to gross terminal revenue) in order to receive any of those prizes".

Commonwealth Brief at 16. The Commonwealth argues that "[i]t makes no more sense to deduct the cost of these promotional prizes from the income generated by slot machines than it would to deduct the same costs from income generated by a casino's restaurants, parking garage, or other commercial enterprises." Commonwealth Brief at 16. It asserts that the costs of the promotional awards are more properly deductible from the calculation of corporate income tax as reasonable business expenses.

Next, the Commonwealth argues that, because the General Assembly provided for the Department of Revenue to calculate the tax due each day based upon the information it receives from the CCS and did not provide another method for tracking the promotional awards, these awards should not be subtracted from the total wagers. Moreover, it contends that the Department is barred by statute from having access to the information on the Players Cards, which are used for the promotional awards, and is therefore unable to monitor these promotional awards.[10] It maintains that allowing for the subtraction of the promotional awards "would be contrary to the basic underlying

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[10] In support, the Commonwealth cites provisions of the definition of the CCS,:

> (a) General Rule. . . . The central control computer employed by the department shall provide: . . . . (4) The delivery of a system that allows the slot machine licensee to install independent player tracking systems and cashless technology as approved by the board.
>
> * * * *
>
> (b) Personal information. - Except as provided for in subsection (a)(4), the central control computer shall not provide for the monitoring or reading of personal or financial information concerning a patron of a slot machine licensee.

4 Pa.C.S. § 1323(a)(4), (b).

intent of the Legislature in establishing strict controls over the operation of slot machine gambling in Pennsylvania," noting that many of the strict controls are rooted in the CCS. Commonwealth Brief at 18. It avers that even if the definition of GTR "could be interpreted as a matter of semantics" to include promotional awards, it "would be entirely inconsistent with the system of strict regulation and accountability intended by the Legislature." Commonwealth Brief at 18-19.

In response to Greenwood's argument that the Commonwealth Court erred in failing to interpret any ambiguity in favor of the taxpayer, the Commonwealth avers that this case does not fall under the general rule for construing tax provisions. See 1 Pa.C.S. § 1928(b)(3), (5). Instead, the Commonwealth contends that the case involves "the challenge to the denial of a deduction rather than the denial of an exemption or exclusion from being subject to a tax in the first place." Commonwealth Brief at 20. It asserts that Greenwood has the burden of proof when seeking a refund due to the improper denial of a deduction, citing Tool Sales and Service Co., Inc. v. Commonwealth, 637 A.2d 607, 613 (Pa. 1993)(quoting 72 Pa.C.S. § 7236 as providing, "In all cases of petitions for reassessment, review or repeal, the burden of proof shall be upon petitioner or appellant as the case may be.").

As noted in Greenwood's argument, the Commonwealth also claims that this Court should afford deference to the regulations adopted by the Department of Revenue which provide, "[d]eterminations of gross terminal revenue and the calculations of taxes and other assessments due will be determined by the Department based on the actual calculations by the CCS." 61 Pa. Code § 1001.8(c)(1). It argues that this regulation is consistent with the statutory definition of GTR regardless of whether this Court concludes that the definitional language is plain or ambiguous. If it is determined to be ambiguous, the Commonwealth contends that we should give deference to the

Department of Revenue's interpretation as the agency with substantial expertise in the area. Arguing that the regulation is not clearly erroneous, the Commonwealth asserts that we cannot declare it invalid.

Responding to Greenwoods' argument regarding the comp exclusion, the Commonwealth asserts that this argument is a "red herring." It contends, "The specific disallowance of certain items from deductible property, though, simply does not expand the meaning or scope of the deduction itself." Commonwealth Brief at 22. It maintains that the central question remains whether the awards are "a result of playing a slot machine." Commonwealth Brief at 22. The Commonwealth further argues that Greenwood's interpretation is absurd because it would allow the deduction of a promotional award merely because the Players Card holder had at one time played a slot machine. It avers that such an award could not be deemed to be "as a result of playing a slot machine." 4 Pa.C.S. § 1103 ("GTR"). For all these reasons, the Commonwealth urges the Court to affirm the decisions below holding that the promotional giveaways cannot be deducted from the calculation of GTR.

In this case, we interpret the statutory language defining the gross terminal revenue for purposes of calculating the slot machine tax. As with any question of statutory interpretation, our standard of review is de novo, and our scope of review is plenary. Mercury Trucking, Inc. v. Pa. Pub. Util. Comm'n, 55 A.3d 1056, 1067 (Pa. 2012). In interpreting a statute, our primary goal is "to ascertain and effectuate the intention of the General Assembly." 1 Pa.C.S. § 1921. "When the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." Id. Additionally, we construe every statute "if possible, to give effect to all its provisions." Id.; see also 1 Pa.C.S. § 1922 ("the General Assembly intends the entire statute to be effective and certain).

Specific interpretive rules apply to statutes relating to taxation instructing that courts must construe strictly "provisions imposing taxes" and "provisions exempting persons and property from taxation." 1 Pa.C.S. § 1928. Somewhat counterintuitively, these two strict construction rules create opposite forces depending on the categorization of the tax provision. On the one hand, provisions that impose taxes are strictly construed in favor of the taxpayer and against the taxing authority. Accordingly, provisions defining what property is subject to the tax, as opposed to what property is "excluded," are interpreted strictly in favor of the taxpayer. See Crawford Cent. Sch. Dist. v. Com., 888 A.2d 616, 620 (Pa. 2005) ("'Exclusions' are given for tax paid on items not intended to be taxed in the first place."); BFC Hardwoods, Inc., 771 A.2d at 763 n.5 (observing in regard to exclusions, "doubts are resolved in favor of the taxpayer in assessing the reach of the taxing statute in the first instance"). Conversely, statutes creating "exemptions" from taxes are construed in favor of the taxing authority and strictly against the taxpayer. See Crawford Cent. Sch. Dist., 888 A.2d at 620 ("'Exemptions' are given for the tax paid on items that, though ordinarily subject to taxation, are excused from taxation because certain criteria have been met.").

We turn first to the plain language of the statute at hand, which provides in relevant part:

> "Gross terminal revenue." The total of cash or cash equivalent wagers received by a slot machine minus the total of:
>
> (1) Cash or cash equivalents paid out to patrons as a result of playing a slot machine which are paid to patrons either manually or paid out by the slot machine.
>
> (2) Cash paid to purchase annuities to fund prizes payable to patrons over a period of time as a result of playing a slot machine.

> (3) Any personal property distributed to a patron as the result of playing a slot machine. This does not include travel expenses, food, refreshments, lodging or services.

4 Pa.C.S. § 1103 (GTR) (effective prior to Jan. 7, 2010).

Neither party disputes that the plain language of the statute only allows for awards to be subtracted from total wagers in determining GTR if they are "a [or the] result of playing a slot machine." Id. The parties' interpretations, however, differ regarding what "a result of playing a slot machine" means. The lower tribunals, in essence, interpreted this language to require that the awards be a result of "winning" a slot machine game as the tribunals either required that the awards be a "direct result of a metered win" or, similarly, that the awards be within the algorithm of a specific slot machine tracked by the CCS. Decision of Bd. of Appeals, July 13, 2009, at 4; Decision of Bd. of Fin. and Rev., Oct. 29, 2013, at 6; Greenwood Gaming, 29 A.3d at 1219. We initially reject, under the plain language of the statute, any requirement that the awards be tied to "winning," by which we mean the process of a patron physically operating a slot machine and the machine registering that the patron has become eligible for a payout pursuant to the algorithm of that machine. In layman's terms, we do not view the phrase "as a result of playing" as being restricted to the prototypical image of coins spilling out of a machine when the spinning reels stop on three of a kind.

We find unpersuasive the Commonwealth Court's reliance on the definition of "slot machine" as indicative of the need for awards to be tied to the algorithm of the machine. The flaw in the analysis is that the definition of GTR uses the term "playing" not "winning" a slot machine. It is beyond cavil that the Legislature understood the difference between playing and winning when it enacted the Gaming Act. See, e.g., 4 Pa.C.S. § 1207(10) (dictating that the theoretical payout percentage of each slot machine must be no less than 85%). Indeed, the definition of "slot machine," that serves as the linchpin of the Commonwealth Court's analysis, provides that "the play or operation” of the slot machine “may” entitle the player to receive cash or merchandise. 4 Pa.C.S. § 1103 (slot machine). The corollary is that “playing” a slot machine, as used in both the definitions of GTR and slot machine, does not necessarily result in winning under the algorithm of the slot machine. We believe that if the Legislature intended the definition of GTR to allow only for the subtraction of payouts for winning a slot machine game, it would have used such specific terminology. Therefore, based on plain language, we reject the Commonwealth Court’s conclusion to the extent it can be read to require a “win” on the slot machine.[11]

To the extent that the Commonwealth’s argument can be limited to requiring that the awards be tracked by the CCS, we also find nothing in the Gaming Act or the regulations cited by the Commonwealth to support this interpretation. We initially observe that the definition of GTR does not reference the CCS, even though GTR and the CCS are both defined in Section 1103. Moreover, while the Gaming Act requires all slot machines to be linked to the CCS “[t]o facilitate the auditing and security programs critical to the integrity of slot machine gaming in this Commonwealth,” 4 Pa.C.S. §1323(a), nothing in that section suggests that a gaming facility cannot maintain other relevant records.

Significantly, Section 1322(b)’s “minimum requirements” for “[s]lot machine accounting controls and audits” are not limited to the CCS. While the legislature in Section 1322(b)(3) mandated “that each slot machine directly provide[] or communicate[] all required activities and financial details to the [CCS] as set by the [Gaming Board]," other subsections contemplate additional financial records. 4 Pa.C.S.

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[11] Even if this language was deemed ambiguous, we further recognize that it would be interpreted in favor of Greenwood as taxpayer, given our determination, infra at 24, that the subsections of the GTR definition set forth exclusions, which are interpreted in favor of the taxpayer, rather than exemptions.

§ 1322(b)(3). Specifically, Section 1322 directs gaming facilities to establish protocols that "[p]rovide for reliable records, accounts and reports of any financial event that occurs in the operation of a slot machine, including reports to the [Gaming Board] related to the slot machines;" "[p]rovide for accurate and reliable financial records"; and "[e]nsure that any financial event that occurs in the operation of a slot machine is recorded adequately to permit proper and timely reporting of gross revenue and the calculation thereof and of fees and taxes and to maintain accountability for assets." 4 Pa.C.S. § 1322(b)(2), (4), (6). These more general subsections would be unnecessary if the universe of financial reporting for slot machines was limited to the CCS. We conclude that nothing in the statutes listed requires the awards to be tracked by the CCS. Moreover, we are not concerned that the integrity of gaming in the Commonwealth will be at risk given that the gaming entities will have to file a petition for a refund documented by adequate and reliable financial records or face appropriate rejection of the petition by the Department of Revenue.

Similarly, we reject the Commonwealth's claim that we should defer to the regulation referencing GTR. Instead, our reading of the regulation relating to "State Gaming Fund Transfers," and in particular the subsection relating to "[t]ax assessments and credit against tax," does not require all items relevant to GTR to be tracked by the CCS. 61 Pa. Code § 1001.8(c)(1). Instead, the relevant language, supra at 13-14, merely provides that the Department's GTR determinations and related tax calculations be based on the CCS. It does not forbid the gaming entities from providing other calculations of GTR not based upon the CCS. In fact, a later subsection addresses how a gaming entity can challenge the Department's conclusions, which arguably would include the calculation of GTR. 61 Pa. Code. § 1001.8(c)(5). Accordingly, we find nothing in the statute or the Department's regulations requiring that the amounts subtracted from total wagers in calculating GTR must be tracked solely by the CCS.[12]

Nonetheless, while we conclude that the plain language of the statute requires neither a metered win nor tracking by the CCS, we find the definition of GTR is still ambiguous regarding the meaning of the phrase "result of playing a slot machine." The Commonwealth convincingly asserts that the promotional awards at issue, which are arguably unrelated to any specific act of playing a specific slot machine, are likewise not related to the purpose underlying the GTR calculations. As the Commonwealth suggests, GTR measures the revenue of a slot machine, which in most simplistic terms is the wagers received minus the winnings paid out. The promotional awards, however, are not precisely correlated to the quantity of wagers received, and thus, according to the Commonwealth, should not be deducted from total wagers any more than they should be deducted as expenses related to the parking garage or the restaurants.

Conversely, Greenwood presents strong arguments that each promotional award has a nexus to a patron's slot machine play and is a direct "result of playing a slot machine," given that each award was the result of prior gaming history or of having the Players Card inserted into a slot machine at a particular time. Moreover, Greenwood observes that the comp exclusion in the personal property subsection would be redundant if the personal property subsection was already restricted to awards tied to a specific slot machine play.

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[12] The parties presented diametrically opposing arguments regarding whether the CCS could track the second and third categories of items in Section 1103 that can be subtracted from total wagers in determining GTR, specifically "[c]ash paid out to purchase annuities" and "personal property." 4 Pa.C.S. § 1103 (GTR). Both Greenwood and the Commonwealth cited the same paragraphs of the Stipulation in support of their arguments. As we conclude that the Gaming Act and the Department's regulations do not require tracking by the CCS, we need not determine this disputed factual question.

Given the apparent ambiguity, we turn to our rules of statutory interpretation involving taxation. As noted, statutes that define what property is and is not subject to taxation are interpreted strictly in favor of the taxpayer and against the Commonwealth. See 1 Pa.C.S. § 1928(b)(3) (requiring strict construction of "[p]rovisions imposing taxes"); see also Crawford Cent. Sch. Dist., 888 A.2d at 620 ("'Exclusions' are given for tax paid on items not intended to be taxed in the first place."); BFC Hardwoods, Inc., 771 A.2d at 763 (observing in regard to exclusions, "doubts are resolved in favor of the taxpayer in assessing the reach of the taxing statute in the first instance"). Greenwood is correct that the definition of GTR in Section 1103 involves defining what is and is not subject to the slot machine tax in the first instance. The section begins with total wagers and from there subtracts (1) cash paid out, (2) cash paid to purchase annuities to fund prizes, and (3) personal property distributed. 4 Pa.C.S. § 1103 (GTR)(1)-(3). The result of this calculation is GTR. It is GTR, not the original total wagers, that serves as the basis for the slot machine tax. 4 Pa.C.S. § 1403 (providing that "each slot machine licensee shall pay a daily tax of 34% from its daily gross terminal revenue from the slot machines in operation at its facility and a local share assessment . . ."). Thus, subsection (1)-(3) are exclusions, which must be interpreted strictly in the favor of Greenwood as the taxpayer.[13]

Therefore, any ambiguity in the phrase "as a result of playing a slot machine" should be interpreted in favor of the taxpayer, including the consideration of whether the

[13] We reject the Commonwealth's suggestion that this case involves neither an exemption nor an exclusion but rather a refund. While the Commonwealth is correct that Greenwood has the burden of demonstrating its right to a refund, Greenwood is arguing for a refund based upon the applicability of statutory language. Therefore, we interpret the statutory language under our rules of statutory construction, not based on who is bringing the claim. In its brief to this Court, the Commonwealth does not offer argument that this is not an exclusion.

“playing” should be tied to a specific slot machine. Accordingly, we conclude that the amounts that can be deducted from total wagers need not be tied to specific machines, but rather can be tied more generally to slot machine play at the gaming facility. We further find support for this reading in the “comp exclusion” included in subsection (3). As Greenwood argues, the comp exclusion would be an unnecessary statutory section if the gaming facility could only subtract personal property distributed to a patron that was tied to a specific machine. Comps, such as free drinks and lodging, are not given to patrons as a result of playing a particular slot machine. Instead, they are provided as an enticement for continued slot machine gaming, just like the promotional awards in the case at bar. Thus, we conclude that the Legislature’s inclusion of the comp exclusion is indicative of an intent to allow gaming facilities to subtract amounts, such as the promotional awards, without requiring these sums to be tied to the play of a specific slot machine at a specific time. See 1 Pa.C.S. § 1921(a) (requiring every statute to be construed to give effect to all its provisions).

Nevertheless, to be deductible, the promotional awards must result from playing slot machines, and Greenwood is obligated to prove as much. After review of the Stipulation, we conclude that questions of fact remain concerning whether the specific awards claimed are a “result of playing a slot machine.” For example, in regard to the promotional awards given to patrons who had their Players Cards inserted in a slot machine at a specific time, the Stipulation does not indicate how insertion of the Players Card relates to actually “playing” the slot machine, as required by Section 1103’s definition of GTR. As another illustration, the Stipulation catalogues the cost of roses given to women dining in Greenwood’s restaurant on Valentine’s Day and the cost of plastic eggs given at Easter which enclosed free slot play, without indicating how the items were “personal property distributed to a patron as the result of playing a slot machine," 4 Pa.C.S. § 1103 (GTR)(3), as opposed to "as the result of" eating in the restaurant or walking into the casino. Stipulation at 14 ¶70, 15 ¶73. We recognize that these and other factual issues were not addressed by the parties or the tribunals below given that the debate then centered on whether the distributions had to be related to a metered win of a slot machine or tracked by the CCS.[14] Accordingly, development of a record is required to determine whether each amount claimed by Greenwood was distributed as a result of a patron's slot machine play.

Accordingly, we reverse the order of the Commonwealth Court and remand for further proceedings to determine if the claimed amounts were a result of playing a slot machine as interpreted in this decision.

Messrs. Justice Saylor and Eakin, Madame Justice Todd and Messrs. Justice McCaffery and Stevens join the opinion.

Mr. Chief Justice Castille files a dissenting opinion.

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[14] We acknowledge that Greenwood has asserted that it would have provided a temporal nexus between the promotional awards and slot machine play if that had been the focus of the inquiry in the tribunals below. Greenwood Brief at 8, n.4.

[J-75A&B-2011]
IN THE SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

CASTILLE, C.J., SAYLOR, EAKIN, BAER, TODD, McCAFFERY, ORIE MELVIN, JJ.

THE HOSPITAL & HEALTHSYSTEM ASSOCIATION OF PENNSYLVANIA, GEISINGER HEALTH SYSTEM, ST. VINCENT HEALTH CENTER AND ABINGTON MEMORIAL HOSPITAL	:	No. 20 MAP 2010 Appeal from the Order of the Commonwealth Court at No. 522 MD 2009 dated April 15, 2010
v.	:	
THE COMMONWEALTH OF PENNSYLVANIA, THE DEPARTMENT OF INSURANCE, THE TREASURY DEPARTMENT, AND THE OFFICE OF THE BUDGET OF THE COMMONWEALTH OF PENNSYLVANIA	:	
APPEAL OF: COMMONWEALTH OF PENNSYLVANIA, THE DEPARTMENT OF INSURANCE AND THE OFFICE OF THE BUDGET OF THE COMMONWEALTH OF PENNSYLVANIA	:	ARGUED: September 14, 2011
THE PENNSYLVANIA MEDICAL SOCIETY, ON BEHALF OF ITSELF AND ALL OF ITS MEMBERS	:	No. 21 MAP 2010 Appeal from the Order of the Commonwealth Court at No. 523 MD 2009 dated April 15, 2010
v.	:	
THE COMMONWEALTH OF PENNSYLVANIA; THE DEPARTMENT OF INSURANCE, THE TREASURY DEPARTMENT, AND THE OFFICE OF THE BUDGET OF THE COMMONWEALTH OF PENNSYLVANIA	:	

APPEAL OF: COMMONWEALTH OF PENNSYLVANIA, THE DEPARTMENT OF INSURANCE AND THE OFFICE OF THE BUDGET OF THE COMMONWEALTH OF PENNSYLVANIA : ARGUED: September 14, 2011

OPINION

MR. JUSTICE SAYLOR[1] **DECIDED: September 26, 2013**

In this direct appeal, we determine the constitutionality of legislation mandating a one-time transfer of money from the Medical Care Availability and Reduction of Error Fund to Pennsylvania's General Fund.

I. Background

In 2002, the General Assembly enacted the Medical Care Availability and Reduction of Error Act (the "MCARE Act"),[2] which requires health care providers to maintain a minimum level of professional liability insurance. The MCARE Act also created the Medical Care Availability and Reduction of Error Fund (the "MCARE Fund"), which is designated as a "special fund" within the state treasury. 40 P.S. §1303.712(a). The MCARE Fund is administered by the Insurance Department of Pennsylvania. See id. §1303.713(a).

Under the MCARE Act, Pennsylvania physicians, hospitals, and certain other health care providers, as a condition of practicing in Pennsylvania, are required to purchase medical professional liability insurance (or provide self-insurance) in the amount of $500,000 per occurrence or claim, and to participate in the MCARE Fund. See 40 P.S. §1303.711(a), (d)(2), (e). The MCARE Fund provides a secondary layer of

[1] This case was reassigned to this author.

[2] Act of Mar. 20, 2002, P.L. 154, No. 13 (as amended 40 P.S. §§1303.101-1303.1115).

liability coverage to providers by paying, subject to the fund's liability limits, damages awarded in medical malpractice actions in excess of the required minimum level of professional liability coverage. See id. §1303.711(g). Presently, the fund's liability limit is $500,000 per occurrence. See id. §1303.712(c). The MCARE Fund is funded by annual assessments levied upon health care providers based on a statutory formula, and loans secured, when needed, from other state funds, such as the Catastrophic Loss Benefits Continuation Fund. See id. §§1303.712(d), 1303.713(c).[3]

Although the MCARE Fund is similar to a supplemental insurance carrier, there are differences, the main one for present purposes being that there is no risk transfer in exchange for premiums. Rather, the statutory formula for assessments levied against health care providers is designed to: (i) reimburse the fund for the payment of reported claims that became final during the preceding year; (ii) pay expenses of the fund incurred during the preceding year; (iii) pay principal and interest on monies that the fund borrowed; and (iv) create a reserve that is ten percent of the sum of (i)-(iii) above. See 40 P.S. §1303.712(d). At any time there may be unfunded liability arising from unreported or unresolved claims. If and when the Insurance Commissioner determines that the private insurance market has the capacity to satisfy professional liability requirements, the MCARE Fund will cease providing coverage for new liability. See id. §§1303.712(c)(2), 1303.711(d)(4). The fund will not immediately terminate, however, as it will still be responsible for excess coverage on unreported or unresolved claims stemming from events that occurred during coverage years. Because assessments are based on the claims paid in the prior year, the MCARE Fund will continue to collect

[3] At the time MCARE became law, the MCARE Fund was also funded by surcharges on motor vehicle violations. See 75 Pa.C.S. §6506(b) (repealed). That provision was repealed by the Act of June 30, 2011, P.L. 159, No. 26, §13. Vehicle surcharges are now deposited in the Commonwealth's General Fund. See id. §9; 72 P.S. §1798-E.

assessments until all claims for which it is responsible have been satisfied. The fund's actuaries have projected that it may continue to pay claims – and thus, collect assessments – for forty years after the fund ceases to provide coverage. At that time, monies remaining in the fund are to be distributed to health care providers in proportion to their assessments during the preceding year. See id. §1303.712(k).

Due to a revenue shortfall, the Commonwealth faced a budget impasse for the 2009-10 fiscal year that lasted approximately 100 days. An interim budget was passed in early August of 2009, and the impasse was finally resolved on October 9, 2009, when the Governor approved a supplemental appropriations bill, as well as implementing legislation making amendments to Pennsylvania's Fiscal Code.[4] See Act of Oct. 9, 2009, P.L. 537, No. 50 ("Act 50"). One of Act 50's provisions designed to balance the budget directed that $100 million be transferred from the MCARE Fund to the General Fund. See 72 P.S. §1717.1-K(1).[5] That provision is at the center of this case.

On October 13, 2009, Appellees filed petitions for review in the nature of complaints for declaratory judgment and injunctive relief in the Commonwealth Court's original jurisdiction.[6] The petitions named as respondents the Commonwealth of Pennsylvania, the Insurance Department, the Treasury Department, and the Office of

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[4] Act of Apr. 9, 1929, P.L. 343, No. 176.

[5] Pennsylvania is required to have a balanced budget. See PA. CONST. art. VIII, §§12, 13; Jubelirer v. Rendell, 598 Pa. 16, 41-42, 953 A.2d 514, 529 (2008).

[6] Two petitions were filed, one by the Pennsylvania Medical Society ("PAMS") on behalf of itself and its members, and the other by Hospital & Healthsystem Association of Pennsylvania ("HAP") on behalf of itself and its members, Geisinger Health System, St. Vincent Health Center and Abington Memorial Hospital. The petitions were consolidated on November 9, 2009.

the Budget (collectively, the "Commonwealth"),[7] and sought a declaration that: (1) the transfer of $100 million from the MCARE Fund to the General Fund extinguished vested rights or constituted an illegal taking in violation of the due process guarantees contained in Article I, Section 1 of the Pennsylvania Constitution and the Fourteenth Amendment to the U.S. Constitution (Count I); and (2) the transfer violated the Uniformity Clause of the Pennsylvania Constitution (Count II). The petitions also requested injunctive relief to prevent the transfer of funds or remediate any unlawful action taken pursuant to Act 50.

Concerned that the Commonwealth might effectuate the transfer and dissipate the funds, Appellees filed an application for preliminary injunctive relief in the nature of a temporary restraining order. They alleged that the only way to preserve the status quo pending the outcome of the litigation would be to retain the monies in the MCARE Fund, since there was no guarantee that the Commonwealth could reconstitute the funds from any other source. The Commonwealth responded that a preliminary injunction was unwarranted because, inter alia, it was not needed to prevent immediate and irreparable harm. See generally Warehime v. Warehime, 580 Pa. 201, 209-10, 860 A.2d 41, 46-47 (2004) (reciting the six prerequisites that a party must establish to obtain preliminary injunctive relief, including a showing that such relief is necessary to prevent immediate and irreparable harm). The Commonwealth suggested, in this regard, that it could "make [Appellees] whole" by depositing $100 million back into the MCARE Fund in the event of an adverse judgment. Commonwealth's Memorandum in Opposition to Petitioners' Application for Special Relief in the Nature of a Temporary Restraining Order at 15, reproduced in R.R. 202a. By order dated October 19, 2009, the

[7] The Treasury Department was later dismissed from the actions on the basis of a stipulation entered by the parties.

Commonwealth Court expressed agreement with the Commonwealth's position in this regard, and denied the requested relief. The court noted, in particular, that Appellees based their irreparable-harm assertion on an assumption that the Commonwealth would not honor a final judicial order, which amounted to "pure speculation." HAP v. Commonwealth, 522 & 523 M.D. 2009, Order at 6 (Pa. Cmwlth. Oct. 19, 2009), reproduced in R.R. 216a. Thereafter, the Treasury Department effectuated the $100 million transfer on October 30, 2009.

The petitions were eventually consolidated, whereupon Appellees filed an application for summary relief. See Pa.R.A.P. 1532(b). On April 15, 2010, the Commonwealth Court granted Appellees' request in a published opinion, holding that the transfer of monies from the MCARE Fund to the General Fund was unlawful in that it impaired Appellees' vested rights. See Hosp. & Healthsystem Ass'n of Pa. v. Commonwealth, 997 A.2d 392, 401 (Pa. Cmwlth. 2010) (en banc) ("HAP I").[8]

First, the court disagreed with the Commonwealth's assertion that Appellees were not entitled to summary relief because there were material facts in dispute and

[8] Because the accompanying order granted the application for summary relief without further elaboration, see id. at 403, it implicitly subsumed a directive to the Commonwealth to return $100 million to the MCARE Fund. See Application for Summary Relief, at 9, ¶44, reproduced in R.R. 226a (reflecting that the prayer for relief includes a request for such a directive).

Separately, on the same day the Commonwealth Court also granted summary relief to PAMS and several physicians in a distinct matter, in which the petitioners challenged a portion of Act 50 that repealed the MCARE Act's Health Care Provider Retention Program and directed the transfer of $708 million from the Health Care Provider Retention Account ("HCPRA") to the General Fund. See Pa. Med. Soc'y v. Dep't of Pub. Welfare, 994 A.2d 33 (Pa. Cmwlth. 2010) (en banc) ("PAMS I"). This Court reversed, concluding that any prospective transfers from the HCPRA to the MCARE Fund were discretionary, and hence, Appellees had no vested entitlement to the funds in question. See Pa. Med. Soc'y v. Dep't of Pub. Welfare, 614 Pa. 574, 603-04, 39 A.3d 267, 285-86 (2012) ("PAMS II").

discovery remained outstanding, reasoning that the issue before the court regarding the lawfulness of the $100 million transfer was a question of law that needed no additional factual development. See id. at 396-97 & n.9. Next, the court rejected the Commonwealth's contention that Appellees did not have standing to bring their respective actions. Finding that the transfer of $100 million from the MCARE Fund diverted those monies from their intended purpose of providing insurance coverage to participating health care providers and prevented them from ultimately being refunded to those providers upon the MCARE Fund's termination, the court concluded that Appellees were aggrieved and had standing to bring the present legal challenge. See id. at 397-98.

With respect to Appellees' argument that they have vested rights in the monies in the MCARE Fund, the majority acknowledged that the General Assembly is free to repeal and amend legislation, but observed that Section 1976 of the Statutory Construction Act, as well as the Remedies Clause of the Pennsylvania Constitution, protect vested rights and accrued causes of action from impairment by subsequent legislation. See PA. CONST. art. I, §11 ("[E]very man for an injury done him . . . shall have remedy by due course of law[.]"); 1 Pa.C.S. §1976(a) ("The repeal of any civil provisions of a statute shall not affect or impair any . . . right existing or accrued . . .."). The court indicated, first, that "the depletion of the MCARE Fund leaves participating providers with a deficit they must make up in the event that claims must be paid thereafter." HAP I, 997 A.2d at 400. It then noted that Sections 712(a) and 712(k) of the MCARE Act guarantee that the monies in the MCARE Fund will be used for MCARE-related purposes or returned to contributing health care providers upon the fund's termination. Particularly in light of this latter observation, the Commonwealth Court ultimately held that Appellees have a vested entitlement – rising above the level of a “mere expectation” – to have the monies used for those purposes, and that such a right “cannot be extinguished by the addition of Section 1717.1-K of the Fiscal Code.” Id. at 401.

As to Appellees’ alternative argument, the court concluded that the transfer did not implicate uniformity concerns. See PA. CONST. art. VIII, §1 (“All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws.”). The court reasoned that, because the assessments paid into the MCARE Fund are intended to reduce the high costs of medical liability insurance, are placed in a special fund within the state treasury, and do not raise revenue or generate interest income for the Commonwealth, the assessments are akin to license fees, rather than taxes that must conform to uniformity requirements. See HAP I, 997 A.2d at 402.

Judge (now President Judge) Pellegrini dissented, incorporating the dissent he filed in PAMS I. In that matter, he had concluded that: Appellees did not have vested rights to the monies at issue; there were disputed facts in need of resolution that precluded the grant of summary relief; the members of PAMS and HAP lacked standing; the Commonwealth was unable to comply with the majority’s order and transfer funds from the General Fund to any other account without first obtaining express authorization from the General Assembly; the General Assembly was an indispensable party, and as such, its absence deprived the court of jurisdiction; and the entire matter was non-justiciable under the political question doctrine. See id. at 403 (Pellegrini, J., dissenting) (citing PAMS I, 994 A.2d at 46-53 (Pellegrini, J., dissenting)).

The Commonwealth appealed to this Court, raising threshold issues pertaining to justiciability and standing, arguing that Appellees had no vested interest in the money that was transferred to the General Fund, and contending that summary relief was premature because contested factual issues remained, requiring further discovery.

II. Justiciability

A. Political Question

One threshold question forwarded by the Commonwealth pertains to whether this case is non-justiciable under the political-question doctrine, a principle that derives from the separation of powers among the three coordinate branches of government. See Pa. Sch. Bds. Ass'n v. Commonwealth Ass'n of Sch. Adm'rs, 569 Pa. 436, 451, 805 A.2d 476, 484-85 (2002). The Commonwealth notes that, in Baker v. Carr, 369 U.S. 186, 211, 82 S. Ct. 691, 706 (1962), the Supreme Court determined that the judiciary should not reach the merits of a dispute, inter alia, where the actions being challenged are constitutionally committed to another branch of government. The Commonwealth maintains that Appellees are asking this Court to dictate how the General Assembly should budget and appropriate funds, and that such functions are constitutionally committed to the executive and legislative branches.[9]

[9] The Commonwealth also suggests that it lacks the power to transfer money back into the MCARE Fund and, as such, it cannot comply with any remedy requiring such a monetary transfer. See Brief for Commonwealth, at 49. As Appellees correctly note, however, see Brief for Appellees at 50-51, the Commonwealth is judicially estopped from making this argument because, as explained, it prevailed on an opposite contention when opposing Appellees' request for a preliminary injunction. See generally New Hampshire v. Maine, 532 U.S. 742, 749, 121 S. Ct. 1808, 1814 (2001) (stating that judicial estoppel "prevents a party from prevailing in one phase of a case on an argument and then relying on a contradictory argument to prevail in another phase." (quoting Pegram v. Herdrich, 530 U.S. 211, 227 n.8, 120 S. Ct. 2143, 2153 n.8 (2000))); In re Estate of Bullotta, 575 Pa. 587, 591, 838 A.2d 594, 596 (2003) (observing that litigants may not "play[] fast and loose" with the courts by "switching positions as required by the moment" (internal quotation marks and citations omitted)). Moreover, this Court may determine the requirements of the law whether or not our role extends to (continued…)

Appellees respond that, although this case may have financial implications for the Commonwealth, that is true of many judicial decisions involving the Commonwealth. They reason that courts should not shrink from their duty to protect citizens' constitutional rights, whether or not the dispute arises in a political context. Appellees also proffer that the Commonwealth waived this issue by failing to raise it before the Commonwealth Court.

"Ordinarily, the exercise of the judiciary's power to review the constitutionality of legislative action does not offend the principle of separation of powers." Sweeney v. Tucker, 473 Pa. 493, 508, 375 A.2d 698, 705 (1977) (citing Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803)); see also Powell v. McCormack, 395 U.S. 486, 549, 89 S. Ct. 1944, 1978 (1969) ("Our system of government requires that . . . courts on occasion interpret the Constitution in a manner at variance with the construction given the document by another branch. The alleged conflict that such an adjudication may cause cannot justify the courts' avoiding their constitutional responsibility."). Still, judicial abstention under the political-question precept may be implicated in certain limited settings, such as where it is demonstrable from the constitution's text that the matter in question is committed to the political branches, or where there is an "unusual need for unquestioning adherence to a political decision already made." Baker, 369 U.S. at 217, 82 S. Ct. at 710.[10]

(…continued)
directing how compliance with the law will be effectuated. See Thornburgh v. Lewis, 504 Pa. 206, 212, 470 A.2d 952, 955 (1983).

[10] The often-quoted passage from Baker states:

> Prominent on the surface of any case held to involve a political question is found a textually demonstrable constitutional commitment of the issue to a coordinate

(continued…)

In Sweeney, this Court highlighted a difference between controversies where the judiciary determines whether another branch did or did not act within the power conferred on it by the Constitution, and matters involving non-justiciable political questions. Drawing on scholarship, Sweeney indicated that cases falling into the latter category occur where the determination of whether the government acted appropriately has itself been "entrusted exclusively and finally to the political branches of government for self-monitoring." Sweeney, 473 Pa. at 509, 375 A.2d at 706 (quoting Louis Henkin, Is there a "Political Question" Doctrine?, 85 YALE L.J. 597, 599 (1976)).

To illustrate, Sweeney referenced Powell, which involved whether the House of Representatives could refuse to seat a duly-elected member. The challenge was deemed justiciable because the Constitution sets forth express qualifications for membership, and Congress is not at liberty to add new qualifications. See Powell, 395 U.S. at 547-48, 89 S. Ct. at 1977-78. Quoting from Justice Douglas's concurrence, the Sweeney Court continued that a challenge to the expulsion of an already-seated member for misconduct, see U.S. CONST. art. I, §5 (permitting Congress to "punish its Members for disorderly Behaviour" and to expel a member by two-thirds vote), might be non-justiciable, since the grounds for punishment or expulsion of a member are

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(…continued)

> political department; or a lack of judicially discoverable and manageable standards for resolving it; or the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion; or the impossibility of a court's undertaking independent resolution without expressing lack of the respect due coordinate branches of government; or an unusual need for unquestioning adherence to a political decision already made; or the potentiality of embarrassment from multifarious pronouncements by various departments on one question.

Id.

committed by the Constitution to the House's internal rules. See Sweeney, 473 Pa. at 512, 375 A.2d at 707. Consistent with Sweeney, a plurality of this Court in Blackwell v. City of Philadelphia, 546 Pa. 358, 684 A.2d 1068 (1996), developed that, although there is no definitive "semantic cataloguing" of cases in which a non-justiciable political question is raised, as a general proposition courts "refuse to scrutinize a legislature's choice of, or compliance with, internal rules and procedures," so long as the legislative body or its members "did not violate any constitutional or statutory provision." Id. at 365, 684 A.2d at 1071.[11]

Finally, the need for courts to fulfill their role of enforcing constitutional limitations is particularly acute where the interests or entitlements of individual citizens are at stake. See Sweeney, 473 Pa. at 517, 375 A.2d at 709 ("[T]he political question doctrine is disfavored when a claim is made that individual liberties have been infringed."). Drawing upon this Court's decision in Consumer Party of Pennsylvania v. Commonwealth, 510 Pa. 158, 507 A.2d 323 (1986), overruled on other grounds by

[11] Compare, e.g., Mapp v. Lawaetz, 882 F.2d 49, 54 (3d Cir. 1989) (refusing to reach the merits of a complaint alleging that the Virgin Islands legislature failed to adhere to an internal rule requiring a two-thirds majority vote to remove a member for misconduct), and Blackwell, 546 Pa. at 368, 684 A.2d at 1073 (finding a dispute non-justiciable where the plaintiff asserted that the city council violated its own rules in discharging a council member's special assistant) (plurality in relevant part), with Zemprelli v. Daniels, 496 Pa. 247, 258, 436 A.2d 1165, 1170 (1981) (holding that a justiciable question was presented where the issue was whether an internal rule of the state Senate concerning the confirmation of gubernatorial appointments was consistent with the state Constitution's requirements for confirmation), Sweeney, 473 Pa. at 522, 375 A.2d at 712 (finding that the political question doctrine did not preclude judicial review of a claim that the expulsion of a member of the Pennsylvania House of Representatives from his seat violated his federal constitutional rights), and Pa. Sch. Bds. Ass'n, 569 Pa. at 451-52, 805 A.2d at 485 (determining that the political question doctrine did not prevent the Court from deciding the validity of legislation which was challenged based on Article III, Section 4 of the Pennsylvania Constitution, which requires every bill to be considered on three separate days in each House).

Pennsylvanians Against Gambling Expansion Fund, Inc. v. Commonwealth, 583 Pa. 275, 316-17, 877 A.2d 383, 408 (2005), the Commonwealth Court has explained that:

> A determination that an issue is a nonjusticiable political question is essentially a matter of judicial abstention or restraint. As our Supreme Court has said: "To preserve the delicate balance critical to a proper functioning of a tripartite system of government, this Court has exercised restraint to avoid an intrusion upon the prerogatives of a sister branch of government. . . ."
>
> Here, Petitioners allege various constitutional violations. In such cases, we will not abdicate our responsibility to "insure that government functions within the bounds of constitutional prescription . . . under the guise of deference to a co-equal branch of government. . . . [I]t would be a serious dereliction on our part to deliberately ignore a clear constitutional violation."

Jubelirer v. Singel, 162 Pa. Cmwlth. 55, 66-67, 638 A.2d 352, 358 (1994) (quoting Consumer Party, 510 Pa. at 176-78, 507 A.2d at 332-333).

As in Jubelirer, Appellees here allege constitutional violations, namely, that Act 50 violates their constitutionally-guaranteed rights to due process and uniformity of taxation. This is significant because, regardless of the extent to which the political branches are responsible for budgetary matters, they are not permitted to enact budget-related legislation that violates the constitutional rights of Pennsylvania citizens. Applying the guidelines set forth in Baker, moreover, we find that determining whether Act 50's transfer of $100 million from the MCARE Fund to the General Fund violated the Constitution is not a matter that has been textually committed to a coordinate branch of government, nor is there an unusual need for unquestioning adherence to the legislative decision already made, particularly as the Commonwealth has represented that it can comply with an order granting relief. Furthermore, this case does not present any of the other characteristics of a non-justiciable political question mentioned in Baker. For example, there is no "potentiality of embarrassment from multifarious pronouncements by various departments on one question." See supra note 10. Notably, in this respect, the political question doctrine does not exist to remove a question of law from the Judiciary's purview merely because another branch has stated its own opinion of the salient legal issue. See Council 13, AFSCME, AFL-CIO ex rel. Fillman v. Rendell, 604 Pa. 352, 373, 986 A.2d 63, 76 (2009).[12] Hence, we conclude Appellees have not asserted a non-justiciable political question.[13]

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[12] The Commonwealth states briefly that there are no judicially manageable standards to apply, and that the constitutionality of the challenged legislation can only be decided with an initial, legislative policy determination. "Simply put," the Commonwealth continues, "where is the money to come from and what other programs should be defunded?" Brief for Commonwealth at 48. Such questions need not be answered in order to resolve whether the initial transfer of the money violated Appellees' constitutional rights. As will be seen, moreover, there are judicially manageable standards for making that assessment.

The Commonwealth also asserts that any ruling in favor of Appellees would express a "lack of the respect due coordinate branches of the government." Id. (quoting, indirectly, Baker, 369 U.S. at 217, 82 S. Ct. at 710). The Commonwealth appears to interpret the "respect" criterion more broadly than Baker intended. See, e.g., United States v. Munoz-Flores, 495 U.S. 385, 390, 110 S. Ct. 1964, 1968 (1990) ("The Government may be right that a judicial finding that Congress has passed an unconstitutional law might in some sense be said to entail a 'lack of respect' for Congress' judgment. But disrespect, in the sense the Government uses the term, cannot be sufficient to create a political question. If it were, every judicial resolution of a constitutional challenge to a [statute] would be impermissible." (emphasis in original)).

[13] In view of our holding, we need not presently decide whether a political-question argument may be waived – an issue on which this Court has not spoken. See generally Commonwealth v. Hughes, 581 Pa. 274, 304& n.12, 865 A.2d 761, 778-79 & n.12 (2004) (for prudential reasons, declining to resolve whether a competency claim may be waived where the claim lacked merit). We believe it prudent to leave that question for a case where its resolution is material to the outcome, particularly given the lack of focused advocacy on the issue from both sides of the present dispute.

B. Standing

The Commonwealth also contends that Appellees lack standing to challenge the $100 million transfer. Primarily, it alleges that Appellees lack a direct and immediate interest in the resolution of the legal question presented. Its argument has two parts. First, it argues that any prospective distribution of the remaining balance in the MCARE Fund to health care providers upon the fund's termination is remote and speculative. Second, it asserts that the statutory formula for the computation of yearly assessments does not depend, directly or indirectly, on the fund's balance at the end of the preceding year. Hence, the argument goes, Appellees' future assessments would not be reduced even if their legal argument prevails and $100 million is transferred back into the MCARE Fund. See Brief for Commonwealth at 44-46.

"The requirement of standing under Pennsylvania law is prudential in nature, and stems from the principle that judicial intervention is appropriate only where the underlying controversy is real and concrete, rather than abstract." City of Phila. v. Commonwealth, 575 Pa. 542, 559, 838 A.2d 566, 577 (2003). "A party has standing to bring a cause of action if it is 'aggrieved' by the actions complained of, that is, if its interest in the outcome of the litigation is substantial, direct, and immediate." City of Phila. v. Schweiker, 579 Pa. 591, 604, 858 A.2d 75, 83 (2004). A "substantial" interest is one that surpasses the common interest of all citizens in procuring obedience to the law. See Bergdoll v. Kane, 557 Pa. 72, 84, 731 A.2d 1261, 1268 (1999) (quoting S. Whitehall Twp. Police Serv. v. S. Whitehall Twp., 521 Pa. 82, 86-87, 555 A.2d 793, 795 (1989)). A "direct" interest requires a showing that the matter complained of caused harm to the party. See id. An "immediate" interest involves the nature of the causal connection, see id., and signifies that judicial intervention is ordinarily inappropriate when the harm alleged is remote and speculative. See City of Phila., 575 Pa. at 561, 838 A.2d at 578.

Appellees averred in their petitions that the $100 million transfer diverted monies that they paid into the MCARE Fund under compulsion of law and, as such, (a) violated their right, protected by the Due Process Clause, to have the funds used to satisfy judgments against them pursuant to the MCARE Act, and (b) constituted an impermissible, non-uniform tax upon health care providers. They also claimed that the re-infusion of $100 million back into the MCARE Fund would reduce their assessments under the statutory formula (an issue on which litigation is pending, as discussed below), and would additionally act as a buffer to protect them against spikes in assessments due to unfunded liabilities.

We conclude that Appellees' claims satisfy all three prongs of the standing test as enumerated above. Prior to the enactment of Act 50, the money in the MCARE Fund was legally dedicated for MCARE purposes only, i.e., to satisfy judgments against Appellees. Appellees' interest in having that money used for such purposes clearly surpasses the common interest of all citizens in seeing that laws are obeyed. Also, the transfer of funds is the direct and immediate cause of the alleged infringement of Appellees' vested entitlements, as well as the alleged non-uniform taxation. In view of these circumstances, we conclude that the providers are aggrieved parties entitled to pursue both of their causes of action.[14] That being the case, moreover, we need not

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[14] It also appears that the Hospital & Healthsystem Association of Pennsylvania and the Pennsylvania Medical Society each has associational standing as a representative of its members. See Warth v. Seldin, 422 U.S. 490, 511, 95 S. Ct. 2197, 2211 (1975). Regardless, the fact that the individual providers have standing is alone sufficient for this Court to reach the merits. See City of Phila., 575 Pa. at 563 n.8, 838 A.2d at 579 n.8 (2003) (where a city and its mayor sought relief, the Court did not need to consider whether the mayor had standing after it determined that the city had standing).

determine whether Act 50's effect on the distribution of monies upon termination of the MCARE Fund, potentially many years in the future, is too remote or speculative to confer standing.

III. Merits

A. Vested Interests

We now turn to the merits of Appellees' claim that, at the time Act 50 was passed, they had a constitutionally-protected vested interest in having existing MCARE monies used for MCARE purposes, such that the interest could not be infringed by the legislation under review. Appellees' present advocacy intermixes concepts of vested rights under the Due Process Clause and causes of action under the Remedies Clause. See Brief for Appellees at 29-41. Although they place much of their emphasis on the Remedies Clause, see PA. CONST. art. I, §11 ("All courts shall be open; and every man for an injury done him in his lands, goods, person or reputation shall have remedy by due course of law[.]"), we consider the due process aspect of Appellees' argument sufficiently developed to preserve that claim as such. See, e.g., Brief for Appellees at 29-30 (arguing that due process prohibits interference with vested rights, and quoting cases reflecting this prohibition).[15] Moreover, we have often considered the Remedies Clause as being directed to protecting causes of action (and defenses) from impairment

[15] The state and federal due process provisions, see PA. CONST. art. I, §§1, 9; U.S. CONST. amend. XIV, are "substantially equivalent" in their protective scope. Krenzelak v. Krenzelak, 503 Pa. 373, 382, 469 A.2d 987, 991 (1983). Appellees each raised due process claims in the first count of their respective Petitions for Review, see Petition for Review of Hosp. & Healthsystem Ass'n of Pa., et al., at 8-10, reproduced in R.R. 26a-28a; Petition for Review of Pa. Med. Soc'y, at 7-9, reproduced in R.R. 53a-55a, and have, throughout the litigation, pursued due process arguments based on an asserted impairment of vested rights. See Petitioners' Brief in Support of Application for Summary Relief, at 13-23, reproduced in R.R. 413a-423a; Petitioners' Reply Brief in Support of Application for Summary Relief, at 9-17, reproduced in R.R. 935a-943a.

after they have accrued.[16] Because Appellees do not contend that Act 50 undermined a cause of action that accrued in their favor during the pre-enactment timeframe, but instead forward averments concerning their alleged interests vis-à-vis the use of certain funds, we believe it would be most straightforward to treat their vested-rights claim as primarily implicating protections under the Due Process Clause.

The Commonwealth argues that Appellees did not have a vested right in the MCARE monies because the MCARE fund is not a trust fund. Although its predecessor, the Medical Professional Liability Catastrophe Loss Fund (the "CAT Fund"), see 40 P.S. §1303.701(d) (superseded); see generally Heim v. MCARE Fund, 611 Pa. 1, 3-4, 23 A.3d 506, 507-08 (2011), was established as a trust fund, the MCARE Fund, observes the Commonwealth, is denoted as a "special" fund within the State Treasury. The Commonwealth proffers, in this regard, that the Governor's Office Manual of Accounting defines a trust fund as a fund containing assets held in trust for someone else, whereas it states that a special fund is subject to budgetary control and, as such, may be redirected to other uses based on legislative changes.

The Commonwealth additionally maintains that nothing in the MCARE Act created vested rights as to the use of MCARE monies. It acknowledges that Section 712(a) of the MCARE Act states that Fund monies "shall be used to pay claims against" health care professionals. The Commonwealth reasons, however, that statutory pledges are unenforceable as against subsequent General Assemblies, and that, in any event, the money has never been promised to providers themselves, but to the victims

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[16] See, e.g., Ieropoli v. AC&S Corp., 577 Pa. 138, 149-51, 842 A.2d 919, 926-27 (2004) (quoting Menges v. Dentler, 33 Pa. 495, 498-99 (1859), and Lewis v. Pa. R.R. Co., 220 Pa. 317, 323-24, 69 A. 821, 823 (1908)); Gibson v. Commonwealth, 490 Pa. 156, 160-61, 415 A.2d 80, 83 (1980); see also Konidaris v. Portnoff Law Assocs., 598 Pa. 55, 75, 953 A.2d 1231, 1242 (2008) (referencing "our Court's extension of the Remedies Clause to defenses").

of their alleged malpractice. As well, the Commonwealth develops that, in the pre-budget-crisis timeframe, the fund received well over $100 million derived from cigarette taxes and motor vehicle violation surcharges, which was used to fund abatements to provider assessments under the state's Health Care Provider Retention Program (addressed more fully in PAMS II). Thus, in the Commonwealth's view, it was entitled to reallocate at least $100 million on that basis alone. The Commonwealth contends further that the MCARE Fund has always met its statutory obligations, and there is no reason to believe that any future claim will remain unpaid as a result of the transfer of $100 million. Overall, the Commonwealth argues that, to hold that the already-paid-in money could not be diverted to another governmental use would restrain legislative bodies from reacting to changing priorities and circumstances.

Alternatively, the Commonwealth asserts that, even assuming Appellees had a vested interest in the money transferred out of the MCARE Fund, Act 50 did not impair that interest, for two reasons. First, the Commonwealth avers that the funding formula for calculating assessments is independent of the balance in the fund and, as such, it is independent of the amount diverted from the fund. Second, the Commonwealth maintains that, because the MCARE Fund has covered all claims for which it has been liable, Appellees have received the benefits to which they were entitled under the MCARE Act. Rather than suffering an impairment of a vested right, according to the Commonwealth, Appellees have received – and will continue to receive – fair exchange for their assessments.[17]

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[17] The Commonwealth also argues that the provision for distribution of proceeds under Section 712(k) decades in the future did not create any vested right harmed by the 2009 legislation. We will discuss this aspect of the MCARE Act below, in addressing whether the transferred funds amounted to surplus monies within the MCARE Fund.

Appellees respond that their interest in the transferred money was indeed vested because Section 712 establishes a quid pro quo whereby health care providers are required to pay assessments to be licensed to practice in Pennsylvania, while the money in the fund is to be used to satisfy judgments against them. In this respect, Appellees note that the language of Section 712(a) is mandatory, providing that MCARE money "shall," rather than "may," be used to pay claims against health care providers. See 40 P.S. §1303.712(a). Appellees proffer that the mandatory nature of the directive remains in force regardless of whether some monies have been included in the fund from non-provider sources such as cigarette taxes or vehicle violations, and regardless of whether the Governor's manual classifies the fund as a trust fund or a special fund.

Further, Appellees suggest that Act 50 impaired their vested rights because every dollar taken from the MCARE Fund is necessarily a dollar that providers will have to pay into the fund in the future to cover claims. Thus, because the MCARE Fund pays liabilities by levying annual assessments according to the statutory funding formula, and future liabilities are unfunded, Appellees reason that they will be subject to higher annual assessments to pay for present and future claims as a result of Act 50. In this respect, they also argue that, in the event the MCARE Fund has insufficient funds to pay claims and expenses, it will have to borrow money, a cost providers will have to bear via the following year's assessments. Accordingly, Appellees state that it is immaterial whether they have received all to which they are entitled, as the Commonwealth highlights. Rather, Appellees aver that, regardless of the MCARE Fund's history of claims payments leading up to Act 50, providers remain obligated to pay assessments sufficient to cover claims that will become payable in the future, and that the subtraction of a substantial amount of money from the fund to balance the 2009-10 budget cannot help but increase their future payments.

"An application for summary relief may be granted if a party's right to judgment is clear and no material issues of fact are in dispute." Jubelirer v. Rendell, 598 Pa. 16, 28, 953 A.2d 514, 521 (2008) (internal quotation marks and citation omitted); see Pa.R.A.P. 1532(b). In ruling on a request for summary relief, the Commonwealth Court views the evidence in the light most favorable to the non-moving party, and enters judgment only if there is no genuine issue as to any material fact and the right to relief is clear as a matter of law. See Chester Cmty. Charter Sch. v. Dep't of Educ., 44 A.3d 715, 720 n.6 (Pa. Cmwlth. 2012).[18] In reviewing the Commonwealth Court's decision to grant summary relief, this Court also considers the record favorably to the non-moving party and resolves all doubts as to the existence of a genuine issue of material fact against the moving party. See PAMS II, 614 Pa. at 589, 39 A.3d at 277. A fact is considered material if its resolution could affect the outcome of the case under the governing law. See Strine v. MCARE Fund, 586 Pa. 395, 402, 894 A.2d 733, 738 (2006) (citing Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S. Ct. 2505, 2510 (1986)).

Applying these principles to the present case, it is important to note, preliminarily, that the challenged provision of the Fiscal Code is not directed to any funding to be obtained after the date of its enactment. Rather, it mandates that $100 million that had already been paid into the MCARE Fund be transferred to the General Fund. See 72 P.S. §1717.1-K(1). At the time those monies were paid in, the governing statute provided that they "shall be used to pay claims against participating health care providers." 40 P.S. §1303.712(a). Such use was thus a legal consequence of their payment at the time they were supplied. The change in use dictated by Section 1717.1-

[18] The summary relief standard under this rule is similar to the summary judgment standard under the Pennsylvania Rules of Civil Procedure. See PAMS II, 614 Pa. at 589 n.11, 39 A.3d at 276 n.11; Brittain v. Beard, 601 Pa. 409, 417, 974 A.2d 479, 484 (2009); Pa.R.A.P. 1532, Official Note.

K(1) alters that consequence and, as such, is retrospective in nature. See generally Landgraf v. USI Film Prods., 511 U.S. 244, 270, 114 S. Ct. 1483, 1499 (1994) (indicating that a statute is "retrospective" or "retroactive" if it "attaches new legal consequences to events completed before its enactment"); see also id. at 269 n.23, 114 S. Ct. at 1499 n.23 (citing authorities). The retrospective character of Section 1717.1-K(1), in turn, implicates this Court's recognition that due process norms limit the government's ability to extinguish vested rights (or entitlements) through retroactive legislation. See, e.g., Krenzelak v. Krenzelak, 503 Pa. 373, 388, 469 A.2d 987, 994 (1983); Bellomini v. State Employees' Ret. Bd., 498 Pa. 204, 212, 445 A.2d 737, 741 (1982) (plurality). The question becomes, then, whether the health care providers had a vested entitlement to have the pre-enactment assessment monies used for MCARE purposes.

The MCARE Act is unusual in that it amounts to something very similar to a government-run supplemental insurance program. It was enacted to abate a malpractice insurance exigency serious enough to require legislative intervention. As such, MCARE comprises social legislation specifically designed (among other things) to ensure that Pennsylvania citizens have access to the care they need by incentivizing health care professionals to stay in Pennsylvania, or move to Pennsylvania, and fulfill those needs. See, e.g., 40 P.S. §§1303.102 ("It is the purpose of th[e MCARE] act to ensure that medical care is available in this Commonwealth through a comprehensive and high-quality health care system."); 1303.502 ("Ensuring the future availability of and access to quality health care is a fundamental responsibility that the General Assembly must fulfill as a promise to our children, our parents and our grandparents."); 1303.514. To this end, MCARE conditions a medical provider's ability to practice in Pennsylvania on participation in the MCARE Fund, which entails the payment of substantial monetary assessments within a statutory scheme that mandates that all such assessments be used to satisfy claims against the providers. See 40 P.S. §1303.712(a). This latter condition is the linchpin to having the system work as intended. The assessment program was never intended as a general mechanism to raise tax revenue and, furthermore, there is a rational relationship between the monies paid in and their mandated use under Section 712(a) so as to prevent the condition-of-doing-business aspect of MCARE from having extortive overtones.

Within that context, the 2009 budget law redirected the MCARE Fund's monies to close a general budgetary gap – a measure having nothing to do with the MCARE statute or its purposes. We mention this not as a criticism of the Legislature's judgment, since this Court is not tasked with evaluating the wisdom of that body's policy choices. Rather, the point is that the Legislature encouraged providers to rely on a scheme that it designed, participation in which was mandatory, and under which assessments extracted from medical providers were required to be used in a manner rationally related to the carrying on of their practices. Accordingly, the providers were led to believe that they could depend upon the program as established in making major practice-related decisions.

This state of affairs elevated MCARE Fund monies above the status of standard budgeting allocations that all affected parties understand may be altered at will by the Legislature. Instead, the Legislature effectively said to the providers, "you must supply these funds, and they will be used to satisfy judgments against you."[19] That being the

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[19] Although, as the Commonwealth points out, some of the monies in the MCARE Fund may have originated from sources other than assessments, the fact remains that all such monies were commingled and, upon entering the MCARE Fund, were dedicated to the fund's purposes.

(continued…)

case, we conclude that the MCARE Fund, although labeled a "special fund," is in the nature of a trust fund whose monies are held for the purpose designated by statute. See Daugherty v. Riley, 34 P.2d 1005, 1010 (Cal. 1934) (reaching a similar conclusion with regard to a "special fund" set aside for exclusive use by a state commission on corporations). Since that purpose involved satisfying judgments against the health care providers, such providers retained a vested entitlement under the Due Process Clause to have the money utilized in the manner directed by statute. See generally Konidaris v. Portnoff Law Assocs., 598 Pa. 55, 74, 953 A.2d 1231, 1242 (2008) (explaining that a "vested" right is one that rises above the level of a "mere expectation" that existing law will continue in place).[20] Contrary to the Commonwealth's argument, moreover, it is inconsequential that MCARE monies are never paid directly to providers, since they are paid to malpractice plaintiffs as a means of satisfying judgments against providers. Accord Wis. Med. Soc'y v. Morgan, 787 N.W.2d 22, 45 (Wis. 2010) ("Under this arrangement, the Fund's payment of excess judgments benefits the health care

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(…continued)
The Pennsylvania Senate, as amicus, adds that the General Assembly must retain the authority to "re-appropriate [funds] as the public's needs change from year-to-year," and emphasizes that the 2009 budget crisis was severe. Senate's Amicus Brief at 15-16. To clarify, we are not suggesting that Section 712(a) binds subsequent legislatures on how MCARE monies may be used going forward. The question is whether the General Assembly was free to redirect assessment monies already paid into the MCARE Fund at the time the 2009 budget legislation was enacted. If the Constitution precluded it from doing so, the severity of the fiscal crisis is immaterial, as the Senate acknowledges. See id. at 15.

[20] Accord Bible v. Dep't of Labor & Indus., 548 Pa. 247, 261, 696 A.2d 1149, 1156 (1997) (quoting Lewis v. Pa. R.R. Co., 220 Pa. 317, 324, 69 A. 821, 823 (1908)); see also Landgraf, 511 U.S. at 265-66, 114 S. Ct. at 1497 (warning that "settled expectations should not be lightly disrupted," and highlighting the importance of scrutinizing retrospective laws with particular caution because of the Legislature's "unmatched powers . . . to sweep away settled expectations suddenly and without individualized consideration").

providers because the payments are, in essence, made on the health care providers' behalf. They have a property interest in the payment of these excess judgments."); cf. Alliance of Am. Insurers v. Chu, 571 N.E.2d 672, 678 (N.Y. 1991) (invalidating a law redirecting to the state's general fund monies earned by an insurance security fund before the law's enactment, where such monies had, in the pre-enactment timeframe, been statutorily mandated to be returned to the contributors or credited toward their future assessments).

On the other hand, courts have recognized that legislative bodies retain authority to control the fate of special funds in order to serve the changing needs of the government. See Washington, D.C. Ass'n of Realtors, Inc. v. District of Columbia, 44 A.3d 299, 305 & n.28 (D.C. 2012) (collecting cases for the "principle that a state legislature may, by statute, divert special funds set aside for particular purposes to a different purpose so long as doing so would not contravene a specific constitutional provision controlling the fund or breach a contractual obligation"). While that precept's application may be limited in connection to monies held in trust or otherwise protected by vested entitlements as to the manner of their use, such authority ordinarily remains with regard to any surplus monies that continue in the fund after the accomplishment of its purposes. See 81A C.J.S. States §387 (2012) (indicating that a surplus in a trust fund may be diverted notwithstanding that legislatures may not ordinarily authorize a diversion of special funds where such a diversion would be unconstitutional or amount to a breach of trust or contract); Daugherty, 34 P.2d at 1010 (suggesting that if and when the commission on corporations no longer needs the funds held in trust, the state legislature may use them for other public purposes).[21] Whether the contested $100

[21] In dissent, Mr. Justice Baer relies on Daugherty's holding to the effect that monies in a trust fund cannot be supplanted if they are necessary to accomplish the fund's objectives. We have no disagreement with that proposition, and reference Daugherty (continued…)

million, or some part of it, represented a surplus in the MCARE Fund at the time Act 50 was passed is therefore a fact which is material to the outcome of Appellees' due-process/vested-rights claim.

Notably, the question was in dispute during the proceedings in the Commonwealth Court. As the Commonwealth correctly observes, the court's summary disposition rested, at least in part, on its assumptions that "the depletion of the MCARE Fund leaves participating providers with a deficit they must make up in the event that claims must be paid thereafter," HAP I, 997 A.2d at 400, and that "the future obligations of the MCARE Fund are in jeopardy due to the transfer of the $100 million," id. at 396 n.9. See Brief for Commonwealth at 36, 52. The evidentiary record, however, is not entirely clear on this point and, moreover, includes a declaration by the Insurance Commissioner explaining that, due to the manner in which the fund makes payments and obtains funds, it will have enough money to fulfill all of its obligations in spite of the $100 million transfer. See Declaration of Peter J. Adams, reproduced in R.R. 656a-658a; see also id. at 2 ¶8 (alleging that the MCARE balance was $322 million before the $100 million was transferred).[22] When such evidence is viewed in the light most favorable to the Commonwealth as the non-moving party, it raises a genuine, material

(…continued)
only insofar as its dispositive and persuasive rationale does not preclude the transfer of monies when they are no longer needed or when such a diversion would not "interfere . . . with the objects for which [the] fund was created." Daugherty, 34 P.2d at 1010.

[22] The declaration was attached as an exhibit to the Commonwealth's Memorandum in Opposition to Petitioners' Application for Summary Relief.

question of fact concerning a possible surplus, which in turn implicates the Legislature's authority with regard to the $100 million, as explained above.[23]

This factual circumstance also serves to highlight a more general legal issue that was never addressed by the Commonwealth Court, namely, how to determine whether a surplus exists within the framework of the MCARE Fund. At least two features of the fund appear relevant to such an inquiry. First, the annual assessment formula does not expressly take into account the size of the reserves already present. This militates in favor of the concept that the diverted monies were surplus funds, unless the formula implicitly accounts for extant reserves.[24] Second, although one could argue that the distribution of remaining funds upon termination of the MCARE Fund under Section 712(k) precludes any possibility of such reserves being characterized as surplus as of the time Act 50 was passed, see, e.g., Dissenting Opinion, slip op. at 8 (Baer, J.), we find it significant that the distribution, if it occurs at all, does not appear likely to take place for at least forty years. Given such a long time interval, the identities of the parties who would receive the money is uncertain, inasmuch as new providers may establish practices and existing providers may cease practicing or leave Pennsylvania during the intervening period.

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[23] As we have determined that the MCARE monies were effectively held in trust, the government bears the burden of demonstrating that the diverted funds were in the nature of a surplus. See 500 James Hance Court v. Pa. Prevailing Wage Appeals Bd., 613 Pa. 238, 272-73, 33 A.3d 555, 575-76 (2011).

[24] The Commonwealth Court recently held that the statutory formula accounts for extant reserves via direct implication of its express language. See Hosp. & Healthsystem Ass'n of Pa. v. Ins. Comm'r, ___ A.3d ___, 2013 WL 4033850 (Pa. Cmwlth. Aug. 9, 2013) (en banc) (petition for allowance of appeal pending at No. 681 MAL 2013). How this affects the determination as to the existence and size of a surplus is to be considered in the first instance by the Commonwealth Court on remand.

In sum, then, we hold that the October 2009 amendment to the Fiscal Code transferring $100 million from the MCARE Fund to the General Fund implicated the providers' due process rights, but that the question of whether the legislation was finally unconstitutional requires further factual development. Accordingly, we will reverse the Commonwealth Court's order granting summary relief and remand for further proceedings.

B. Tax Uniformity

Finally, Appellees seek to preserve the judgment in their favor by renewing an argument they made to the Commonwealth Court, namely, that the $100 million diversion to the General Fund amounts to a discriminatory tax in violation of the Uniformity Clause of the Pennsylvania Constitution. See PA. CONST. art. VIII, §1 (requiring that taxes be (a) uniform on the same class of subjects, and (b) collected under general laws). Appellees submit that the Commonwealth Court improperly disposed of this issue by viewing it as a challenge to the initial collection of the assessments, which the court described as license fees, see HAP I, 997 A.2d at 402, rather than to the transfer of the assessment monies to the General Fund, which Appellees contend converted them into general-revenue taxes. Appellees argue that such a "tax" was non-uniform because there is no logical basis for singling out health care providers to contribute extra funds for the Commonwealth's general expenditures. See Brief for Appellees at 42 ("No reasonable difference exists between health care providers and all other taxpayers sufficient to justify this difference in tax treatment.").[25]

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[25] Appellees do not argue that the alleged tax is invalid on the basis that it was not levied under a general law. Also, the Commonwealth has not provided any advocacy on this issue.

In matters of taxation, this Court has historically analyzed the limitations imposed by the state Uniformity Clause and the federal Equal Protection Clause as being "largely coterminous." Clifton v. Allegheny Cnty., 600 Pa. 662, 687 n.21, 969 A.2d 1197, 1212 n.21 (2009).[26] These clauses do not obligate the government to treat all persons identically, but they do assure that all similarly-situated persons are treated alike. See Small v. Horn, 554 Pa. 600, 615, 722 A.2d 664, 672 (1998) (Equal Protection Clause); Leonard v. Thornburgh, 507 Pa. 317, 321, 489 A.2d 1349, 1352 (1985) (Uniformity Clause). Thus, when the Legislature makes a classification in levying a tax, it will survive scrutiny so long as there is some reasonable justification for treating the relevant group of taxpayers differently than others. See id. Indeed, the Legislature has wide discretion in matters of taxation, see Clifton, 600 Pa. at 685, 969 A.2d at 1211, and a taxpayer pursuing a Uniformity Clause challenge has the burden of demonstrating that the classification is unreasonable. See Devlin v. City of Phila., 580 Pa. 564, 588, 862 A.2d 1234, 1249 (2004); see also Wilson Partners, L.P. v. Bd. of Fin. & Revenue, 558 Pa. 462, 471, 737 A.2d 1215, 1220 (1999) ("When challenging a taxing statute, it is the taxpayer's burden to demonstrate, not only that the enactment results in some form of classification, but also that such classification is unreasonable, in that it is not rationally related to any legitimate state purpose.").

Because Act 50 directed the transfer of $100 million from the MCARE Fund to the General Fund in an effort to balance the state budget, Appellees make a colorable argument that that money was, in effect, converted into tax revenue. Nevertheless,

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[26] In some contexts the Uniformity Clause has been recognized as reflecting more stringent limitations. See, e.g., Downingtown Area Sch. Dist. v. Chester Cnty. Bd. of Assessment Appeals, 590 Pa. 459, 469 n.9, 913 A.2d 194, 201 n.9 (2006). We do not foreclose the possibility that the Uniformity Clause provides greater protections in other ways as well, based on a developed analysis of its text, history, and meaning. Here, however, the parties have not provided such an analysis.

even if we assume, without deciding, that the $100 million diversion amounted, in practical effect, to a tax on health care providers, it does not follow that the Uniformity Clause has been offended. This is because, as noted, taxing classifications are constitutionally permissible if they are reasonable. In light of our disposition of Appellees' due process claim, there remains an outstanding question of whether the $100 million constituted a surplus. If it did, then that in itself will supply an adequate basis for the legislative treatment of such money differently from the fees paid by other Pennsylvania citizens, particularly in light of the contribution from sources other than provider assessments. Therefore, at the present juncture, Appellees' uniformity theory cannot supply an independent justification for affirmance.

IV. Conclusion

Accordingly, the Commonwealth Court's order granting summary relief to Appellees is reversed and the matter is remanded for further proceedings.

Former Justice Orie Melvin did not participate in the decision of this case.

Mr. Chief Justice Castille and Messrs. Justice Eakin and McCaffery join the opinion.

Mr. Justice Baer files a dissenting opinion.

Madame Justice Todd files a dissenting opinion.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Hospital & Healthsystem Association of Pennsylvania, Pennsylvania Medical Society and Pennsylvania Podiatric Medical Association, Petitioners	:	
v.	:	No. 939 C.D. 2011
	:	Argued: March 13, 2012
Insurance Commissioner, Respondent	:	

BEFORE: HONORABLE DAN PELLEGRINI, President Judge
HONORABLE BERNARD L. McGINLEY, Judge
HONORABLE BONNIE BRIGANCE LEADBETTER, Judge
HONORABLE RENÉE COHN JUBELIRER, Judge
HONORABLE MARY HANNAH LEAVITT, Judge
HONORABLE P. KEVIN BROBSON, Judge
HONORABLE PATRICIA A. McCULLOUGH, Judge

OPINION BY JUDGE LEAVITT[1] FILED: August 9, 2013

Petitioners[2] are health care providers and trade associations that have petitioned for review of an adjudication of the Insurance Commissioner that denied their challenge to the assessments imposed upon them by the Medical Care Availability and Reduction of Error (MCARE) Fund for the years 2009, 2010 and 2011. These assessments provide the monies used by the MCARE Fund to pay

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[1] This opinion was reassigned to the authoring judge on March 20, 2013.

[2] The petition for review identifies the following as petitioners: Hospital & Healthsystem Association of Pennsylvania, in conjunction with Grand View Hospital, Geisinger Health System, and University of Pittsburgh Medical Center; Pennsylvania Medical Society, in conjunction with Margaret S. Atwell, M.D. and William R. Dewar, III, M.D.; and Pennsylvania Podiatric Medical Association, in conjunction with John Fawcett, D.P.M.

medical malpractice claims in excess of what the health care provider's primary insurer pays. Petitioners assert that their assessments were excessive because they resulted in a collection of more monies than were needed by the MCARE Fund to pay claims for one year and provide a 10% reserve. We agree and reverse.

Background

Since 1975, the Commonwealth has been directly involved in providing medical malpractice insurance to health care providers in Pennsylvania. The Health Care Services Malpractice Act, Act of October 15, 1975, P.L. 390, *as amended*, formerly 40 P.S. §§1301.101 – 1301.1006,[3] was enacted to confront the "medical malpractice crisis," *i.e.*, the unavailability and costliness of medical malpractice insurance, that existed here and in many other jurisdictions at the time. *See McCoy v. Board of Medical Education and Licensure*, 391 A.2d 723, 725 (Pa. Cmwlth. 1978). The General Assembly addressed this crisis by establishing a mandatory medical malpractice insurance system and a mandatory arbitration system. Mandatory arbitration was held to be unconstitutional, and that part of the statute was rendered ineffective and unenforceable. *Mattos v. Thompson*, 491 Pa. 385, 421 A.2d 190 (1980). However, the statutory mandate that health care providers purchase medical malpractice insurance withstood a constitutional challenge. *McCoy*, 391 A.2d at 727 (holding that a physician, even one who had practiced 40 years without a claim of malpractice, could be forced to make this purchase for the first time in his professional life). A health care provider's refusal

[3] The Health Care Services Malpractice Act was repealed by the Act of March 20, 2002, P.L. 154.

to purchase malpractice insurance coverage in 1975 was, and continues to be, sanctioned by the provider's loss of his professional license. *Id.* at 728.[4]

Under the 1975 insurance system, each health care provider, physician or hospital, was required to purchase an annual policy of medical malpractice insurance that provided coverage in the amount of $100,000 per occurrence and $300,000 in the aggregate. Section 701(a) of the Health Care Services Malpractice Act, formerly 40 P.S. §1301.701.[5] Where a health care provider was unable to purchase this primary policy in the private insurance marketplace, the purchase could be made through the assistance of the Joint Underwriting Association. Section 801(a) of the Health Care Services Malpractice Act, formerly 40 P.S. §1301.801.[6] In addition, each health care provider was required to purchase excess coverage in the amount of $1,000,000 per claim from the "Medical Professional Liability Catastrophe Loss Fund," a special fund in the Pennsylvania Treasury set up to provide excess coverage above the provider's primary coverage. This fund became known as the "CAT Fund." It paid, annually, up to $1,000,000 per occurrence and up to $3,000,000 in the aggregate for each health care provider. Section 701(c) of the Health Care Services Malpractice Act, formerly 40 P.S. §1301.701(c).[7] The CAT Fund was funded by a surcharge upon the premium the provider paid for the primary coverage; the surcharge was set at 10% of the health care provider's annual premium for the primary coverage or $100, whichever was

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[4] Technically, the provider can self-insure. Section 711(a)(2) of the Medical Care Availability and Reduction of Error Act, Act of March 20, 2002, P.L. 154, 40 P.S. §1303.711(a)(2). This option is generally used only by hospital providers.

[5] Section 701(a) was repealed by the Act of March 20, 2002, P.L. 154.

[6] Section 801 was repealed by the Act of March 20, 2002, P.L. 154.

[7] Section 701(c) was repealed by the Act of March 20, 2002, P.L. 154.

greater. Section 701(d) of the Health Care Services Malpractice Act, formerly 40 P.S. §1301.701(d).[8]

Over time, the legislature enacted many amendments to the Health Care Services Malpractice Act. Those amendments, *inter alia*, reduced the level of excess coverage provided by the CAT Fund and increased the level of primary coverage required to be purchased by the health care provider. For example, the 1996 amendments made the individual health care provider responsible for primary coverage in the amount of $300,000 per occurrence and $900,000 in the aggregate; the CAT Fund paid the next $900,000 for each occurrence and $2,700,000 in the aggregate.[9] The 1996 amendment also called for continued future increases in the level of primary coverage and decreases in the excess coverage provided by the CAT Fund. *See* Section 3 of the Act of November 26, 1996, P.L. 776. Changes were also made to the CAT Fund surcharge, its amount and calculation. *Id.*

In 2002, the General Assembly repealed the Health Care Services Malpractice Act and started over with new legislation: the Medical Care Availability and Reduction of Error (MCARE) Act.[10] The MCARE Act addressed a newly perceived crisis, *i.e.*, the *cost* of medical malpractice insurance. There was concern that the cost of medical malpractice insurance in Pennsylvania had increased to the point that physicians educated and trained in Pennsylvania were

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[8] Section 701(d) was repealed by the Act of March 20, 2002, P.L. 154.

[9] Hospitals had to insure their professional liability in the amount of $300,000 per occurrence and $1,500,000 per annual aggregate. Section 701(a)(l)(i) of the Health Care Services Malpractice Act, formerly 40 P.S. §1301.701(a)(1)(i), repealed by the Act of March 20, 2002, P.L. 154.

[10] Act of March 20, 2002, P.L. 154, *as amended*, 40 P.S. §§1303.101–1303.1115. Sections 1101 through 1115, 40 P.S. §§1303.1101–1303.1115, were repealed by the Act of October 9, 2009, P.L. 537.

leaving to set up practice in other states where the costs of this insurance were lower.

Relevant to this case, the MCARE Act abolished the CAT Fund and replaced it with the MCARE Fund. Monies in the CAT Fund were transferred to the MCARE Fund along with the CAT Fund's liabilities. Section 712(b) of the MCARE Act, 40 P.S. §1303.712(b). Like its predecessor, the MCARE Fund was set up to provide insurance coverage in excess of the mandatory levels of primary medical malpractice coverage. *See* Section 712(a) of the MCARE Act, 40 P.S. §1303.712(a). For policies issued or renewed in 2002, the first year of the MCARE Act, physicians were required to purchase primary coverage in the amount of $500,000 per occurrence and $1,500,000 in the aggregate; hospitals had to purchase $500,000 per occurrence and $2,500,000 annual aggregate coverage. Section 711(d)(l) of the MCARE Act, 40 P.S. §1303.711(d)(l). The corresponding coverage from the MCARE Fund for calendar year 2002 for each provider and each hospital was $700,000 per occurrence and $2,100,000 per annual aggregate. Section 712(c)(1) of the MCARE Act, 40 P.S. §1303.712(c)(1). In 2003, this coverage available from the MCARE Fund dropped to $500,000 per occurrence and $1,500,000 per annual aggregate. Section 712(c)(2)(i) of the MCARE Act, 40 P.S. §1303.712(c)(2)(i).

The MCARE Fund is scheduled for termination. To that end, the MCARE Act has established a schedule for continued increases in the amount of primary coverage that must be purchased by health care providers and continued decreases in the amount of excess coverage that will be available from the MCARE Fund. For example, for policies issued in 2006, the mandatory level of primary medical malpractice coverage was scheduled to increase to

$750,000/$2,250,000, and the amount of excess coverage provided by the MCARE Fund was scheduled to drop to $250,000 per occurrence and $750,000 in the aggregate. Sections 711(d)(3)(i), 712(c)(2)(ii) of the MCARE Act, 40 P.S. §§1303.711(d)(3)(i), 1303.712(c)(2)(ii). In this way, the MCARE Act provides for a gradual transfer of all medical malpractice insurance coverage, primary and excess, to the private insurance market.

MCARE Fund Assessments

The MCARE Fund obtains its funding from an annual assessment levied on health care providers. *See* Section 712(d) of the MCARE Act, 40 P.S. §1303.712(d). Petitioners assert that their MCARE Fund assessments for 2009, 2010 and 2011 were not calculated in accordance with Section 712(d) and, thus, they filed an administrative appeal with the Insurance Commissioner pursuant to Section 712(d)(3) of the MCARE Act, 40 P.S. §1303.712(d)(3).[11] The evidentiary record was made by stipulation of the parties.

The stipulation describes the MCARE Fund as a "pay-as-you-go" program of insurance. Unlike a private insurance company, it does not establish reserves to cover injuries that occur in the assessment year but do not become adjudicated awards for several years thereafter. *See* Joint Stipulation of Facts, ¶8; Reproduced Record at 10a (R.R. __). *See also Hospital & Healthsystem Association of Pennsylvania v. Commonwealth*, 997 A.2d 392, 394 (Pa. Cmwlth. 2010), *appeal filed and probable jurisdiction noted at* 20 MAP 2010. Instead, the

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[11] Section 712(d)(3) of the MCARE Act states:

> Any appeal of the [health care provider's] assessment shall be filed with the department.

40 P.S. §1303.712(d)(3).

MCARE Fund is set up to raise only those funds necessary to "cover claims and expenses for the assessment year." *Id.* The MCARE Fund projects its annual expected claim payments on the basis of the prior year's payments. *Pennsylvania Medical Society v. Department of Public Welfare*, 614 Pa. 574, __, 39 A.3d 267, 272 (2012). This means that the amount collected from health care providers in a given year may be more, or less, than what is actually needed to pay the MCARE Fund's claims and expenses for that year.

The stipulation provides that the MCARE Fund set the 2009 aggregate assessment total at $204,223,545, *i.e.*, the total amount to be collected from all health care providers to fund one year of operations. This figure was reached by adding together: (1) claims payments for 2008 in the amount of $173,892,874; (2) expenses for the 2008 claim year in the amount of $11,764,894; and (3) 10% of the sum of the preceding two figures, or $18,565,777. Joint Stipulation of Facts, ¶14; R.R. 11a. If the claims in 2008 had emptied the MCARE Fund's coffers, it could have borrowed what was needed to cover the shortfall. Section 713(c) of the MCARE Act, 40 P.S. §1303.713(c). In that case, the 2009 assessment would have been larger because it would also have added the amount of principal and interest payments owing on those loans to the aggregate of 2008 claims and expenses, *i.e.*, $185,657,768. Section 712(d)(1)(iii) of the MCARE Act, 40 P.S. §1303.712(d)(l)(iii).

In making its calculation for 2009, the MCARE Fund ignored its 2008 accrued unspent balance of approximately $104 million. Joint Stipulation of Facts, ¶15; R.R. 11a. Likewise, PricewaterhouseCoopers, which sets the annual assessment total, did not consider the MCARE Fund's unspent balance when it calculated the assessment totals for 2010 and 2011. Had it done so, the assessments would have been significantly lower. Instead, in 2009, $100 million was transferred out of the MCARE Fund into the Commonwealth's General Fund for the purpose of funding the operations of state government. Section 1717.1-K of the Act of April 9, 1929, P.L. 343 (Fiscal Code), *as amended*, added by the Act of October 9, 2009, P.L. 537, 72 P.S. §1717.1-K. This Court held that this transfer of funds was illegal. *Hospital & Healthsystem Association*, 997 A.2d at 403. A petition for allowance of appeal of this Court's decision is presently pending before our Supreme Court, with probable jurisdiction noted at 20 MAP 2010.

Petitioners appealed their 2009, 2010 and 2011 assessments on the theory that the MCARE Fund's year-end balance should have been included in the aggregate assessment calculation for 2009 and the following years. The Insurance Commissioner found in favor of the MCARE Fund, concluding that unspent balances in the MCARE Fund were irrelevant to the calculation of the aggregate annual assessment. Petitioners then petitioned for this Court's review.

On appeal,[12] Petitioners argue that the Insurance Commissioner's adjudication cannot be reconciled with the plain language of Section 712(d)(1) of the MCARE Act. They contend that ignoring an unspent balance in the MCARE Fund produces a reserve far in excess of the 10% level set by statute. The dollar amount of the MCARE Fund's reserve will change from year to year but, Petitioners argue, should not exceed 10% of the prior year's claims and expenses. The aggregate assessment must be calculated to achieve that goal.

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[12] When reviewing pure questions of law, this Court exercises *de novo* review that is plenary in scope. *Penneco Oil Co., Inc. v. County of Fayette*, 4 A.3d 722, 724 n.2 (Pa. Cmwlth. 2010).

Section 712(d)(1) of the MCARE Act

At issue is the meaning of Section 712(d)(l) of the MCARE Act, which establishes the formula by which the MCARE Fund calculates the funds it will need for the following year. It states, in relevant part, as follows:

> For calendar year 2003 and for each year thereafter, the fund shall be funded by an assessment on each participating health care provider. Assessments shall be levied by the department on or after January 1 of each year. *The assessment shall* be based on the prevailing primary premium[13] for each participating health care provider and shall, *in the aggregate, produce an amount sufficient to do all of the following*:
>
> (i) Reimburse the fund for the payment of reported claims which became final during the preceding claims period.
>
> (ii) Pay expenses of the fund incurred during the preceding claims period.
>
> (iii) Pay principal and interest on moneys transferred into the fund in accordance with section 713(c) [authorizing the Governor to make loans to the Fund].

[13] The "prevailing primary premium" is the premium that the Pennsylvania Professional Liability Joint Underwriting Association (JUA) charges a provider of like specialty and territory under its approved rate schedule. *See* Section 712 of the Act, 40 P.S. §1303.712; Joint Stipulation of Facts, ¶9; R.R. 10a. The JUA is a statutory facility, made up of all private insurers authorized to write medical malpractice insurance in the Commonwealth, that serves as the insurer of last resort. It provides insurance to health care providers that are unable to obtain medical malpractice insurance in the open market. Section 732 of the MCARE Act, 40 P.S. §1303.732. Each individual health care provider's assessment is determined by calculating the total annual assessment and, then, dividing it among participating health care providers. This is done by applying a percentage to the individual provider's "prevailing primary premium." Joint Stipulation of Facts, ¶11; R.R. 11a. The assessment rule for 2009 decreased from 20% to 19% of the prevailing primary premium. *Id.* at ¶5; R.R. 10a.

> (iv) Provide a reserve that shall be 10% of the sum of subparagraphs (i), (ii) and (iii).

40 P.S. §1303.712(d)(1) (emphasis added). Simply, the aggregate assessment must be "sufficient" to produce a balance sheet that replaces what was spent in the prior year and provides a reserve of 10%. The dollar amount of the 10% reserve changes from year to year, depending on the prior year's claims and expenses.

The MCARE Fund has construed Section 712(d)(1) to mean that 110% of the prior year's expenditures must be collected each year from health care providers, regardless of the starting balance. Adjudication and Order at 17. This exercise means that unspent balances will accumulate even as claims decline, consistent with the MCARE Fund's scheduled termination, or as earnings on the 10% reserve increase.

Petitioners assert that this is error because, inevitably, this interpretation will lead to an accumulation of unspent balances that is inconsistent with a pay-as-you-go system that was supposed to *reduce* the cost of medical malpractice insurance in Pennsylvania. Most importantly, the MCARE Fund's interpretation distorts the actual language of Section 712(d)(1), as illustrated below:

> The assessment … shall, ~~in the aggregate, produce an amount sufficient to do all~~ <u>be equal to the sum</u> of the following:

Joint Brief of Petitioners at 19.[14] If the above-rewrite expresses the legislature's intention, then why did it not use this shorter, and clearer, language? Why, instead,

[14] Additions to Section 712(d)(l) are underlined, deletions struck through.

did it use so many additional words, none of which have been given any meaning or effect by the MCARE Fund?

When interpreting a statute, this Court is guided by the Statutory Construction Act of 1972, 1 Pa. C.S. §§1501-1991, which provides that "the object of all interpretation and construction of all statutes is to ascertain and effectuate the intention of the General Assembly." 1 Pa. C.S. §1921(a). "The clearest indication of legislative intent is generally the plain language of a statute." *Walker v. Eleby*, 577 Pa. 104, 123, 842 A.2d 389, 400 (2004). A plain language approach also requires the court to "listen attentively to what a statute says[;] [o]ne must also listen attentively to what it does not say." *Kmonk-Sullivan v. State Farm Mutual Insurance Co.*, 567 Pa. 514, 525, 788 A.2d 955, 962 (2001) (quoting Justice Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 536 (1947)). Only "[w]hen the words of the statute are not explicit" may this Court resort to statutory construction. 1 Pa. C.S. §1921(c).

The central and dominant phrase in Section 712(d)(l) is that "[t]he assessment … shall, in the aggregate, *produce an amount sufficient* to do all of the following [tasks]." 40 P.S. §1303.712(d)(l) (emphasis added). The words "aggregate" and "amount sufficient to do all of the following" were chosen for a reason. "Aggregate" and "sufficiency" instruct the MCARE Fund to take into account any balance in the MCARE Fund when doing its assessment calculation. The aggregate assessment must leave the MCARE Fund with monies sufficient to pay expenses equal to what was paid in the prior year and with a reserve. That reserve "shall be" 10% of "the sum of" the prior year's claim payments and expenses.

As noted, in construing statutes, courts must be mindful of what the legislature did *not* say. *Kmonk-Sullivan*, 567 Pa. at 525, 788 A.2d at 962. Here, the legislature did *not* say that "the annual assessment shall be equal to the sum of the following four 'sums.'" The legislature did not use the phrase "equal to the sum of" in the critical introduction to Section 712(d)(l), even though that particular phrase appears often in Pennsylvania statutes.[15] The legislature's silence is significant in other ways.

Most importantly, the MCARE Act says nothing about the accumulation of unspent balances in excess of the 10% reserve. It does not authorize them. Accordingly, it provides no direction on when and how to use them. Likewise, the MCARE Act provides no guidance on the income generated by an accumulation of unspent balances, which can be considerable given the present unspent balance of $104 million. The MCARE Act's silence on these matters makes perfect sense only if the legislature never intended that such an accumulation would develop.

The legislature has addressed the possibility of an unspent balance in only one place in the statute. Section 712(k) of the MCARE Act provides that upon termination of the MCARE Fund, "[a]ny balance remaining in the fund" shall be returned to the healthcare providers who paid "assessments *in the preceding calendar year*." 40 P.S. §1303.712(k) (emphasis added). The very wording of this

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[15] *See, e.g.,* Section 503(e)(1), (2) of the Act of June 27, 2006, P.L. 1873, 53 P.S. §6926.503(e)(1), (2) ("sum of all of the following"); 24 Pa. C.S. §8342(a) ("equal to the sum of the following"); Section 2509.6(b) of the Act of March 10, 1949, P.L. 30, added by the Act of August 5, 1991, P.L. 219, *as amended*, 24 P.S. §25-2509.6(b) ("dollars available ... shall be the sum of the following"); and Section 2502.48(b) of the Act of March 10, 1949, P.L. 30, added by the Act of July 9, 2008, P.L. 846, *as amended*, 24 P.S. §25-2502.48(b) (determine "adequacy target ... by calculating the sum of the following").

directive is instructive. It presumes a small, if "any," balance and suggests that there should not be an unspent balance in any other year. Were it otherwise, the legislature would have directed the return of accumulated unspent balances to all the providers who, in preceding years, contributed to the accumulated unspent balances lest the providers in the final year enjoy a windfall.

Assuming, *arguendo*, that the legislature intended the MCARE Fund to accumulate unspent balances, then Section 712(d) is constitutionally infirm because it did not give the MCARE Fund any direction on how to use such unspent balances. An agency's authority must be limited and guided by statutory standards. *MCT Transportation, Inc. v. Philadelphia Parking Authority*, 60 A.3d 899, 904-05 (Pa. Cmwlth. 2013). The General Assembly may not delegate its legislative authority to an agency; it must make the basic policy choices. The basic policy choices have not been made for how to use a multi-year accumulation of large unspent balances because the legislature did not intend that they be created.

The MCARE Act states that the MCARE Fund's reserve "shall be" 10% of the prior year's claims and expenses. Instead, after the 2009 assessment, the MCARE Fund had a reserve of 64%.[16] This result cannot be squared with the stated purposes of the MCARE Act or the precise wording of Section 712(d)(l).

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[16] The 2009 aggregate assessment was calculated to be $204 million. This consisted of 2008 claims and expenses (approximately $185 million) plus 10% (approximately $18.5 million). The MCARE Fund sought these funds even as it projected a $100 million surplus. Joint Stipulation of Facts, ¶13; R.R. 11a. The actual reserve established by this assessment was $118.5 million (this was the $100 million in the MCARE Fund plus the $18.5 million collected in 2009). This sets a reserve of 64% ($118.5 million/$185 million) of the 2008 expenses. A 10% reserve is $18.5 million. Thus, the 2009 assessment collected $100 million more than needed.

MCARE Fund's Construction of Section 712(d)

The MCARE Fund argues for a construction of Section 712(d) that it believes will serve the public interest. First, it argues that its construction will promote stability in annual assessments, noting that MCARE Fund assessments have been adding approximately 18% to 21% to a health care provider's prevailing primary premium. Second, it offers potential uses for the unspent balances in the MCARE Fund. They can be used (1) to pay claims in a year that the 10% reserve is exhausted and (2) to reduce provider assessments when the MCARE Fund phase-out is implemented. These suggested uses of the unspent balances may be good ideas, but they are not provided in the MCARE Act.

To begin with, the legislature has anticipated the possibility of a year where claims and expenses run through the MCARE Fund's reserve. To meet the possibility, the legislature has authorized the MCARE Fund to borrow funds. Section 713(c) of the MCARE Act, 40 P.S. §1303.713(c). That is why the repayment of loans has been made part of the annual aggregate assessment calculation.

The MCARE Fund's assertion that its construction achieves stability in annual assessments misses the mark. Stability is not a value expressed in the MCARE Act, but a reduction in the cost of medical malpractice insurance is an expressed value. "Stability," in theory, would justify an assessment that never declined even as the MCARE Fund's annual expenses dramatically declined. Stable, unchanging assessments hold no logic for a statutory fund scheduled for ever reducing liabilities. In this context, "stability" is just another word for "excessive."

The MCARE Fund points to a 1975 version of the surcharge provision in the repealed Health Care Services Malpractice Act. A survey of "prior iterations of an act" may shed light on legislative intent. *PECO Energy Co. v. Pennsylvania Public Utility Commission*, 568 Pa. 39, 47, 791 A.2d 1155, 1160 (2002).[17] The MCARE Fund believes that this survey supports its construction of Section 712(d)(1).

The CAT Fund was funded by provider surcharges that were calculated as follows:

> The surcharge shall be based on the cost to each health care provider for maintenance of the professional liability insurance and shall be the appropriate percentage thereof, *necessary to produce an amount sufficient to reimburse the fund for the payment of all claims paid and expenses incurred during the preceding calendar year and to provide an amount necessary to maintain an additional $15,000,000.*

Section 701(e)(l) of the Health Care Services Malpractice Act, formerly 40 P.S. §1301.701(e)(1) (emphasis added).[18] Litigation ensued on whether the "additional $15,000,000" was intended as a floor or ceiling on the CAT Fund balance. In *Meier v. Maleski*, 670 A.2d 755 (Pa. Cmwlth. 1996), this Court concluded that this statutory provision was ambiguous. In 1975, former Section 701(d) had provided:

> If the total fund exceeds the sum of $15,000,000 at the end of any calendar year after the payment of all claims and expenses,

[17] "The former law, if any, including other statutes upon the same or similar subjects" is an appropriate tool in ascertaining legislative intent. 1 Pa. C.S. §1921(c)(5). Changes in statutory language ordinarily indicate a change in legislative intent. *Masland v. Bachman*, 473 Pa. 280, 374 A.2d 517 (1977); *WRC North Fork Heights, Inc. v. Board of Assessment Appeals*, 917 A.2d 893, 906 n.13 (Pa. Cmwlth. 2007).

[18] Section 701(e)(1) was repealed by the Act of March 20, 2002, P.L. 154.

> including the expenses of operation of the office of the director, the director shall reduce the surcharge provided in this section in order to maintain the fund at an approximate level of $15,000,000.

Formerly 40 P.S. §1301.701(d). Reading Section 701(d) and Section 701(e)(1) together meant that the "additional $15,000,000" was the maximum surplus. However, in 1980 Section 701(d) was repealed.[19] Noting that a change in language indicates a change in legislative intent, this Court opined as follows:

> The 1980 amendments clearly eliminated the previously existing $15,000,000 cap and accompanying surcharge reduction requirement. If, as Petitioners claim, the General Assembly intended that this [surcharge] reduction obligation remain, no alteration would have been necessary. Thus, we must conclude that the material changes in the provision evidence a clear legislative intent to abolish the statutory cap.

Meier, 670 A.2d at 760 (footnote omitted). Accordingly, we construed the language in Section 701(d) "to maintain an additional $15,000,000" to provide a floor, not a ceiling. The holding in *Meier* is not dispositive of the meaning of Section 712(d)(1) for several reasons.

When first enacted, the Health Care Services Malpractice Act calculated the surcharges at issue in Section 701(d) by using "actuarial principles." In 1980, however, the legislature repealed that system and replaced it with a "pay-as-you-go" system. In that context, Section 701(d) was amended to require the CAT Fund to "maintain an additional $15,000,000." Then in 1996, after *Meier*

[19] The 1975 version of Section 701(d) was repealed by Section 3 of the Act of October 16, 1980, P.L. 971; the 1980 version of Section 701(d) was repealed by the Act of March 20, 2002, P.L. 154. The 1980 version of Section 701(d) allowed the CAT Fund to do an emergency surcharge in the event the CAT Fund was at risk of exhausting its funds.

was decided, the legislature amended Section 701(d) to replace the language for "an additional $15 million" to "an additional 15% of the [prior year's] final claims and expenses."[20] This final change to Section 701(d) connected the "additional" component of the surcharge to the CAT Fund's actual expenses.

Section 701(d), along with the rest of the Health Care Services Malpractice Act, has been repealed. In 2002, the legislature hit the restart button by enacting a new law. Although the MCARE Act has retained some features of the prior system, it instituted a new regime. It replaced Section 701(d) with a new approach and new language.

Section 712(d)(1), unlike the prior surcharge provision for the CAT Fund, begins with the aggregate annual assessment. It directs that the annual aggregate assessment be "sufficient" to create a balance sheet that will cover the four listed items: claims, expenses, debt repayment and a reserve. In this scheme, a "reduction" is an unnecessary and illogical exercise. Further, Section 712(d)(1) uses new terminology. The "surcharge" is gone and has been replaced with an "assessment." Maintenance of "an additional 15%" is gone. The new directive in Section 712(d)(1) is that the MCARE Fund "shall" have "a reserve" of 10%.

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[20] The 1996 amendments to Section 701(e)(1) of the Health Care Services Malpractice Act provided, in relevant part, as follows:

> The surcharge shall be based on the ~~cost to~~ <u>prevailing primary premium for</u> each health care provider for maintenance of professional liability insurance and shall be the appropriate percentage thereof, necessary to produce an amount sufficient to reimburse the fund for the payment of ~~all claims paid~~ <u>final claims</u> and expenses incurred during the preceding ~~calendar year~~ <u>claims period</u> and to provide an amount necessary to maintain an additional ~~$15,000,000.~~ <u>15% of the final claims and expenses incurred during the preceding claims period.</u>

Section 3 of the Act of November 26, 1996, P.L. 776 (additions underlined, deletions struck through).

Section 712(d)(1) does not say "reserves" or "annual reserve." In short, the mandate for "a 10% reserve" set the floor and the ceiling, eliminating the ambiguity perceived in *Meier*.[21]

The MCARE Fund's reliance upon the 1975 version of Section 701(d), repealed in 1980, is, thus, unpersuasive. First, it does not account for the several iterations of Section 701(d) nor does it account for the new approach and terminology used in the MCARE Act. Second, it is ironic. The MCARE Fund itself argues that the accumulated unspent balances should be used to "reduce" provider assessments, but at an uncertain point in the future of its choosing.

The aggregate assessment must raise funds "sufficient" to meet the specified purposes in Section 712(d)(l). This means that the MCARE Fund must begin its annual aggregate assessment calculation with its unspent balance and add to it the amounts "sufficient" to cover the prior year's claims and expenses and to "provide a 10% reserve." Instead, the MCARE Fund's calculation has provided a 64% reserve.

As noted, 712(k) of the MCARE Act has slated the MCARE Fund for extinction. It states that "[a]ny balance remaining in the fund upon such termination shall be returned by the department to the participating health care providers that participated in the fund in proportion to their assessments *in the preceding calendar year*." 40 P.S. §1303.712(k) (emphasis added). The inequity of refunding an accumulated balance in the MCARE Fund in the year of termination only to those health care providers that participated in the preceding

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[21] Further, by reducing the CAT Fund era percentage of 15% to a "10% reserve," the legislature expressed the view that a reserve in the MCARE Fund of 15% would be too high. The MCARE Fund construction of Section 712(d)(1) makes the 10% reserve a meaningless number.

year's assessment (and perhaps *only* in the preceding year, if it was a provider's first year of practice in the Commonwealth) is obvious. *See* 1 Pa. C.S. §1922(1) (noting that we must presume that General Assembly does not intend a result that is absurd or unreasonable).

The fact that the General Assembly chose to limit distribution of any balance in the MCARE Fund at termination to those that participated in the Fund in the *preceding* calendar year indicates that the legislature intended a direct correlation between the *actual* MCARE Fund balance at termination and the population of providers assessed in the prior year.

We reject the MCARE Fund's proffered policy and statutory construction arguments offered to support its construction of Section 712(d)(1) of the MCARE Act.

Conclusion

Our interpretation of Section 712(d)(1) of the MCARE Act realizes the expressly stated legislative goals of the Act, *i.e.*, creating a health care system that provides for *affordable* professional liability insurance.[22] Requiring health care providers to fund a new 10% reserve every assessment year, without regard to the monies already held by the MCARE Fund, undermines that goal. Such an approach repeatedly and needlessly charges participating providers an assessment in excess of what is necessary to fund the statutorily-required 10% reserve. It creates a separate off-balance sheet fund within the MCARE Fund, without benefit to the providers and without explicit legislative authority. Because the population of providers changes over time, the providers who enter such a system in the

[22] Section 102 of the Act of March 20, 2002, P.L. 154, *as amended,* 40 P.S. §1303.102.

earlier years will end up subsidizing the participating providers in the later years. This is unfairly discriminatory.

For all of the foregoing reasons, we reverse the order of the Insurance Commissioner and remand this matter to the Commissioner to recalculate the MCARE assessments for 2009, 2010 and 2011 in accordance with this opinion.

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MARY HANNAH LEAVITT, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Hospital & Healthsystem Association of Pennsylvania, Pennsylvania Medical Society and Pennsylvania Podiatric Medical Association, Petitioners	:	
v.	:	No. 939 C.D. 2011
Insurance Commissioner, Respondent	:	

<u>O R D E R</u>

AND NOW, this 9th day of August, 2013, the order of the Insurance Commissioner in the above-captioned matter, dated May 6, 2011, is REVERSED and the matter is REMANDED to the Commissioner to recalculate the assessments levied under the Medical Care Availability and Reduction of Error Act, Act of March 20, 2002, P.L. 154, *as amended*, 40 P.S. §§1303.101–1303.1115, for the years 2009, 2010, and 2011 in accordance with the attached opinion.

Jurisdiction relinquished.

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MARY HANNAH LEAVITT, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Hospital & Healthsystem Association of Pennsylvania, Pennsylvania Medical Society and Pennsylvania Podiatric Medical Association, Petitioners	:	
v.	:	No. 939 C.D. 2011 Argued: March 13, 2012
Insurance Commissioner, Respondent	:	

BEFORE: **HONORABLE DAN PELLEGRINI,** President Judge
HONORABLE BERNARD L. McGINLEY, Judge
HONORABLE BONNIE BRIGANCE LEADBETTER, Judge
HONORABLE RENÉE COHN JUBELIRER, Judge
HONORABLE MARY HANNAH LEAVITT, Judge
HONORABLE P. KEVIN BROBSON, Judge
HONORABLE PATRICIA A. McCULLOUGH, Judge

DISSENTING OPINION BY JUDGE LEADBETTER **FILED: August 9, 2013**

I must respectfully dissent because I agree with the Commissioner's construction and application of Section 712(d) of the Act,[1] 40 P.S. § 1303.712(d). The assessment formula set forth therein is explicit. The statute plainly mandates that the *assessment* shall produce the amount necessary to cover the itemized factors, not that after the assessments the fund shall be sufficient to cover them. As written, it clearly does not expressly require consideration or inclusion of the

[1] Act of March 20, 2002, P.L. 154, *as amended*.

Fund's prior year-end balance in calculating the reserve or the total amount to be assessed. Such consideration is also not implicitly required by the statutory language. Because future claims and expenses are not known, the statutory scheme predicts the funds anticipated to be needed for the upcoming year based upon the preceding year's experience and provides for an additional 10% buffer or reserve to cover unanticipated claims or expenses that exceed the previous year's figures. Thus, the annual assessment calculation is, as the Commissioner contends, the sum of the previous year's claims and expenses, any principal and interest due, and 10% of the sum of the three aforesaid amounts. There simply is no mention of the Fund's year-end balance in the assessment formula and such consideration would be contrary to the language of Section 712(d).

The purpose of Section 712(d) is to calculate the amount of the annual assessment to be imposed, which has legislatively been determined to be 110% of the prior year's expenditures. Section 712(d) simply does not relate to or pertain to the Fund's accumulated balance; nor does Section 712(d) provide any authority to the Department or its agents to manage or address the Fund's balance in the context of calculating the annual aggregate assessments to be collected from providers.

I also believe that this construction is consistent with both precedent and legislative history. A similar issue arose under the former statutory scheme involving the Health Care Services Malpractice Act[2] (former Act) and the Medical Professional Liability Catastrophe Loss Fund (commonly referred to as the CAT Fund). Similar to the current scheme, one of the primary purposes of the CAT

[2] Act of October 15, 1975, P.L. 390, *as amended*, 40 P.S. §§ 1301.101 - 1301.1004, repealed by the Act of March 20, 2002, P.L. 154.

Fund was to assure the availability of reasonably priced professional liability insurance for Pennsylvania health care providers. *See Meier, M.D. v. Maleski*, 670 A.2d 755, 756 n.2 (Pa. Cmwlth. 1996), *aff'd without op.*, 549 Pa. 171, 700 A.2d 1262 (1997) [citing Section 102, 40 P.S. § 1301.102, repealed]. The former CAT Fund provided additional liability insurance coverage above the basic insurance coverage limits and was funded by, *inter alia*, annual surcharges levied on health care providers. *Id.* [citing Section 701(d), (e) and (f), 40 P.S. § 1301.701(d), (e), and (f), repealed]. Surcharges were calculated pursuant to Section 701(e)(1) of the former Act, which stated:

> The fund shall be funded by the levying of an annual surcharge on or after January 1 of every year on all health care providers entitled to participate in the fund. The surcharge shall be determined by the director . . . . The surcharge shall be based on the cost to each health care provider for maintenance of the professional liability insurance and shall be the appropriate percentage thereof, *necessary to produce an amount sufficient to reimburse the fund for the payment of all claims paid and expenses incurred during the preceding calendar year and to provide an amount necessary to maintain an additional $15,000,000.*

40 P.S. § 1301.701(e)(1) (emphasis added). Litigation ensued regarding whether the $15 million surplus provision set forth above was intended as a floor or ceiling on the CAT Fund balance. According to the health care provider petitioners, former Section 701(e)(1) mandated that any CAT Fund balance exceeding the $15 million cap should be applied to reduce the surcharge for the upcoming year. *See Meier*, 670 A.2d at 757. Similar to Petitioners here, the *Meier* petitioners argued that the statutory provision authorized the Fund to collect only enough to pay claims and expenses and maintain a $15 million fund balance, nothing more. This

court concluded that the provision was ambiguous regarding whether the $15 million was intended to be a minimum or maximum and turned, in part, to legislative history to resolve the issue. The court noted that as originally enacted in 1975, former Section 701(d) provided:

> If the total fund exceeds the sum of $15,000,000 at the end of any calendar year after the payment of all claims and expenses, including the expenses of operation of the office of the director, the director shall reduce the surcharge provided in this section in order to maintain the fund at an approximate level of $15,000,000.

40 P.S. § 1301.701(d) (subsequently amended in part in 1980 and then repealed). In 1980, the surcharge reduction requirement was deleted and the director was given the authority to levy an emergency surcharge should the fund be exhausted through payment of all claims and expenses. Section 701(3), 40 P.S. § 1301.701(e)(3) (repealed). Noting that a change in language indicates a change in legislative intent, the court opined:

> [T]he legislative history . . . resolves any question of the meaning of section 701(e)(1) in favor of the [Commonwealth] Respondents' interpretation. The 1980 amendments clearly eliminated the previously existing $15,000,000 cap and accompanying surcharge reduction requirement. If, as Petitioners claim, the General Assembly intended that this reduction obligation remain, no alteration would have been necessary. Thus, we must conclude that the material changes in the provision evidence a clear legislative intent to abolish the statutory cap.

Meier, 670 A.2d at 760 (footnote omitted).[3]

In light of the language chosen by the General Assembly in originally enacting former Section 701(d), the subsequent amendment in 1980 to remove the surcharge reduction provision and our reported opinion in *Meier* analyzing the import of the statutory change, I conclude that had the General Assembly intended the present MCARE Fund's year-end balance to be factored into the assessment calculation, it would have expressly done so in crafting Section 712(d).

Accordingly, I would affirm.

BONNIE BRIGANCE LEADBETTER,
Judge

President Judge Pellegrini joins in this dissenting opinion.

[3] The court's conclusion was further bolstered by a Committee Report which recommended removal of the cap in order to allow the CAT Fund to accumulate more money in order to prevent sudden large surcharges.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Hospital & Healthsystem Association of Pennsylvania, Pennsylvania Medical Society and Pennsylvania Podiatric Medical Association, Petitioners	:	
v.	:	No. 939 C.D. 2011 Argued: March 13, 2012
Insurance Commissioner, Respondent	:	

BEFORE: HONORABLE DAN PELLEGRINI, President Judge
HONORABLE BERNARD L. McGINLEY, Judge
HONORABLE BONNIE BRIGANCE LEADBETTER, Judge
HONORABLE RENÉE COHN JUBELIRER, Judge
HONORABLE MARY HANNAH LEAVITT, Judge
HONORABLE P. KEVIN BROBSON, Judge
HONORABLE PATRICIA A. McCULLOUGH, Judge

CONCURRING OPINION
BY JUDGE BROBSON **FILED: August 9, 2013**

Because I believe that the adjudication of the Pennsylvania Insurance Commissioner (Commissioner) in this matter is at odds with the governing statutory language, the Commissioner's adjudication must be reversed with a majority opinion that provides a path forward if this Court's decision becomes the final word on this matter. It is for this reason that I join the majority opinion. I write separately only to offer an alternative construction of the governing statutory language that would also support reversal, but would provide for a different method of calculating assessments than that laid out by the majority.

Section 712 of the Medical Care Availability and Reduction of Error (MCARE) Act (Act)[1] establishes the MCARE Fund. To evaluate the General Assembly's intent in one subsection of Section 712 requires the consideration of the entire section, if not the entire Act. *See* 1 Pa. C.S. § 1921(a); *Snyder v. Com., Dep't of Transp.*, 441 A.2d 494, 496 (Pa. Cmwlth. 1982) ("[S]ections of a statute must be construed with reference to the entire statute and not apart from their context.").

In context, Section 712 of the Act provides that monies in the MCARE Fund "shall be used to pay claims against participating health care providers for losses or damages awarded in medical professional liability actions against them in excess of" the statutorily-required basic professional liability insurance coverage. Section 712(a) of the Act. Section 712 also provides that those very same participating providers are to fund the MCARE Fund through annual assessments. Section 712(d) of the Act.[2]

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[1] Section 712 of the Act, Act of March 20, 2002, P.L. 154, *as amended*, 40 P.S. § 1303.712.

[2] Section 712(a) and (d) of the Act provide:

> **(a) Establishment.—**There is hereby established within the State Treasury a special fund to be known as the Medical Care Availability and Reduction of Error Fund. Money in the fund shall be used to pay claims against participating health care providers for losses or damages awarded in medical professional liability actions against them in excess of the basic insurance coverage required by section 711(d), liabilities transferred in accordance with subsection (b) and for the administration of the fund.
>
> . . . .
>
> **(d) Assessments.—**
>
> (1) For calendar year 2003 and for each year thereafter, the fund shall be funded by an assessment on each participating health care provider. Assessments shall be

The annual assessments are "based on the prevailing primary premium for each participating health care provider"[3]—meaning, the assessment is

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levied by the department on or after January 1 of each year. The assessment shall be based on the prevailing primary premium for each participating health care provider and shall, in the aggregate, produce an amount sufficient to do all of the following:

(i) Reimburse the fund for the payment of reported claims which became final during the preceding claims period.

(ii) Pay expenses of the fund incurred during the preceding claims period.

(iii) Pay principal and interest on moneys transferred into the fund in accordance with section 713(c).

(iv) Provide a reserve that shall be 10% of the sum of subparagraphs (i), (ii) and (iii).

(2) The department shall notify all basic insurance coverage insurers and self-insured participating health care providers of the assessment by November 1 for the succeeding calendar year.

(3) Any appeal of the assessment shall be filed with the department.

(Footnotes omitted.) Also relevant for purposes of analyzing the issue in this case is Section 712(k) of the Act, which provides:

(k) Termination.—Upon satisfaction of all liabilities of the fund, the fund shall terminate. Any balance remaining in the fund upon such termination shall be returned by the department to the participating health care providers who participated in the fund in proportion to their assessments in the preceding calendar year.

[3] "Prevailing primary premium" is the premium rate associated with a particular health care provider for an occurrence policy issued by the Pennsylvania Professional Liability Joint Underwriting Association (JUA). Section 702 of the Act, Act of March 20, 2002, P.L. 154, *as amended*, 40 P.S. § 1303.702. The JUA is a statutory insurance pool, made up of all insurers authorized to write medical malpractice insurance in the Commonwealth. The JUA serves as the insurer of last resort for health care providers who are unable to secure their liability insurance in

a multiplier that, when applied to a particular health care provider's prevailing primary premium, yields the amount of that health care provider's annual assessment. Health care providers pay this annual assessment *in addition to* their annual medical malpractice insurance premium.

In order to determine the appropriate multiplier, the Pennsylvania Insurance Department (Department) must first determine the total amount of funds to be generated by the assessment. Again, in context, at issue is the maintenance and operation of the MCARE Fund. The MCARE Fund pays claims on a "pay-as-you-go" basis, meaning that the MCARE Fund does not build into its assessment scheme an actuarial assessment of incurred but not reported or reported but unresolved claims, as most private insurers do and are required to do by law. Instead, the Department assesses the annual needs of the MCARE Fund based on the expenses of the MCARE Fund in the year immediately preceding.

This brings me to Section 712(d)(1) of the Act. It provides, in relevant part:

> The assessment . . . shall, in the aggregate, *produce an amount sufficient* to do all of the following:
>
> (i) Reimburse the fund for the payment of reported claims which became final during the preceding claims period.
>
> (ii) Pay expenses of the fund incurred during the preceding claims period.
>
> (iii) Pay principal and interest on moneys transferred into the fund in accordance with section 713(c).[4]

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the open market at prevailing rates. Section 732 of the Act, Act of March 20, 2002, P.L. 154, *as amended*, 40 P.S. § 1303.732.

[4] Section 713(c) of the Act authorizes the Governor to transfer money into the MCARE Fund if the MCARE Fund lacks sufficient monies to pay its liabilities. Section 713(c) of the Act,

(iv) *Provide a reserve that shall be 10%* of the sum of subparagraph (i), (ii), and (iii).

(Emphasis added.) Subparagraphs (i), (ii), and (iii) are clearly intended as reimbursement/payment devices. They are meant to replenish the MCARE Fund for claims and expenses actually paid in the prior year and to pay off loan obligations actually incurred in the prior year. Thus, the assessment must include "sufficient" monies to restore the MCARE Fund balance to where it would have been had none of these claims and expenses been paid and as if the loan/transfer of funds had not occurred. This is in keeping with the MCARE Fund's "pay-as-you-go" system.

But subparagraph (iv) is different. That subparagraph speaks in terms of providing for a "reserve." The General Assembly's use of the term "reserve" is telling.[5] The General Assembly's use of the concept of a "reserve" could reasonably be interpreted as referring not to the assessment in isolation, but rather to an assumption or anticipation that current year expenses and liabilities for the MCARE Fund would be 10% higher than the prior year. Thus, the General Assembly may have wanted to ensure that there is an additional amount of money *in the MCARE Fund*—a reserve—"sufficient" to pay for this assumed or anticipated additional obligation.

To ensure that there is a "10% reserve," the General Assembly may have intended that the Department look to the MCARE Fund balance at the end of the year immediately preceding, in order to determine the "amount sufficient" to

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Act of March 20, 2002, P.L. 154, *as amended*, 40 P.S. § 1303.713(c). Such transfers are treated as loans, and must be paid back with interest. *Id.*

[5] In the insurance industry, a "reserve" is defined as "[s]ums of money an insurer is required to set aside as a fund for the liquidation of future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount." Black's Law Dictionary 1308-09 (6th ed. 1990).

"[p]rovide a reserve that shall be 10% of the sum of subparagraphs (i), (ii) and (iii)." By the chosen statutory language, the General Assembly may have intended that the MCARE Fund reserve in the current year be capped at 10% of the MCARE Fund's expenses and liabilities from the year immediately preceding. I reach this conclusion because of the General Assembly's use of the phrase "shall be 10%" in reference to the reserve. If the General Assembly had intended the 10% reserve to be only a *floor*, it would have chosen different language—*e.g.* "shall be *at least* 10%." Moreover, if there is a balance in the prior year, failure to account for that balance would produce an assessment that is *excessive*, in that it could "provide a reserve" *in excess of 10%*.

This alternative interpretation of Section 712(d)(1) of the Act furthers one of the expressly stated legislative goals of the Act—*i.e.*, creating a health care system that provides for accessible *and affordable* professional liability insurance.[6] Requiring health care providers to fund a 10% reserve every assessment year, without regard to the monies already held in reserve by the MCARE Fund, does nothing to make professional liability insurance affordable in the Commonwealth.

Finally, Section 712(k) of the Act supports this alternative interpretation. This provision anticipates the future termination of the MCARE Fund. On that day, "[a]ny balance remaining in the fund upon such termination shall be returned by the department to the participating health care providers who participated in the fund in proportion to their assessments *in the preceding calendar year*." (Emphasis added.) The Commissioner adopted an interpretation of Section 712(d)(1) that could create, and has created, a substantial reserve in the MCARE Fund over a period of *many* years. Under this interpretation, the inequity

[6] Section 102 of the Act, Act of March 20, 2002, P.L. 154, *as amended*, 40 P.S. § 102.

and absurdity of only refunding the balance in the MCARE Fund in the year of termination to those health care providers who participated in the MCARE Fund in the preceding year (and perhaps *only* in the preceding year, meaning it was the health care provider's first year of practice in the Commonwealth) is obvious. *See* 1 Pa. C.S. § 1922(1) (noting that we must presume that General Assembly does not intend a result that is absurd or unreasonable).

The fact that the General Assembly chose to limit distribution of any balance in the MCARE Fund at termination to those who participated in the MCARE Fund in the preceding calendar year also supports a conclusion that the General Assembly intended and envisioned a direct correlation between the *actual* MCARE Fund balance at termination and those assessed in the prior year. This alternative interpretation of Section 712(d)(1) of the Act, requiring only an assessment of an amount sufficient to provide for a 10% reserve in the MCARE Fund and nothing more, is consistent with this scheme.

P. KEVIN BROBSON, Judge

Judge Cohn Jubelirer joins in this concurring opinion.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Bensalem Racing Association, Inc. and Keystone Turf Club, Inc. (d/b/a Philadelphia Park Racetrack), Petitioners	:	No. 1053 C.D. 2010
	:	No. 2710 C.D. 2010
v.	:	Argued: February 9, 2011
Pennsylvania State Harness Racing Commission, Respondent	:	

BEFORE: **HONORABLE BONNIE BRIGANCE LEADBETTER, President Judge**
HONORABLE DAN PELLEGRINI, Judge
HONORABLE RENÉE COHN JUBELIRER, Judge
HONORABLE MARY HANNAH LEAVITT, Judge
HONORABLE P. KEVIN BROBSON, Judge
HONORABLE PATRICIA A. McCULLOUGH, Judge
HONORABLE JOHNNY J. BUTLER, Judge

OPINION BY JUDGE BROBSON **FILED: March 21, 2011**

These consolidated appeals arise out of a proceeding before Respondent Pennsylvania Harness Racing Commission (Harness Commission) on a petition of Intervenor Chester Downs and Marina, LLC d/b/a Harrah's Chester Casino & Racetrack (Harrah's Chester) for permission to conduct telephone account wagering pursuant to Section 218(b) of the Race Horse Industry Reform Act, Act of December 17, 1981, P.L. 435, *as amended*, 4 P.S. §§ 325.101-.402 (Reform Act). Petitioners Bensalem Racing Association, Inc. and Keystone Turf Club, Inc. jointly d/b/a Philadelphia Park Racetrack (Philadelphia Park) seek to appeal three (3) orders issued by the Harness Commission in that proceeding: (1) a May 27, 2010 Order, which the Harness Commission designated as a "Conditional

Approval Order" (First Approval Order); (2) a May 27, 2010 Order denying Philadelphia Park's Petition to Intervene (Intervention Order); and (3) a September 30, 2010 Order, which the Harness Commission designated as the "Final Order" granting approval to Harrah's Chester (Second Approval Order). For the reasons that follow, we reverse as to the Harness Commission's Intervention Order. As a result, we must vacate the First Approval Order and the Second Approval Order and remand for further proceedings.[1]

I. BACKGROUND

Since April 2003, Harrah's Chester has been duly licensed by the Harness Commission to conduct harness horse racing and pari-mutuel wagering at its facility pursuant to the Reform Act. On or about April 1, 2010, Harrah's Chester filed a verified petition with the Harness Commission, seeking permission to conduct telephone account wagering under Section 218(b) of the Reform Act, which provides, in pertinent part:

> Each commission may upon request by any licensed corporation grant permission to the licensed corporation to conduct a telephone account wagering system; provided, however, that all telephone messages to place wagers must be to a place within the race track enclosure: And further provided, That all moneys used to place telephone wagers be on deposit in an amount sufficient to cover the wager at the race track where the account is opened. Each commission may promulgate rules or regulations to regulate telephone account wagering. . . . All telephone account wagering systems shall be solely operated by the licensed corporations.

[1] The Court notes that our review is based on a very thin administrative record. The Commission did not conduct any hearings on Harrah's Chester's petition or Philadelphia Park's petition to intervene. Instead, it appears that, with respect to both requests for relief, the Commission relied exclusively on the contents of written submissions. We thus have similarly focused our view on the written submissions in evaluating Philadelphia Park's challenge to the Intervention Order.

4 P.S. § 325.218(b).[2] Harrah's Chester filed an amended petition on or about May 25, 2010. In both its original and amended petition, it proposed an account wagering system (AWS) that it contended complied in all respects with the Reform Act and the Harness Commission's regulations. Part of the proposed system included the use of a third-party contractor.

On April 23, 2010, Philadelphia Park filed its verified petition to intervene with the Harness Commission. The petition included nineteen (19) numbered paragraphs. Philadelphia Park also attached to its intervention petition a proposed "Motion to Dismiss and Answer in Opposition to Account Wagering Petition." On or about May 3, 2010, Harrah's Chester filed a response to the intervention petition. The response had two parts: (1) a preliminary statement in the nature of a general denial, and (2) a paragraph-by-paragraph response. In the paragraph-by-paragraph response, Harrah's Chester *denied* sixteen (16) of the nineteen (19) paragraphs in the intervention petition and *denied as stated* a seventeenth. In all, then, Harrah's Chester purported to admit only the allegations contained in two (2) paragraphs of the intervention petition. (Reproduced Record (R.R.) 26a, 56a-57a.) We can discern, however, some additional, undisputed facts based on further scrutiny of the papers.

Philadelphia Park (*i.e.*, its constituent owners) is licensed by the Harness Commission to conduct harness racing and pari-mutuel waging. It is also approved to conduct telephone account wagering under Section 218(b) of the Reform Act. Philadelphia Park has engaged in each of these licensed and authorized activities at its facility in southeastern Pennsylvania. Harrah's

[2] "Commissions" is defined in the Act to include the Harness Commission and the State Horse Racing Commission. Section 102 of the Act, 4 P.S. § 325.102.

Chester's facility is located within a 35-mile radius of the Philadelphia Park facility. (*Id.* 25a-26a, 56a.) Indeed, Harrah's Chester's primary market area (PMA)[3] and Philadelphia Park's PMA partially overlap. (*Id.* 27a, 59a.) Based on these undisputed facts, neither the parties nor the Harness Commission dispute that Philadelphia Park and Harrah's Chester *are* competitors in harness racing and pari-mutuel gaming and, if the Harness Commission's approval orders stand, *will be* (or even currently are) competitors in telephone account wagering.

In support of intervention, Philadelphia Park relied on its status as a current competitor of Harrah's Chester and a prospective competitor of Harrah's Chester in the area of telephone account wagering. Philadelphia Park's intervention papers express concern over the impact that a new entrant into the telephone account wagering market would have on the existing market—"the grant of Harrah's Chester's application will only serve to cannibalize the existing market." (*Id.* at 27a.) Harrah's Chester denied this assertion. (*Id.* at 58a-59a.) Philadelphia Park also, however, conceded in its intervention papers that it does not have an *exclusive* right to conduct telephone account wagering in its PMA. It nonetheless articulated the following concern:

> While Harrah's Chester may have equal rights to conduct account wagering within the shared portions of the [PMA], [Philadelphia Park] has a direct, substantial and immediate interest in ensuring that such account wagering is conducted in conformance with the requirements and protections, specifically designed for

[3] "The primary market area of a race track, for purposes of this act, is defined as that land area included in a circle drawn with the race track as the center and a radius of 35 air miles." Section 218(e) of the Act, 4 P.S. § 325.218(e).

> [Philadelphia Park's] benefit, in the Reform Act and Horse and Harness Racing Commission Regulations.

(*Id.* 27a-28a.)[4]

The alleged legal deficiencies in Harrah's Chester's petition for approval of its AWS are more specifically set forth in Philadelphia Park's proposed answer and motion to dismiss the petition for approval (attached as an exhibit to Philadelphia Park's intervention petition):

> Overall, [Philadelphia Park] opposes the relief requested because the account wagering system proposed by Harrah's Chester is violative of numerous requirements of Section 218(b) of the Reform Act . . . . Summarily, in violation of these laws, Harrah's Chester's account wagering business is to be operated almost entirely by an out-of-state account wagering company which would routinely accept account wagers originating in Pennsylvania, is not solely operated by a licensed corporation, and is not operated exclusively by Harrah's Chester's licensed employees.

(*Id.* at 33a-34a (footnotes omitted).) Philadelphia Park also avers the following:

> It is fully admitted that the operation of an account wagering system can be an important tool for a licensed corporation. However, like other business activities, account wagering systems must be conducted in compliance with all applicable laws. Otherwise, illegal account wagering systems will be provided a competitive advantage over an account wagering system, like that operated by [Philadelphia Park], which bears the burden and expense of full legal compliance while Harrah's [Chester] and its contractor cannibalize [Philadelphia Park's] existing business. [Philadelphia Park] in adhering to Pennsylvania law with respect to account wagering currently employs ten people at its racetrack for the account wagering operation. Permitting this Petition will cause an unfair competitive advantage to Harrah's

[4] Harrah's Chester denied this assertion as a "legal conclusion[] to which no response is required." (*Id.* at 59a.)

> Chester and will cause the loss of jobs at Philadelphia Park.

(*Id.* at 41a-42a.) It further claims:

> It is admitted that account wagering systems provide increased exposure to the races wagered on by account wagering patrons. However, this does not excuse the conduct of a system that is not in compliance with applicable laws. As is evident from the petition and its passing-the-buck to a third party contractor, Harrah's Chester intends to reap the benefits of account wagering without making the investment in its facility that is required under the Reform Act and the Commission's regulations and that [Philadelphia Park] and other existing licensed corporations have already made. Such a result is wholly inequitable and plainly inconsistent with the best interests of racing.

(*Id.* at 42a.)

As noted above, the Harness Commission did not conduct any hearing on Philadelphia Park's intervention petition.[5] The Intervention Order provides:

> **AND NOW**, this 27th of May, 2010, upon consideration of the Petition to Intervene and Request for Hearing, by Bensalem Racing Association, Inc. and Keystone Club, Inc. (d/b/a Philadelphia Park) and their Motion to Dismiss and Answer to the above Petition for Permission to Conduct an Account Wagering System;

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[5] We note that the Harness Commission does not take the position on appeal that, for purposes of ruling on Philadelphia Park's intervention request, it accepted all well-pleaded averments of fact in the intervention petition as true. To the contrary, the Harness Commission explained its approach to the intervention request as follows:

> The Commission's Intervention Denial Order *is specifically based upon* a review and assessment of Philadelphia Park's verified pleadings, the allegations contained therein, and the *admitted-to* facts, as filed with the Commission on April 23, 2010. Other than the self-serving conclusions of law contained in Philadelphia Park's Petition to Intervene and its Motion to Dismiss/Answer there is very little *factual evidence* for the Commission to find Philadelphia Park "eligible" to intervene . . . .

(Harness Comm'n Br. at 12 (emphasis added).)

> and upon consideration of Harrah's Chester's Answer in Opposition to Philadelphia Park's Petition, the Commission, in its discretion, finds *that Philadelphia Park's Petition has failed to demonstrate to the Commission that it has a right to Intervene or an interest of such nature that intervention is necessary or appropriate to the administration of the account wagering provisions of the Race Horse Industry Reform Act.*
>
> In accordance with 1 Pa. Code §35.28(a)(1-3), Philadelphia Park's Petition to Intervene and accompanying documents is hereby **DENIED**.

(*Id.* at 7a (emphasis added).)

Philadelphia Park argues that it satisfied the requirements for intervention in the proceeding below because the granting of Harrah's Chester's petition would erode unique rights vested in Philadelphia Park by the Reform Act to conduct account wagering within its PMA. Harrah's Chester's entry into account wagering will cause Philadelphia Park financial harm and "cannibalize" its existing customer base. Moreover, as a licensed corporation and as a member of a class the Reform Act seeks to protect, Philadelphia Park has a substantial, direct, and immediate interest in ensuring the Harrah's Chester's entry into account wagering, if permitted, is done in a manner that is consistent with the requirements of law and with the best interests of Pennsylvania horse racing.

The Harness Commission responds that it denied intervention based upon a review of Philadelphia Park's verified pleadings, which contained self-serving conclusions of law and little factual evidence for the Harness Commission to find Philadelphia Park eligible to intervene in Harrah's Chester's petition. The Harness Commission, therefore, determined that Philadelphia Park failed to establish a right to intervention or an interest of such a nature that intervention was necessary or appropriate. In the Harness Commission's view, Philadelphia Park's interests were far too remote and did not support claims of substantial financial interest. Harrah's Chester offers similar reasons to support the Harness Commission's decision to deny Philadelphia Park's intervention petition.

II. ANALYSIS

A. Standard of Review

While an agency has considerable discretion to grant or deny a petition to intervene, such decisions remain subject to review of this Court and will be reversed where the agency's decision constitutes an error of law or an abuse of discretion. *Malt Beverages Distribs. Ass'n v. Pa. Liquor Control Bd.*, 881 A.2d 37, 42 (Pa. Cmwlth. 2005) (*Sheetz I*), *appeal denied*, 586 Pa. 775, 895 A.2d 1264 (2006). An agency's decision on intervention will not be disturbed absent a manifest abuse of discretion. *West Chester Area Sch. Dist. v. Collegium Charter Sch.*, 571 Pa. 503, 812 A.2d 1172 (2002); *Browning-Ferris, Inc. v. Dep't of Envtl. Res.*, 598 A.2d 1061 (Pa. Cmwlth. 1991). An abuse of discretion is not merely an error in judgment. *Bedford Downs Mgmt. Corp. v. State Harness Racing Comm'n*, 592 Pa. 475, 926 A.2d 908 (2007). Rather, discretion is abused where the law is overridden or misapplied, or the judgment exercised is clearly unreasonable, or the result of partiality, prejudice, bias, or ill-will, as shown by the evidence or the record. *Id.*

B. Intervention Generally

Intervention in a proceeding under the Reform Act is governed by Sections 35.27 through 35.32 of the General Rules of Administrative Practice and Procedure (GRAPP), 1 Pa. Code §§ 35.27-.32. *Pittsburgh Palisades Park, LLC v. Pa. State Horse Racing Comm'n,* 844 A.2d 62, 65 (Pa. Cmwlth.) (en banc), *appeal denied*, 581 Pa. 702, 864 A.2d 1206 (2004). Request to intervene in an administrative proceeding is by petition. 1 Pa. Code § 35.27(2). With respect to who is eligible to intervene, Section 35.28 provides:

> (a) *Persons.* A petition to intervene may be filed by a person claiming a right to intervene or an interest of such nature that intervention is necessary or appropriate to the administration of the statute under which the proceeding is brought. The right or interest may be one of the following:
>
> > (1) A right conferred by statute of the United States or of this Commonwealth.
> >
> > (2) An interest which may be directly affected and which is not adequately represented by existing parties, and as to which petitioners may be bound by the action of the agency in the proceeding. The following may have an interest: consumers, customers or other patrons served by the applicant or respondent; holders of securities of the applicant or respondent; employes of the applicant or respondent; competitors of the applicant or respondent.
> >
> > (3) Other interest of such nature that participation of the petitioner may be in the public interest.
>
> (b) *Commonwealth.* The Commonwealth or an officer or agency thereof may intervene as of right in a proceeding subject to this part.

1 Pa. Code § 35.28. While Section 35.28 of GRAPP establishes criteria for a third party's *eligibility* to intervene in a proceeding before an administrative agency, that section does not *require* the agency to grant intervention. *Pa. Dental Assoc. v. Ins. Dep't*, 551 A.2d 1148, 1151 (Pa. Cmwlth. 1988); *see also Keystone Redevelopment Partners, LLC v. Gaming Control Bd.*, 5 A.3d 448, 460-61 (Pa. Cmwlth. 2010) ("[E]ven if [petitioner] satisfied all the criteria set forth in the regulation, the Board would not be compelled to permit intervention. Rather, the Board's decision on intervention is an exercise of discretion, the review of which is deferential.").

Instead, the agency may exercise its discretion to deny intervention even if the eligibility criteria of Section 35.28 are satisfied.

Eligible persons seek intervention to influence the outcome of a particular administrative agency proceeding. Those who seek to appeal an agency adjudication to this Court, by contrast, wish to undo that outcome. This is an important distinction and one that is obvious when comparing the eligibility requirements for intervention above and the test for standing to appeal. Section 702 of the Administrative Agency Law (AAL), which authorizes appeals from Commonwealth agency adjudications, provides:

> Any person *aggrieved* by an adjudication of a Commonwealth agency who has a *direct interest* in such adjudication shall have the right to appeal therefrom to the court vested with jurisdiction of such appeals by or pursuant to Title 42 (relating to judiciary and judicial procedure).

2 Pa. C.S. § 702 (emphasis added). In *Citizens Against Gambling Subsidies, Inc. v. Pennsylvania Gaming Control Board*, 591 Pa. 312, 318-19, 916 A.2d 624, 628 (2007) (per curiam), our Supreme Court succinctly, but comprehensively, set forth the test for standing in administrative agency appeals:

> Standing to appeal generally requires both status as a party and aggrievement. The rights and liabilities of a party to an action may be attained, where appropriate, through intervention in the tribunal having original jurisdiction. The traditional test for aggrievement entails demonstration of a direct, immediate, and substantial interest. The purpose of this requirement is to guard against improper litigants by requiring some proof of an interest in the outcome that surpasses the common interest of all citizens.
>
> *As Petitioners highlight, by virtue of Section 702 of the Administrative Agency Law, neither party status nor traditional aggrievement is necessary to challenge*

> *actions of an administrative agency.* Rather, standing to appeal administrative decisions extends to "persons," including non-parties, who have a "direct interest" in the subject matter, as distinguished from a "direct, immediate, and substantial" interest. *A direct interest requires a showing that the matter complained of caused harm to the person's interest.* Although not the full equivalent of "direct, immediate, and substantial," *the direct interest requirement retains the function of differentiating material interests that are discrete to some person or limited class of persons from more diffuse ones that are common among the citizenry.*

(Citations omitted) (emphasis added); *see also Soc'y Hill Civic Ass'n v. Pa. Gaming Control Bd.*, 593 Pa. 1, 928 A.2d 175 (2007) (applying Court's analysis in *Citizens*).

Like Section 702 of the AAL, Section 35.28(a)(2) of GRAPP provides that a person seeking intervention must have "[a]n interest which may be directly affected." It does not require demonstration of a "direct, immediate, and substantial" interest—which our Supreme Court characterized in *Citizens* as the "traditional" test for standing. It is also not necessary for an entity seeking intervention in an administrative proceeding to show that it *is* suffering present "harm" or *will* definitively suffer harm in the future. This is obvious not only from the use of the words "may be directly affected" in Section 35.28(a)(2), but also because actual harm, if any, can only be determined after the agency issues its adjudication. It is at that point that a party *or nonparty* wishing to appeal the agency adjudication under Section 702 of the AAL must be prepared to show that the adjudication caused harm to the person's interests—*i.e.*, that the person has "standing" to appeal.[6]

[6] We explained this limited overlap between intervention under GRAPP and standing to appeal under Section 702 of the AAL in *Pennsylvania Association of Independent Insurance Agents v. Foster*, 616 A.2d 100 (Pa. Cmwlth. 1992) (*PAIIA*). There we noted that while a party's

We have before seen this interaction between intervention and standing to appeal in the context of a company that seeks to challenge a competitor's request for favorable administrative agency action. In *MEC Pennsylvania Racing, Inc. v. Pennsylvania State Horse Racing Commission*, 827 A.2d 580 (Pa. Cmwlth. 2003), Penn National and MEC, licensees of the Pennsylvania State Horse Racing Commission (Horse Commission), appealed an order of the Horse Commission, granting a license to Presque Isle to conduct horse racing meetings and pari-mutuel wagering. Despite repeated requests by MEC, the Horse Commission did not hold a formal hearing (*i.e.*, a hearing that complies with the AAL) on the Presque Isle application. Instead, it held an open meeting to the public, without any right of cross-examination. It also accepted written submissions from the public. It issued its final order approving the application on November 19, 2002.

Presque Isle moved to quash the appeals, raising two issues for our review. The first was whether the Horse Commission's Order under the Reform Act was an appealable order. We held that the Horse Commission's order approving Presque Isle's license application met the definition of an "adjudication" under the AAL and thus was an appealable order. *MEC*, 827 A.2d at 587-88. The second issue was whether, assuming the order was appealable, MEC and Penn National had standing to appeal under Section 702 of the AAL. Without the benefit of our Supreme Court's articulation in *Citizens* of the difference between

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intervenor status before an administrative agency is a factor this Court will consider when determining whether the intervenor has standing to appeal under Section 702 of the AAL, intervenor status is not alone sufficient to confer standing to appeal "where other factors weigh against it." *PAIIA*, 616 A.2d at 103.

standing to appeal under Section 702 and standing to appeal generally, in *MEC* we applied the "traditional standing test." *Id.* at 588.

We held that Penn National had a direct, substantial, and immediate interest in the Horse Commission's decision because both the Horse Commission and Presque Isle acknowledged that a grant of Presque Isle's application would cause pecuniary harm to Penn National's interest. Accordingly, we held that Penn National had standing to appeal. *Id.* at 589. We also held that MEC had standing to appeal:

> MEC also has standing because it demonstrated that the development of a new live racetrack in Erie would result in a direct dilution of attendance and revenue at its own racetracks, as well as adversely impact the racing industry as a whole, including an overall decline in the horse supply for the Mid-Atlantic region. The loss of attendance and revenue will harm a direct, substantial and immediate interest of MEC's. Moreover, in its decision, the Commission extensively discussed why, under 58 Pa. Code § 165.18, the Presque Isle Application was in the "best interest of horse racing." It follows from this discussion that MEC, which makes up approximately one-third of all OTW facilities and one-half of all live racing facilities in the Commonwealth, has standing, like the "local community" in *Cashdollar*,[7] to appeal. Because of

[7] In *Cashdollar v. State Horse Racing Commission*, 600 A.2d 646 (Pa. Cmwlth. 1991), this Court held that residents in a local community had standing to challenge the Horse Commission's licensing decision for failure on the part of the Horse Commission to consider the impact that decision would have on the local community—a factor that, under the Reform Act, the Horse Commission must consider. In *MEC*, we succinctly summarized the legal principle that can be drawn from *Cashdollar*:

> [W]here an administrative agency was directed by its enabling statute to take into consideration the effect of its decision upon a particular class of individuals, then those individuals might have standing to challenge the agency's decision on the basis that it did not fulfill its statutory duty.

MEC, 827 A.2d at 589.

> MEC's undeniable involvement with horse racing, it clearly has a direct interest in any license adjudication affecting those interests in the Commonwealth.

Id. at 589-90 (footnotes omitted).

Having established that (a) the AAL applied to the Horse Commission's licensing decision and (b) both Penn National and MEC satisfied the traditional test for standing to appeal, we next addressed Penn National's and MEC's contention that, under the AAL, they were entitled to a formal hearing on Presque Isle's application, with a right of cross-examination.[8] In answering this question, we looked to the definition of "party" in the AAL, which provides: "Any person who appears in a proceeding before an agency *who has a direct interest in the subject matter of such proceeding*." Section 101 of the AAL, 2 Pa. C.S. § 101 (emphasis added). Applying this definition, we reasoned that because Penn National's and MEC's interests were direct enough to satisfy the traditional standing test to appeal the Horse Commission's Order, "it follows that they also have a 'direct interest in the subject matter' of the proceeding entitling them, as a 'party' to a formal hearing, with cross-examination." *MEC*, 827 A.2d at 590. We held, however, that only MEC made a formal request for a hearing below. We thus vacated the Horse Commission's Order and remanded for formal hearings under the AAL with MEC (but not Penn National) as a party.

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[8] Section 504 of the AAL, 2 Pa. C.S. § 504, provides:

> No adjudication of a Commonwealth agency shall be valid as to any party unless he shall have been afforded reasonable notice of a hearing and an opportunity to be heard. All testimony shall be stenographically recorded and a full and complete record shall be kept of the proceeding.

Section 505 of the AAL, 2 Pa. C.S. § 505, provides: "Reasonable examination and cross-examination shall be permitted." *Id.* § 505.

On remand, MEC waived a hearing and, effectively, withdrew its opposition to the Presque Isle application. By that time, however, a new entity—Pittsburgh Palisades Park, LLC (Palisades)—had entered the fray. It filed an application for a thoroughbred racing license and sought to intervene in the Presque Isle proceeding before the Horse Commission on remand. The Horse Commission denied the intervention request and reinstated Presque Isle's license. Palisades appealed to this Court. *Pittsburgh Palisades Park, LLC*, 844 A.2d at 64-65.

Unlike in *MEC*, the issue before the Court in *Palisades* was not standing to appeal. Rather, like the case presently before us, the issue before the Court in *Palisades* was purely a question of whether the Horse Commission abused its discretion in denying Palisades' request to intervene. The Court thus focused its analysis on Section 35.28(a) of GRAPP and the three circumstances under which a person would be eligible to intervene in an administrative agency proceeding under that section. Applying the abuse of discretion standard, we held that Palisades "fails to satisfy any of these requirements so clearly as to compel intervention contrary to the Commission's exercise of discretion." *Id.* at 65-66.

We reasoned that Palisades did not meet the first eligibility category for intervention—*i.e.* a right conferred by statute—because the Reform Act did not provide any person with a statutory right to intervene. *Id.* With respect to the second eligibility category, we opined that Palisades was not "directly affected" by the reinstatement of Presque Isle's license. We noted specifically that Palisades was not a licensed entity and, thus, was not a "competitor" of Presque Isle. We also noted that Palisades did not purport to fall within any other of the classes of persons identified in Section 25.28(a)(2) of GRAPP. We found it persuasive that

Palisades did not object to or participate in the initial proceedings before the Horse Commission on Presque Isle's license application. We further reasoned:

> Palisades is not bound by the Commission's decision because it possesses no right or obligations as a result of the reinstatement of the license to Presque Isle. Further, any interest [Palisades] may have as one of many applicants for a future license is too speculative to compel intervention as of right.

Id. at 66. Finally, we rejected Palisades' argument that intervention was in the public interest:

> Third, . . . Palisades' interest in the Presque Isle license is not sufficient to compel intervention "in the public interest." On this issue, Pittsburgh Palisades contends it defends the public's interest in open, honest government, subject to the rule of law rather than to caprice or favoritism. What these noble contentions ignore is the public interest in finality. Presque Isle's initial application was submitted in June, 2001. There followed 16 months of noticed public meetings and written submissions involving 25 entities, including current license holders, industry associations and elected officials. As none of the participants in those extensive proceedings assigns error or seeks enlargement of the record, the public's interest in finality preponderates against purifying the process by reinitiating with a new party.

Id. (citation omitted).

In *Sheetz I*, the Pennsylvania Liquor Control Board (LCB), like the Harness Commission in this case, simultaneously issued its decision on the merits of an application to transfer an eating place malt beverage license to a convenience store (Sheetz) and on the intervention request of the Malt Beverages Distribution Association (MBDA).[9] But unlike the Harness Commission, the LCB held a hearing to address both the merits of the transfer application and whether MBDA

[9] MBDA is a Pennsylvania association of beer distributors. *Sheetz I*, 881 A.2d at 39.

"would be directly aggrieved" if the LCB granted the transfer application. The LCB approved the transfer, but denied intervention to MBDA. MBDA appealed.[10]

On appeal, we applied the traditional test for standing to determine whether the LCB erred in denying intervention to MBDA. We noted that the record clearly established that retail sales at any distributor near the proposed transferee would be damaged by the transfer because Sheetz offers a range of products that a distributor cannot offer (*e.g.*, food, gas, and other convenience store items). *Sheetz I*, 881 A.2d at 42. Indeed, the record testimony was that the loss of business would be catastrophic to a competing distributor. *Id.* We determined that this established interest was sufficient under "even the narrowest interpretation of association standing principles," and, consequently, that the LCB erred in not granting the intervention petition. *Id.*; *see MEC*, 827 A.2d at 590 (entity that establishes standing under traditional standing principles has interest direct enough for intervention under GRAPP). Alternatively, we held that because the Liquor Code created the distributors in question and, to a certain extent, protects that class, "[a] statewide trade association, such as MBDA, is likely much better suited to represent the interests of the class when a proposal is made that has the potential to alter dramatically the current balance under applicable statutory proceedings." *Sheetz I*, 881 A.2d at 43.[11]

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[10] We note that the rules governing intervention in LCB proceedings are different from those set forth in GRAPP. *See* 40 Pa. Code § 17.12. Nonetheless, they are sufficiently similar for purposes of our analysis.

[11] In a subsequent appeal from a separate but similar LCB adjudication, we upheld the LCB's decision to grant intervention to MBDA, based on LCB's adherence to our decision in *Sheetz I*. *Malt Beverages Distrib. Ass'n v. Pa. Liquor Control Bd.*, 965 A.2d 1254 (Pa. Cmwlth. 2009) (en banc), *aff'd*, ___ Pa. ___, 8 A.3d 885 (2010).

In *Capital BlueCross v. Pennsylvania Insurance Department*, 937 A.2d 552 (Pa. Cmwlth 2007) (en banc), *appeal denied*, 600 Pa. 106, 963 A.2d 906 (2009), the Court again addressed the issue of a competitor's standing to appeal. Capital BlueCross (CBC) filed a petition for review with this Court, seeking to challenge an adjudication of the Pennsylvania Insurance Commissioner (Commissioner) favorable to one of CBC's competitors—Highmark Inc. (Highmark). But unlike the competitors in *MEC*, CBC made no effort to intervene or to otherwise participate in proceedings before the Commissioner that led to the adjudication in question. Highmark moved to quash CBC's appeal for lack of standing based, in part, on CBC's failure to participate in the administrative proceeding that led to the adjudication. Relying on Section 702 of the AAL, CBC argued that it was not required to be a party below in order to appeal the adjudication. Moreover, it cited several cases from this Court and the Pennsylvania Supreme Court, recognizing that competitive injury of a direct competitor may confer standing. *See In re Application of El Rancho Grande, Inc.*, 496 Pa. 496, 437 A.2d 1150 (1981); *PAIIA*; *Pa. Auto. Ass'n v. State Bd. of Vehicle Mfr., Dealers and Salespersons*, 550 A.2d 1041 (Pa. Cmwlth. 1988).[12]

Unlike the Court in *MEC*, the Court in *Capital BlueCross* had the benefit of the Pennsylvania Supreme Court's guidance in *Citizens* and *Society Hill*. We examined the Supreme Court's decision in *Citizens* and the various decisions regarding competitor standing. Based on that examination, we concluded that CBC's failure to participate in the administrative proceeding and its failure to present in that proceeding evidence of harm to its interests barred the company from appealing the adjudication to this Court:

[12] These cases also appear in the parties' briefs in this appeal.

> In sum, absent an independent statutory basis for standing, a litigant asserting competitor standing to appeal an agency action must establish a direct interest in it by presenting evidence of causation of harm to its financial interest by the agency action.

Capital BlueCross, 937 A.2d at 593 (citation omitted). Though CBC argued that any attempt to participate in the administrative agency proceedings would have been futile, we rejected the argument:

> This argument would be more persuasive if Capital had attempted to intervene and was prevented from doing so; however, Capital made no effort at all to intervene or even participate at some more modest status.

Id.[13]

C. <u>Philadelphia Park's Intervention</u>

In assessing whether the Harness Commission abused its discretion in denying Philadelphia Park's intervention request, we first note that the only reason the Harness Commission gave in its Intervention Order for denying intervention was its finding that Philadelphia Park's intervention petition "failed to demonstrate to the Commission that [Philadelphia Park] has a right to Intervene or an interest of such a nature that intervention is necessary or appropriate to the administration of the account wagering provisions of the [Reform Act]." (R.R. 7a.) In other words,

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[13] This lack of participation in administrative proceedings below was a significant factor in our recent decision in *Keystone Redevelopment Partners*. In that case, we affirmed the Pennsylvania Gaming Control Board's (Board) decision to deny intervention in a proceeding on a petition by a licensee for an extension of time to commence operation. Keystone Redevelopment Partners, LLC (Keystone), the party appealing the intervention order, was an unsuccessful applicant before the Board who did not appeal the denial of its application and grant of licensee's application. Nonetheless, it sought to intervene three years later in the Board's proceedings on the licensee's request for an extension of time to commence operations. In affirming the Board's decision, we found persuasive the Board's findings that Keystone did not appeal the original licensing proceedings and that it was not currently a licensee and, therefore, could not be considered a competitor for purposes of intervention. Based on these and other findings by the Board, we held that the Board did not abuse its discretion in denying intervention. *Keystone Redevelopment Partners*, 5 A.3d at 460-64.

the Harness Commission found that Philadelphia Park was not eligible to intervene under Section 35.28(a) of GRAPP. Our review of the intervention papers and the case law persuades us that the Harness Commission's denial of Philadelphia Park's intervention request on this ground was an abuse of discretion.

Philadelphia Park falls squarely within the class of persons eligible to intervene under Section 35.28(a)(2).[14] It is undisputed that Philadelphia Park is currently a licensee of the Harness Commission in the same geographic market (overlapping PMA) as Harrah's Chester. At the time it sought intervention below, Philadelphia Park was an *existing* competitor of Harrah's Chester in harness racing and pari-mutuel wagering. Moreover, at the time Philadelphia Park sought intervention, it was a certainty that a favorable ruling by the Harness Commission on Harrah's Chester's application would make Philadelphia Park a competitor of Harrah's Chester in telephone account wagering. These undisputed facts alone compel the conclusion that Philadelphia Park's interest in the outcome of the administrative proceeding below was far greater than the interests of the would-be intervenors in *Palisades* and *Keystone Redevelopment Partners*.

Both the Harness Commission and Harrah's Chester argue that Philadelphia Park's only alleged interest is that of a competitor seeking to preserve its current position as the principal or only licensee in its geographic market authorized to conduct telephone account wagering. They claim that an interest in limiting competition alone is not an interest sufficient to confer standing under GRAPP. We simply cannot find support for this position in Philadelphia Park's intervention papers.

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[14] Because it is so clear to this Court that Philadelphia Park is eligible to intervene under Section 35.28(a)(2), we do not address the parties' arguments regarding eligibility under (a)(1) or (a)(3).

It is true that the Reform Act clearly contemplates that licensees' PMAs may overlap. The Reform Act, however, also provides protection to these competing licensees: "[I]f two tracks share primary market area as defined herein, both tracks shall have *equal rights* to the market in the shared area." Section 218(d) of the Reform Act, 4 P.S. § 325.218(d) (emphasis added). In its intervention petition, Philadelphia Park clearly articulated its concern that approval of Harrah's Chester's AWS would run contrary to the notion of "equal" competition embodied by this provision in the Reform Act:

> While Harrah's Chester may have equal rights to conduct account wagering within the shared portions of the [PMA], [Philadelphia Park] has a direct, substantial and immediate interest in ensuring that such account wagering is conducted in conformance with the requirements and protections, specifically designed for [Philadelphia Park's] benefit, in the Reform Act and Horse and Harness Racing Commission Regulations.

(R.R. 27a-28a.) Philadelphia Park's primary contention on the merits of Harrah's Chester's petition for approval of its AWS is that the system, as proposed, does not comply with the requirements of Section 218 of the Reform Act or the Harness Commission's telephone account wagering regulations (58 Pa. Code §§ 187.1-.4). Philadelphia Park contends, and we agree, that subsumed within the notion of equal competition are fair and lawful competition. Philadelphia Park articulates fair and reasonable concerns in this regard. As a licensee, it claims that it has complied with the Reform Law and regulations with respect to its telephone account wagering system at some expense in terms of investment in facility improvements and human resources. If, as Philadelphia Park contends, Harrah's Chester's AWS does not comply with the Reform Law and regulations and this noncompliance would provide Harrah's Chester with an unfair, unequal competitive advantage, this is a harm that Philadelphia Park should have a fair and reasonable opportunity to prevent in proceedings before the Harness Commission.

In light of the foregoing, Philadelphia Park, as an existing and prospective competitor of Harrah's Chester, has a clear interest in Harrah's Chester's application for approval of its AWS under the Reform Act. This interest goes beyond a mere pecuniary interest in preserving its market position; rather, it is an interest in equal competition for business expressly recognized in the Reform Act. And this interest alone provides a sufficient basis to establish eligibility to intervene under Section 35.28(a)(2).[15]

We also note that a competitor's pecuniary interest in the outcome of an administrative proceeding can support intervention. *See MEC*; *Sheetz I*; *Capital BlueCross*. In its intervention papers, Philadelphia Park articulates a pecuniary interest in the Harness Commission's decision on par with the interest we recognized in *MEC—i.e.*, concern over the dilution of its telephone account wagering business and revenue by the introduction of a competitor into the market. Harrah's Chester, in its response, "acknowledge[ed] that its introduction of account wagering could dilute [Philadelphia Park's] own account wagering business." (R.R. at 58a.) We believe that this stated concern over pecuniary harm and

[15] Harrah's Chester argues in its brief that even if Philadelphia Park satisfies the direct interest prong of Section 35.28(a)(2) of GRAPP, it does not satisfy the other prongs of that section—(1) that Philadelphia Park's interests are not adequately represented by existing parties, and (b) that Philadelphia Park would be bound by the Harness Commission's decision on Harrah's Chester's AWS petition. We disagree. In our review of the sparse record on appeal, the only "existing parties" below were the Harness Commission (the adjudicator) and Harrah's Chester (the application/petitioner), neither of which could be described as representing Philadelphia Park's interests. It is also clear that any decision of the Harness Commission approving Harrah's Chester's AWS would be binding on Philadelphia Park, an existing licensee operating a telephone account wagering system in the same geographic market as Harrah's Chester's proposed AWS.

Harrah's Chester's candid concession were sufficient to establish eligibility to intervene under Section 35.28(a)(2) of GRAPP and this Court's precedent.

The Harness Commission and Harrah's Chester characterize all of Philadelphia Park's claims in support of intervention as merely concerns about "future" harm that is too remote and speculative to support intervention. But in making this argument, the Harness Commission and Harrah's Chester would improperly hold Philadelphia Park to a traditional standing test to establish eligibility to intervene under GRAPP. While our decisions in *MEC* and *Sheetz I* reasoned that an entity that can satisfy the traditional standing test should have been allowed to intervene in the administrative proceeding below, those decision reflect only what our Supreme Court later acknowledged in *Citizens* and *Society Hill—i.e.*, that the traditional standing test is a more onerous test than what a litigant must prove to appeal an administrative agency adjudication under Section 702 of the AAL. It is also a more onerous than what a person must show to be eligible to intervene under Section 35.28(a)(2) of GRAPP. *See PAIIA*, 616 A.2d 103; *MEC*.

As noted above, intervention under GRAPP is sought *before* final administrative action is taken. Thus, whether a particular agency action *will*, with certainty, cause a direct, immediate, and substantial harm to a would-be intervenor's interest is not and cannot be the test for intervention. That is why Section 35.28(a)(2) of GRAPP appropriately provides that a person who has "[a]n interest which *may be* directly affected" can seek to intervene in an administrative proceeding. (Emphasis added.) If "proof" of actual harm is what the Harness Commission believed was required for purposes of its intervention decision, the Harness Commission, like the LCB in *Sheetz I*, should have conducted a hearing and taken evidence on the question of whether Philadelphia Park could actually prove the harm it alleged in its papers.[16] It did not. Instead, it chose to resolve the intervention request on the papers alone. Our review of those papers and the case law compels us to conclude that the Harness Commission applied the wrong legal standard in evaluating Philadelphia Park's intervention request.

D. <u>Remaining Issues</u>

The Court consolidated these matters by Order of January 14, 2011, wherein the Court also granted Philadelphia Park's request to appeal the Second Approval Order *nunc pro tunc*. Harrah's Chester and the Harness Commission moved the Court for reconsideration of the portion of the January 14, 2011 Order granting the *nunc pro tunc* appeal, and the Harness Commission filed its own motion to quash the appeal of the Second Approval Order as untimely. By per curiam Order, we notified the parties that the requests for reconsideration and motion to quash would be decided with the merits. In addition, Philadelphia Park argues in its brief that we should quash the appeal of the First Approval Order for lack of standing.

All of these requests for relief are addressed to Philadelphia Park's appeals of the so-called "merits" determinations—*i.e.*, the approval orders. We have, however, focused on the validity of the underlying administrative proceeding, not the wisdom of the result. Neither the Harness Commission nor Harrah's Chester argues that this Court does not have jurisdiction to review the Intervention Order or that Philadelphia Park lacks standing to appeal the

[16] Indeed, our decision in *Capital BlueCross* strongly suggests that a competitor who participates in a proceeding before an administrative agency should create a record as to the competitor's alleged interest and how its interest would be adversely affected. This record would then be available to this Court for review if the competitor's standing later becomes an issue on appeal.

Intervention Order. In the absence of any argument to the contrary, we are satisfied that Philadelphia Park's appeal of the Intervention Order is properly before us.[17]

For the reasons set forth above, the Harness Commission abused its discretion in denying Philadelphia Park's request to participate as a party intervenor. To right the wrong,[18] not only must we reverse the Intervention Order, we must vacate the First Approval Order and the Second Approval Order and remand this matter for further proceedings. *See MEC*; *Sheetz I*. As a result, we will not address Harrah's Chester's request that we dismiss the appeal of the First Approval Order for lack of standing. We will dismiss as moot Philadelphia Park's appeals of the First Approval Order and Second Approval Order. And, consequently, we will deny the applications for reconsideration of our January 14, 2011 Order and the Harness Commission's application to quash.

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[17] The Harness Commission issued its Intervention Order concurrently with the First Approval Order. Thus if the First Approval Order is a final order appealable under Rule 341 of the Pennsylvania Rules of Appellate Procedure, so too is the Intervention Order. But even if the First Approval Order, as the Harness Commission argues, is not a final order, we would still have jurisdiction to hear the appeal of the Intervention Order under Rule 313 of the Pennsylvania Rules of Appellate Procedure (collateral orders). *See In re Barnes Found.*, 582 Pa. 370, 871 A.2d 792 (2005); *Adams v. Dep't of Health*, 967 A.2d 1082 (Pa. Cmwlth. 2009).

[18] Section 706 of the Judicial Code, 42 Pa. C.S. § 706, provides:

> An appellate court may affirm, modify, vacate, set aside or reverse any order brought before it for review, and may remand the matter and direct the entry of such appropriate order, or require such further proceedings to be had as may be just under the circumstances.

III. CONCLUSION

Based on our review of the Harness Commission's Intervention Order, the parties' arguments, Philadelphia Park's intervention papers, and Harrah's Chester's response thereto, it is clear to the Court that the Harness Commission misapplied the law. Moreover, its conclusion that Philadelphia Park's intervention papers lack any showing that Philadelphia Park was eligible to intervene is based on so narrow of a reading of the intervention papers that we must conclude that the decision is clearly unreasonable. For those reasons, we conclude that the Harness Commission abused its discretion in denying the intervention petition.

It is clear to the Court that Philadelphia Park was eligible to intervene in the proceeding below on Harrah's Chester's application for approval of its AWS. And, while a person's *eligibility* to intervene in a proceeding before an administrative agency does not necessarily require the agency to grant intervention, the Harness Commission's conclusion that Philadelphia Park did not meet the eligibility requirements was the only reason it provided in the Intervention Order to support its denial of Philadelphia Park's intervention petition. We, therefore, reverse the Harness Commission's Intervention Order and Vacate the First Approval Order and Second Approval Order. This matter is remanded for a formal hearing and adjudication in accordance with the AAL.

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P. KEVIN BROBSON, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Bensalem Racing Association, Inc. and Keystone Turf Club, Inc. (d/b/a Philadelphia Park Racetrack), Petitioners	:	No. 1053 C.D. 2010 No. 2710 C.D. 2010
v.	:	
Pennsylvania State Harness Racing Commission, Respondent	:	

O R D E R

AND NOW, this 21st day of March, 2011, the May 27, 2010 Order of Respondent Pennsylvania State Harness Racing Commission denying Petitioner's Petition to Intervene is REVERSED. As a result, Respondents' May 27, 2010 Order and September 30, 2010 Order (Merits Orders), addressing the merits of Intervenor Chester Downs and Marina, LLC d/b/a Harrah's Chester Casino & Racetrack's petition for approval of telephone account wagering are VACATED.

The appeals of the Merits Orders are DISMISSED as moot. The applications seeking reconsideration of our January 14, 2011 Order (No. 2710 C.D. 2010) are DENIED. The applications to quash the appeal docketed at No. 2710 C.D. 2010 are DENIED as moot.

This matter is REMANDED to the Pennsylvania State Harness Racing Commission for a formal hearing and adjudication in accordance with the AAL.

Jurisdiction relinquished.

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P. KEVIN BROBSON, Judge

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PORT OF SEATTLE, WASHINGTON,
Petitioner,

IDACORP ENERGY; WILLIAMS POWER COMPANY INC.; CITY OF TACOMA, WASHINGTON; SOUTHERN CALIFORNIA EDISON COMPANY; CONSTELLATION POWER SOURCE INC.; EL PASO MERCHANT ENERGY L.P.; MORGAN STANLEY CAPITAL GROUP, INC.; TRACTEBEL ENERGY MARKETING INC.; BP ENERGY CO.,
Intervenors,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

M-S-R PUBLIC POWER AGENCY; DUKE ENERGY TRADING AND MARKETING, LLC; PUGET SOUND ENERGY; CITY OF LOS ANGELES DEPARTMENT OF WATER AND POWER; SEMPRA ENERGY TRADING CORP.; ENERGY PLUS LLC; NORTHERN CALIFORNIA POWER AGENCY,
Intervenors,

PORT OF SEATTLE,
Applicant-Intervenor.

No. 03-74139

FERC No.
Federal Power Act

CITY OF SEATTLE,
Petitioner,

IDACORP ENERGY L.P.; PEOPLE OF THE STATE OF CALIFORNIA; PORT OF SEATTLE; DUKE ENERGY NORTH AMERICA, LLC, DUKE ENERGY TRADING AND MARKETING, LLC, (COLLECTIVELY, "DUKE ENERGY"); CITY OF TACOMA,
Intervenors,

BENTON COUNTY, FRANKLIN COUNTY, GRANT COUNTY; TRANSCANADA ENERGY; PUBLIC SERVICE COMPANY OF COLORADO; POWEREX CORP.; CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION; ALCOA INC.; COLUMBIA FALLS ALUMINUM COMPANY, LLC; WILLIAMS POWER COMPANY INC.; CALIFORNIA ELECTRICITY OVERSIGHT BOARD; PORTLAND GENERAL ELECTRIC COMPANY; NORTHERN CALIFORNIA POWER AGENCY; EL PASO MERCHANT ENERGY L.P.,
Intervenors,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

No. 03-74472

FERC No.
Federal Power Act

AVISTA CORPORATION; AVISTA ENERGY; THE CITY OF LOS ANGELES DEPARTMENT OF WATER AND POWER; SEMPRA ENERGY; PUGET SOUND ENERGY; PINNACLE WEST COS.; CONSTELLATION ENERGY COMMODITIES GROUP, INC.; BP ENERGY CO.; TRACTEBEL ENERGY MARKETING INC.; M-S-R PUBLIC POWER AGENCY; MODESTO IRRIGATION DISTRICT (MID); THE CITY OF SANTA CLARA; CITY OF REDDING; CORAL POWER; PPL ENERGYPLUS, LLC; PPL MONTANA,
Intervenors.

CITY OF TACOMA, WASHINGTON,
Petitioner,

DUKE ENERGY NORTH AMERICA, LLC, DUKE ENERGY TRADING AND MARKETING, LLC, (COLLECTIVELY, "DUKE ENERGY"); CALIFORNIA ATTORNEY GENERAL; PORT OF SEATTLE,
Intervenors,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

IDACORP ENERGY L.P.; PINNACLE WEST CAPITAL CORPORATION; NORTHERN CALIFORNIA POWER AGENCY; AVISTA ENERGY INC.; AVISTA CORPORATION; M-S-R PUBLIC POWER AGENCY; PUBLIC SERVICE COMPANY OF COLORADO; CITY OF LOS ANGELES DEPARTMENT OF WATER AND POWER; SEMPRA ENERGY TRADING CORP.; PUBLIC SERVICE COMPANY OF NEW MEXICO; PPL ENERGYPLUS; PPL MONTANA; CORAL POWER, LLC,
Intervenors.

No. 03-74769

FERC No.
Federal Power Act

PUGET SOUND ENERGY,
Petitioner,
v.
FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

DUKE ENERGY NORTH AMERICA, LLC, DUKE ENERGY TRADING AND MARKETING, LLC, (COLLECTIVELY, "DUKE ENERGY"); CITY OF TACOMA, WASHINGTON; CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION; PUBLIC SERVICE COMPANY OF COLORADO; SEMPRA ENERGY TRADING CORP.; CITY OF LOS ANGELES DEPARTMENT OF WATER AND POWER; PINNACLE WEST CAPITAL CORPORATION, (PNW); CORAL POWER, LLC; TRANSCANADA ENERGY LTD.; WILLIAMS POWER COMPANY INC.; NORTHERN CALIFORNIA POWER AGENCY, (NCPA); PORT OF SEATTLE WASHINGTON; M-S-R PUBLIC POWER AGENCY; THE MODESTO IRRIGATION DISTRICT ("MID"), THE CITY OF SANTA CLARA, CALIFORNIA ("SANTA CLARA") AND THE CITY OF REDDING, CALIFORNIA ("REDDING"); CALIFORNIA ELECTRICITY OVERSIGHT BOARD;

No. 04-70110

FERC No. EL-01-10

ALCOA INC.; COLUMBIA FALLS
ALUMINUM COMPANY, LLC
("CFAC"); MORGAN STANLEY
CAPITAL GROUP, INC.; PACIFICCORP;
PEOPLE OF THE STATE OF
CALIFORNIA, ex rel. BILL LOCKYER,
Attorney General,
Applicants-Intervenors.

PEOPLE OF THE STATE OF
CALIFORNIA; BILL LOCKYER,
Attorney General,
Petitioners,

v.

FEDERAL ENERGY REGULATORY
COMMISSION,
Respondent,

MORGAN STANLEY CAPITAL GROUP,
INC.,
Applicant-Intervenor.

No. 04-70185

FERC No.
EL-01-10

PEOPLE OF THE STATE OF CALIFORNIA, *Petitioner,* CITY OF TACOMA, WASHINGTON; PORT OF SEATTLE, WASHINGTON, *Intervenors,* IDACORP ENERGY L.P.; CALIFORNIA ELECTRICITY OVERSIGHT BOARD; TRANSCANADA ENERGY LTD; BENTON, FRANKLIN AND GRANT COUNTY, WASHINGTON PUBLIC UTILITY DISTRICTS; THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION; COLUMBIA FALLS ALUMINUM COMPANY, LLC; ALCOA, INC.; PORTLAND GENERAL ELECTRIC COMPANY; BONNEVILLE POWER ADMINISTRATION; POWEREX CORP.; BENTON COUNTY; FRANKLIN COUNTY; GRANT COUNTY, WASHINGTON, *Intervenors,* v. FEDERAL ENERGY REGULATORY COMMISSION, *Respondent,* BP ENERGY COMPANY; CONSTELLATION ENERGY COMMODITIES GROUP, INC.; CITY OF LOS ANGELES DEPARTMENT OF WATER AND POWER; SEMPRA ENERGY TRADING CORP.; PUGET	No. 04-70703 FERC No. Federal Power Act

SOUND ENERGY, INC.; AVISTA ENERGY, INC.; CORAL POWER, L.L.C.; NORTHERN CALIFORNIA POWER AGENCY; THE M-S-R PUBLIC POWER AGENCY; MODESTO IRRIGATION DISTRICT (MID); CITY OF SANTA CLARA, CALIFORNIA; CITY OF REDDING, CALIFORNIA; PINNACLE WEST COMPANIES; PUBLIC SERVICE COMPANY OF COLORADO; PPL ENERGYPLUS, LLC; PPL MONTANA, LLC; AVISTA CORPORATION,
Intervenors.

CALIFORNIA PUBLIC UTILITIES COMMISSION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

No. 04-71189

FERC No. EL-01-10

OPINION

On Petition for Review of an Order of the Federal Energy Regulatory Commission

Argued and Submitted
January 8, 2007—San Francisco, California

Filed August 24, 2007

Before: Sidney R. Thomas, M. Margaret McKeown, and Richard R. Clifton, Circuit Judges.

Opinion by Judge Thomas;
Concurrence by Judge McKeown

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OPINION

THOMAS, Circuit Judge:

This is another in a series of cases arising out of the energy crisis that occurred in California and other western states in 2000 and 2001. We are asked to review the decision by the Federal Energy Regulatory Commission ("FERC" or "Commission") to deny refunds to wholesale buyers of electricity that purchased energy in the short-term supply market at unusually high prices in the Pacific Northwest. We are also asked to review FERC's decision to exclude from any potential refund those transactions involving energy purchased in the Pacific Northwest for consumption in California. We conclude that we have jurisdiction over FERC's decision to deny refunds, and that FERC abused its discretion in denying potential relief for transactions involving energy that was ultimately consumed in California. We also conclude that in determining whether refunds were warranted, FERC should have considered new evidence of intentional market manipulation submitted by the parties with FERC's approval. At this time, we decline to reach all other issues raised by the parties. We grant the petitions for review in part and remand this case to FERC to address the market manipulation evidence, to include the California-consumed energy in its analysis, and to further consider its refund decision in light of related, intervening opinions of this court.

I

The California energy crisis serves as the backdrop of this litigation. That crisis has been well-documented, *see, e.g.*, *Pub. Utils. Comm'n of State of Cal. v. FERC*, 462 F.3d 1027, 1036-44 (9th Cir. 2006) ("*Pub. Utils. Comm'n*"); *Bonneville Power Admin. v. FERC*, 422 F.3d 908, 910-14 (9th Cir. 2005) ("*BPA*"); *Cal. ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1008-11 (9th Cir. 2004) ("*Lockyer*"), and a full recitation of its history is unnecessary here.

In the mid-1990's, the California legislature deregulated the electricity market, ostensibly to reduce energy prices for consumers. Act of September 23, 1996, 1996 Cal. Legis. Serv. 854 (codified at Cal. Pub. Util. Code §§ 330-398.5). Shortly thereafter, for a variety of reasons related to the deregulation and other market factors, wholesale electricity prices skyrocketed. In May 2000, for instance, average prices in the California short-term supply market, also known as the "spot market," were twice as high as average prices in May 1999. *Pub. Utils. Comm'n*, 462 F.3d at 1040. In June 2000, the first in a series of power blackouts occurred in Northern California, potentially as the result of market manipulation. *Id.*

The effects of this crisis were felt in other areas of the western energy market as well, as "dysfunctions in the spot markets operated by the [California Independent System Operator] and California Power Exchange (PX) affected the prices in the Pacific Northwest," due to the "integrated nature of the Western markets." *Puget Sound Energy, Inc., et al.*, 103 FERC ¶ 61,348 at 62,366-67 (2003) ("June 25, 2003 Order"). The Pacific Northwest is defined as Idaho, Oregon, and Washington, as well as parts of Montana, Nevada, Utah, and Wyoming. 16 U.S.C. § 839a(14).

Prices in the Pacific Northwest spot market skyrocketed during the energy crisis. Other factors, such as an extreme reduction in energy supply due to drought, also contributed to the crisis in the Pacific Northwest, a region that relies heavily on water flow through hydroelectric dams to generate electricity. *Puget Sound Energy, Inc., et al.*, 96 FERC ¶ 63,044 at 65,385 (2001) ("September 24, 2001 ALJ Report"). Unlike the California spot market, which operated through a centralized power exchange using a central clearing price, the Pacific Northwest spot market operated through bilateral contracts negotiated independently between buyers and sellers, without a central clearing price. June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,367. Most of these contracts were entered into under the terms of the Western Systems Power Pool ("WSPP") Agreement, a standard form contract for electricity sales. September 24, 2001 ALJ Report, 96 FERC ¶ 63,044 at 65,386.

Under the Federal Power Act ("FPA"), all rates charged by a public utility — defined, confusingly, as a non-governmental entity, *BPA*, 422 F.3d at 917 — must be "just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful," 16 U.S.C. § 824d(a). Under § 206 of the FPA, FERC has the authority to investigate, on its own initiative or at the request of a complaining party, whether a particular rate is "just and reasonable." *Pub. Utils. Comm'n*, 462 F.3d at 1045. If FERC finds a rate "unjust, unreasonable, unduly discriminatory or preferential," it must determine a just and reasonable rate and order that rate to be "observed and in force." 16 U.S.C. § 824e(a) (2004); *Pub. Utils. Comm'n*, 462 F.3d at 1045. FERC may also order sellers to pay refunds to those who bought energy at the unjust or unreasonable rate. 16 U.S.C. § 824e(b) (2004); *Pub. Utils. Comm'n*, 462 F.3d at 1045. Such refunds are limited to a fifteen-month period following the "refund effective date," which is a date FERC establishes that may be no earlier than sixty days after the filing of the complaint or, in the case of a § 206 proceeding instituted by FERC of its own accord, sixty days after FERC publishes notice of its intention to initiate the proceeding. 16 U.S.C. § 824e(b) (2004). FERC may not order any refunds for the period before the filing of the complaint or the sixty-day period immediately following that filing. *Id.*; *Pub. Utils. Comm'n*, 462 F.3d at 1045.

Pursuant to the FPA, San Diego Gas & Electric ("SDG & E") filed a complaint with FERC regarding the skyrocketing energy prices in California. *See BPA*, 422 F.3d at 912-13. Shortly thereafter, on October 26, 2000, Puget Sound Energy ("Puget") — one of the parties now supporting FERC's decision — filed a complaint with FERC requesting price caps for sales of capacity or energy into Pacific Northwest wholesale power markets. Puget requested a prospective price cap equal to the lowest cap established by FERC in the California markets. Puget's complaint alleged that the California and Pacific Northwest markets were part of the same integrated market of the Western Interconnection, and that market conditions in California influenced market conditions in the Pacific Northwest. The complaint also requested that FERC set a refund effective date, to the extent refunds were necessary, sixty days after the filing of the complaint, or December 25, 2000, the earliest possible refund effective date pursuant to 16 U.S.C. § 824e(b). FERC's notice of the Puget complaint was published in the Federal Register on November 8, 2000, stating that "[t]he Complaint seeks a refund effective date, to the extent any refund is called for, of sixty days after the filing of the Complaint." Puget Sound Energy, Inc., et al.; Electric Rate and Corporate Regulation Filings, 65 Fed. Reg. 66,986 (Nov. 8, 2000).

On December 15, 2000, shortly after finding that prices in the California spot markets were unjust and unreasonable, *Pub. Utils. Comm'n*, 462 F.3d at 1041; *San Diego Gas & Elec. Co., et al.*, 93 FERC ¶ 61,121 at 61,349 (2000), FERC dismissed Puget's complaint, *San Diego Gas & Elec. Co., et al.*, 93 FERC ¶ 61,294 at 62,019 (2000) ("December 15, 2000 Order"). Puget filed a timely request for rehearing on January 12, 2001. On April 26, 2001, in response to the SDG & E complaint, FERC imposed price caps on sales in the California spot markets and instituted a "West-Wide 206 Investigation" into rates in spot markets outside of California, believing that such rates might be unjust and unreasonable. *San Diego Gas & Elec. Co., et al.*, 95 FERC ¶ 61,115 at 61,365 (2001) ("April 26, 2001 Order"). Then, on June 19, 2001, acknowledging that "the California market is integrated with those of other states in the [West]," FERC adopted "a market monitoring and mitigation plan for the [western] spot markets." *San Diego Gas & Elec. Co., et al.*, 95 FERC ¶ 61,418 at 62,567-68 (2001) ("June 19, 2001 Order"). The "need for uniform pricing throughout the Western region" made this plan necessary. *Id.* at 62,568. FERC also ordered market participants to engage in settlement discussions, with the goal of settling past accounts. *Id.* at 62,570. Three days later, FERC clarified that the settlement proceeding was not limited to "California-related matters" but could also focus on "settling past accounts related to sales in the Pacific Northwest." *San Diego Gas & Elec. Co., et al.*, 95 FERC ¶ 61,425 at 62,583 (2001) ("June 22, 2001 Order").

Also on June 22, 2001, Puget filed a motion to dismiss and a notice that it was withdrawing its complaint, explaining that the June 19, 2001 Order instituting price mitigation in the Pacific Northwest satisfied its complaint. On July 9, 2001, the Port of Seattle and the City of Tacoma filed an answer opposing Puget's motion, explaining that a dismissal would prejudice other entities in the Pacific Northwest that relied on Puget's complaint. On the same day, the City of Seattle and the Attorney General of Washington filed late motions to intervene as well as answers in opposition to Puget's notice of withdrawal. Although it does not normally grant late interventions, FERC granted the late motions to intervene filed by the City of Seattle and the Attorney General of Washington because "over the course of the SDG&E proceeding, [FERC] has expanded the scope of its focus from just California to include the entire Western interconnect and also to implicate wholesale spot market transactions of non-public utilities." *San Diego Gas & Elec. Co., et al.*, 96 FERC ¶ 61,120 at 61,504 (2001) ("July 25, 2001 Order"). The next day, July 26, 2001, the Port of Seattle and the City of Tacoma also filed late motions to intervene in the Puget proceeding. FERC granted those motions as well.

In its July 25, 2001 Order, FERC noted that there had been little time during the California settlement discussions to address issues raised by the Pacific Northwest parties. *Id.* at 61,520. As a result, FERC directed "all parties to the Puget Sound complaint proceeding to participate in [a separate preliminary evidentiary proceeding] and to focus on settling past accounts related to spot market sales in the Pacific Northwest. Interested parties to the SDG&E proceeding may participate at their discretion." *Id.* at 61,520-21. The purpose of the "separate preliminary evidentiary proceeding," FERC explained, would be to "facilitate development of a factual record on whether there may have been unjust and unreasonable charges for spot market bilateral sales in the Pacific Northwest for the period beginning December 25, 2000 through June 20, 2001." *Id.* at 61,520.

The preliminary evidentiary proceeding took place from August 1, 2001, to September 17, 2001. The administrative law judge ("ALJ") expedited the proceeding by limiting discovery responses to four business days, prohibiting depositions, and conducting a three-day hearing in which cross-examination was frequently waived. September 24, 2001 ALJ Report, 96 FERC ¶ 63,044 at 65,300. The ALJ found that although prices in the California energy markets affected prices in the Pacific Northwest, "this was not the only thing driving up the prices" there. *Id.* at 65,370. The ALJ also found no evidence of the exercise of market power in the Pacific Northwest, *id.* at 65,369, and found that the Pacific Northwest spot market "performed as a competitive market" during the relevant period, *id.* at 65,386. As a result, the ALJ determined that prices were not unjust or unreasonable and that refunds were unwarranted. *Id.* at 65,385. The ALJ also determined that transactions in the Pacific Northwest spot market involving energy that was consumed in California could not be refunded in the Pacific Northwest proceeding because such transactions were beyond the scope of the Puget complaint. *Id.* at 65,331.

On May 6, 2002, FERC released on its website documents relating to Enron's manipulation of the California energy markets. According to the parties seeking refunds, this new evidence also reflected on market manipulation in the Pacific Northwest because some of Enron's tactics relied on the import and export of electricity to and from California and the Pacific Northwest. The parties seeking refunds also allege that Enron relied on counterpart energy sellers in the Pacific Northwest to carry out its manipulative strategies.

In response to this newly-released evidence of Enron's intentional market manipulation, some of the parties filed motions to reopen the evidentiary record in the Puget complaint. On December 19, 2002, FERC agreed to reopen the evidentiary record, giving the parties until February 28, 2003, to submit "additional evidence concerning potential refunds for spot market bilateral sales transactions in the Pacific Northwest for the period January 1, 2000 through June 20, 2001 and proposed new and/or modified findings of fact." *Puget Sound Energy, Inc., et al.*, 101 FERC ¶ 61,304 at

62,221 (2002) ("December 19, 2002 Order"). FERC later extended the deadline for submitting additional evidence to March 17, 2003. *Puget Sound Energy, Inc., et al.*, 102 FERC ¶ 61,163 at 61,444 (2002).

After receiving the new evidence and holding oral argument, FERC ruled on the ALJ's findings. A divided three-commissioner panel agreed with the ALJ, denying the request for refunds for energy purchases in the Pacific Northwest spot market. June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,367; *Puget Sound Energy, Inc., et al.*, 105 FERC ¶ 61,183 (2003) ("November 10, 2003 Order"). FERC did not, however, respond to or take into account the new evidence of Enron's market manipulation submitted with FERC's approval. FERC also declined to make an explicit finding as to whether spot market prices in the Pacific Northwest were unjust or unreasonable, instead concluding that even if prices were unreasonable, the balance of factors tipped against ordering refunds. June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,367. These equitable factors included, *inter alia*, (1) the presence in the Pacific Northwest market of governmental entities not subject to FERC's jurisdiction and thus not liable for refunds, (2) the unfairness of awarding refunds to parties that imprudently relied on the spot market for their energy needs, (3) the adverse consequences refunds might have on the market, and (4) the time and effort required to calculate refunds in the Pacific Northwest bilateral spot market. *Id.* at 62,367-69. FERC also affirmed the recommendation of the ALJ to exclude from the refund proceeding transactions involving energy that was ultimately consumed in California. November 10, 2003 Order, 105 FERC ¶ 61,183 at 61,964 n.43; *Puget Sound Energy, Inc., et al.*, 106 FERC ¶ 61,109 at 61,368 (2004) ("February 9, 2004 Order"). Commissioner Massey dissented, stating that he would order refunds from the refund effective date, December 25, 2000, through June 20, 2001. June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,370.

In this appeal, governmental entities from the Pacific Northwest — the City of Seattle, the Port of Seattle, and the

City of Tacoma, all of which purchased, on the whole, more electricity during the energy crisis than they sold — petition for review of FERC's decision to deny refunds. The State of California, the Public Utilities Commission of California, and the California Electricity Oversight Board ("the California Parties"), petition for review of FERC's decision to exclude from the refund proceeding transactions involving energy that was ultimately consumed in California, as well as FERC's decision to deny refunds. These parties will be referred to, collectively, as the "Refund Proponents." Supporting FERC's decision to deny refunds are the Bonneville Power Administration, Puget — the public utility that filed the initial complaint in this proceeding but which now opposes refunds — and many other public utility intervenors. These parties will be referred to, collectively, as the "Refund Opponents."

II

We review FERC orders to determine whether they are "arbitrary, capricious, an abuse of discretion, unsupported by substantial evidence, or not in accordance with law." *Cal. Dep't of Water Res. v. FERC*, 341 F.3d 906, 910 (9th Cir. 2003). We defer to FERC's factual findings if those findings are supported by substantial evidence. 16 U.S.C. § 825*l*(b); *Bear Lake Watch, Inc. v. FERC*, 324 F.3d 1071, 1076 (9th Cir. 2003). Substantial evidence " 'means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.' " *Bear Lake Watch*, 324 F.3d at 1076 (quoting *Eichler v. SEC*, 757 F.2d 1066, 1069 (9th Cir. 1985)). " 'If the evidence is susceptible of more than one rational interpretation, we must uphold [FERC's] findings.' " *Id.* (quoting *Eichler*, 757 F.2d at 1069) (alteration in original). We review questions of law de novo. *Am. Rivers v. FERC*, 201 F.3d 1186, 1194 (9th Cir. 1999). FERC's interpretation of the FPA is reviewed under the analysis established in *Chevron U.S.A. Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 842 (1984), and its progeny, *BPA*, 422 F.3d at 914.

As a threshold matter, we must determine whether we have jurisdiction to review FERC's decision to deny refunds for energy transactions in the Pacific Northwest. FERC contends that we lack jurisdiction to review its denial of refunds because this decision is committed to agency discretion by law.

[1] We lack jurisdiction to review "an agency's decision not to prosecute or enforce, whether through civil or criminal process." *Heckler v. Chaney*, 470 U.S. 821, 831 (1985); 5 U.S.C. § 701(a)(2). This is because "an agency decision not to enforce often involves a complicated balancing of a number of factors which are peculiarly within its expertise," such as questions about the best use of the agency's resources. *Heckler*, 470 U.S. at 831. The Supreme Court has cautioned, however, that this exception to judicial review is a narrow one, *id.* at 838; *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 410 (1971), *overruled on other grounds by Califano v. Sanders*, 430 U.S. 99 (1977), limited to those situations in which there is no meaningful standard against which to judge an agency's decision not to act, *Heckler*, 470 U.S. at 830. In those situations, the concern is that courts should not intrude upon an agency's prerogative to pick and choose its priorities, and allocate its resources accordingly, by demanding that an agency prosecute or enforce. Thus, *Heckler* limited the presumption of unreviewability to "agency *refusals to institute* investigative or enforcement proceedings." *Id.* at 838 (emphasis added). When an agency *has instituted* proceedings, meaningful standards exist to review what the agency has done: "when an agency *does* act to enforce, that action itself provides a focus for judicial review, inasmuch as the agency must have exercised its power in some manner. The action at least can be reviewed to determine whether the agency exceeded its statutory powers." *Id.* at 832 (emphasis in original). *See also MCI Telecomms. Corp. v. FCC*, 917 F.2d 30, 41-42 (D.C. Cir. 1990) ("It is one thing for the FCC to decline to investigate a tariff in the first place; that decision is entrusted to its unreviewable discretion. It is quite another for it to note the importance of a question concerning a tariff, request and take evidence from the parties, and hold a hearing on the matter. . . ."). Accordingly, where FERC has made a determination to adjudicate a dispute or take steps towards enforcing a violation of the law, the outcome it chooses is subject to judicial review under the standards of review set forth in the Administrative Procedure Act ("APA"). 5 U.S.C. § 706; *Cal. Dep't of Water Res.*, 341 F.3d at 910.

[2] That is the case here. FERC has already made a decision to commit resources to an examination of whether refunds are warranted for certain energy transactions in the Pacific Northwest for a period of time in 2000 and 2001. In response to the filing of a complaint, FERC has held hearings and taken evidence to adjudicate a dispute between the parties as to whether refunds should be awarded. Although the steps FERC has taken do not require FERC to find that refunds are appropriate, FERC's decision regarding the propriety of awarding refunds is reviewable by this court. Indeed, we regularly exercise judicial review over FERC's decision to grant or deny refunds, *Pub. Utils. Comm'n*, 462 F.3d 1027 (reviewing decision to grant refunds); *Lockyer*, 383 F.3d 1006 (reviewing decision to deny refunds); *Consol. Edison Co. of N.Y., Inc. v. FERC*, 347 F.3d 964 (D.C. Cir. 2003) (reviewing decision to deny refunds), and we do so here.

III

We also must decide whether FERC erred in finding that Puget's original complaint, which launched the Pacific Northwest refund proceeding, was not withdrawn as a matter of law in July 2001. If FERC erred and the opinion was withdrawn, the entire Pacific Northwest evidentiary proceeding before the ALJ, as well as FERC's subsequent decision to deny refunds, would be procedurally barred. If, on the other hand, we determine that Puget's complaint was not withdrawn, we must decide whether the Puget complaint failed to set a refund effective date, which is a statutory requirement for seeking refunds. In other words, Puget and the Refund Opponents ask us to affirm the outcome below on procedural grounds, rather than reach the merits. This we decline to do.

A

[3] As a threshold matter, we conclude that Puget has standing to assert this challenge, even though it was the prevailing party before the agency. The FPA limits judicial review to those parties who have been "aggrieved by an order issued by the Commission." 16 U.S.C. § 825*l*(b). In addition, "[l]ike all parties seeking access to the federal courts, [Puget is] held to the constitutional requirement of standing." *Shell Oil Co. v. FERC*, 47 F.3d 1186, 1200 (D.C. Cir. 1995). The D.C. Circuit has held that both aggrievement and standing require "that petitioners establish, at a minimum, 'injury in fact' to a protected interest." *Id.* (interpreting the similar aggrievement requirement of 28 U.S.C. § 2344).

[4] "[M]ere disagreement with an agency's rationale for a substantively favorable decision, even where such disagreement focuses on an interpretation of law to which a party objects, does not constitute the sort of injury necessary for purposes of Article III standing . . . ." *Id.* at 1202 (internal quotation marks omitted). The general rule is that a party may not appeal from a decree in its favor. *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 176 (1934). There are, however, exceptions to the general rule, one of which we find applicable here. This is the exception for cross-appellants who "might become aggrieved upon reversal on the direct appeal." *Hilton v. Mumaw*, 522 F.2d 588, 603 (9th Cir. 1975). In such a case, "the risk that [a cross-appellant] might become aggrieved upon reversal on the direct appeal is sufficient" to confer standing, even when "the final order from which the direct appeal was taken was entirely favorable to cross-appellants." *Id.*

[5] Puget undoubtedly prevailed before the agency; indeed, it argues that FERC reached the correct result in not granting refunds. Puget has standing, however, because, while not technically bringing a cross-appeal, it essentially finds itself in the position of a cross-appellant who lost a collateral issue below but ultimately prevailed. With the Refund Proponents appealing FERC's denial of refunds, FERC's collateral refusal to let Puget withdraw its complaint would expose Puget to greater refund liability should we reverse. Accordingly, under *Hilton*, the risk that Puget "might become aggrieved upon reversal" allows it to bring this appeal.

B

Although it has standing to raise them, Puget's procedural arguments are unavailing. On June 19, 2001, FERC extended price mitigation beyond California to the rest of the western states, including the Pacific Northwest. June 19, 2001 Order, 95 FERC ¶ 61,418 at 62,568. The June 19, 2001 Order also required public utility sellers and buyers to engage in settlement discussions to determine the amount of refunds owed. *Id.* at 62,570. Three days later, on June 22, 2001, FERC clarified that the settlement discussions should not be limited to California entities but "may also focus on settling past accounts related to sales in the Pacific Northwest." June 22, 2001 Order, 95 FERC ¶ 61,425 at 62,583. On the same day, Puget filed a motion to dismiss its complaint and notice of withdrawal.

Puget contends that its notice of withdrawal of the complaint upon which the Pacific Northwest refund proceeding is based became effective as a matter of law fifteen days after Puget filed the notice, nullifying the entire refund proceeding at issue in this case. Puget's argument is that although some Refund Proponents filed motions in opposition to Puget's notice, these motions in opposition could not have prevented Puget's withdrawal from going into effect because the Refund Proponents were not, at that time, parties to the proceeding.

Because we must defer to FERC's interpretation of its own regulation "so long as [the interpretation] is not plainly erroneous or inconsistent with the regulation," *Entergy Servs., Inc. v. FERC*, 375 F.3d 1204, 1209 (D.C. Cir. 2004) (internal quotation marks omitted), we disagree.

FERC's regulations provide that a withdrawal "of any pleading is effective at the end of 15 days from the date of filing . . . if no motion in opposition to the notice of withdrawal is filed within that period and the decisional authority does not issue an order disallowing the withdrawal within that period." 18 C.F.R. § 385.216(b)(1). If, on the other hand, "a motion in opposition to a notice of withdrawal is filed within the 15 day period, the withdrawal is not effective until the decisional authority issues an order accepting the withdrawal." *Id.* § 385.216(b)(2). Puget contends that although the Refund Proponents opposed Puget's notice, this opposition was not effective because another regulation states that motions may be filed only by "a participant or a person who has filed a timely motion to intervene which has not been denied."[1] *Id.* § 385.212(a)(2). The regulations in turn define "participant" as "any party" or any employee of the Commission. *Id.* § 385.102(b). A "party" is one who has filed the complaint, is a respondent to the proceeding, or who has effectively intervened. *Id.* § 385.102(c). The process of intervening, not particularly relevant here, is laid out at 18 C.F.R. § 385.214.

FERC has interpreted 18 C.F.R. § 385.216(b)(1) as placing no limitation on who may oppose a party's notice of withdrawal. June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,365

[1]Although the language permitting "a person who has filed a *timely* motion to intervene which has not been denied," 18 C.F.R. § 385.212(a)(2) (emphasis added), might apply to someone not yet officially a "participant" or "party," none of the Refund Proponents would fall into this category because their motions to intervene were filed out of time.

n.19. In the alternative, FERC also interpreted the regulations as permitting a non-party to oppose the withdrawal of a complaint by simultaneously filing a motion in opposition to withdrawal as well as a motion to intervene. *Id.*; November 10, 2003 Order, 105 FERC ¶ 61,183 at 61,958-59. In that situation, according to FERC, even if FERC did not grant the motion to intervene until a later date, it could have granted the motion to intervene on the day both motions were filed, thus making the non-party an intervening party capable of filing a motion in opposition under 18 C.F.R. § 385.212(a)(2). June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,365 n.19; November 10, 2003 Order, 105 FERC ¶ 61,183 at 61,958-59. Accordingly, because the Attorney General of Washington and the City of Seattle filed, on July 9, 2001, simultaneous motions to intervene and motions in opposition to the withdrawal, November 10, 2003 Order, 105 FERC ¶ 61,183 at 61,958 n.13, FERC rejected Puget's argument that its complaint had been withdrawn as a matter of law fifteen days after Puget filed its notice of withdrawal, *id.* at 61,958-59.[2]

[6] We see no error in FERC's interpretation of its own regulations. The regulation addressing notices of withdrawal does not explicitly state that opposition to such notices may be made only by formal parties to the proceeding. 18 C.F.R. § 385.216(b)(1). FERC did not err in treating the Attorney General of Washington and the City of Seattle as intervenors for purposes of opposing Puget's notice of withdrawal. We also find support for FERC's decision in the fact that FERC granted the City of Tacoma and the Port of Seattle party status in the California refund proceeding on July 9, 2001. *See Domtar Maine Corp. v. FERC*, 347 F.3d 304, 309 (D.C. Cir. 2003) (permitting retroactive grant of intervention). Given the

[2]The City of Tacoma and the Port of Seattle did not file their motions to intervene in the Pacific Northwest proceeding until July 26, 2001, nearly three weeks after filing their motions in opposition to the withdrawal. They had, however, intervened in the California refund proceeding at the time they opposed Puget's notice of withdrawal.

extremely close ties between the California proceeding and the Pacific Northwest proceeding, and FERC's frequent treatment of the two refund proceedings as one and the same, *see, e.g.*, June 22, 2001 Order, 95 FERC ¶ 61,425 at 62,583 (using the SDG & E heading and clarifying that "all parties to the SDG&E complaint proceeding . . . may also focus on settling past accounts related to sales in the Pacific Northwest"), FERC could also have accepted the opposition motions of Tacoma and the Port of Seattle as filed by parties to the proceeding. For these reasons, we hold that the withdrawal of Puget's complaint did not become effective as a matter of law, and FERC may use the complaint as a basis for awarding refunds in the Pacific Northwest.

C

The Refund Opponents supporting Puget further argue the Pacific Northwest proceeding was procedurally doomed because Puget's complaint did not request a required "refund effective date," thus stripping FERC of any authority to order refunds for electricity purchases in the Pacific Northwest. We reject this argument as well.

Congress has provided that "[w]henever [FERC] institutes a proceeding under this section, [FERC] shall establish a refund effective date." 16 U.S.C. § 824e(b) (2004). This refund effective date may not be earlier than sixty days after the filing of a complaint or the filing of a notice by FERC that it intends to investigate rates sua sponte.[3] *Id.* The refund effective date is important because any refunds ordered by FERC are limited to the fifteen-month period following the refund effective date. *Id.* Without a refund effective date, the entire Pacific Northwest proceeding would have been moot because

[3]Amendments effective August 8, 2005, removed the sixty-day waiting period, permitting the refund effective date to be set as early as the date the complaint is filed or the date the Commission files notice of its investigation. 16 U.S.C. § 824e(b) (2006).

FERC would have been powerless to order refunds for the period sought by the Refund Proponents.

[7] The Refund Opponents argue that Puget's complaint never requested refunds or the setting of a refund effective date. To the contrary, Puget's complaint clearly stated that "[Puget] requests that any refunds ordered by the Commission reflect the prospective nature of the relief sought. If and to the extent any refund is called for in response to [Puget's] petition, [Puget] respectfully requests that the refund effective date be set . . . sixty (60) days after the date of filing of this Complaint."

In the alternative, the Refund Opponents argue that because FERC dismissed Puget's complaint on December 15, 2000, December 15, 2000 Order, 93 FERC ¶ 61,294 at 62,019-20, FERC prevented the establishment of a refund effective date even though Puget filed a petition for rehearing on January 12, 2001. In other words, they argue that buyers and sellers in the Pacific Northwest spot market could not have been on notice that December 25, 2000, may serve as the effective date for refunds because the complaint requesting that date was dismissed prior to December 25, 2000. This argument fails for two reasons. First, market participants in the Pacific Northwest were notified prior to FERC's dismissal of the complaint that Puget had requested a refund effective date of December 25, 2000. FERC itself created a "Notice of Complaint," which stated that Puget's complaint "seeks a refund effective date, to the extent any refund is called for, of sixty days after the filing of the Complaint." FERC's notice also explained that "[c]opies of this filing were served upon parties to the WSPP, and transmitted electronically to the WSPP for posting on its website (www.wspp.org) and for electronic distribution to all parties to the WSPP Agreement." In addition, this notice was published in the Federal Register on November 8, 2000. 65 Fed. Reg. 66,986.

Second, the FPA does not support the contention of the Refund Opponents. On the one hand, the FPA provides that if FERC does not respond to an application for rehearing within thirty days after filing, the application "*may* be deemed to have been denied." 16 U.S.C. § 825*l*(a) (emphasis added). FERC's regulations make this denial automatic, stating that "[u]nless [FERC] acts upon a request for rehearing within 30 days after the request is filed, the request is denied." 18 C.F.R. § 385.713(f). On the other hand, the statute also states that until the record is filed with the court of appeals, FERC may at any time, with reasonable notice, modify or set aside any finding or order it has made. 16 U.S.C. § 825*l*(a). Thus, even if Puget's rehearing request was denied as a matter of law thirty days after it was filed, this denial did not strip FERC of its ability to change its mind and modify its decision in the June 25, 2003 Order.

Moreover, we have already explained that petitions for rehearing keep market participants on notice that an alternative refund effective date, once rejected by FERC, might in the future be made the refund effective date. *Pub. Utils. Comm'n*, 462 F.3d at 1047 ("Further, some of the California Parties promptly sought rehearing of FERC's initial determination of the refund effective date in its August 23, 2000 Order. In short, market participants were quickly apprised that the original refund effective date might be subject to revision."). Here, Puget filed a petition for rehearing challenging FERC's order dismissing its complaint. Thus, sellers in the Pacific Northwest — who were already on notice of Puget's complaint requesting a refund effective date — were sufficiently on notice that Puget's complaint and its attendant refund effective date were still potentially viable because Puget filed a petition for rehearing. Any reliance by sellers on the lack of a refund effective date " 'prior to the issuance of a final order was at their own risk.' " *Id.* (quoting December 19, 2001 Order, 97 FERC ¶ 61,275 at 62,198).

[8] Finally, the Refund Opponents argue that FERC was required to set a refund effective date, if at all, *before* instituting a § 206 refund proceeding. FERC acknowledges in its brief that "[t]he Commission never established an FPA § 206(b) refund effective date for this matter . . . ." However, the plain language of the FPA does not place any restriction on when FERC may set the refund effective date. *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1081 (9th Cir. 1999) ("Where the meaning of a statute is clear from the text, we need look no further."). Rather, the statute states that "[w]henever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date." 16 U.S.C. § 824e(b). The statute mandates the establishment of an effective date, but it does not mandate when FERC must establish it. To the extent the word "institutes" is ambiguous, connoting both that the date shall be established at the time the proceeding begins and that the date shall be established anytime FERC is involved in such a proceeding, we owe deference to FERC's interpretation of the ambiguous language. *Chevron*, 467 U.S. at 842-43. FERC made clear its interpretation when it announced that the statute would permit FERC to set the refund effective date at December 25, 2000. June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,366 n.25.

FERC's interpretation, which would permit it to set the refund effective date at any time, is consistent with the overall framework of the statute, which indicates the primary concern of Congress was to afford notice to market participants of the period of time during which they may be liable for refunds. The sixty-day rule provides notice to the market that if FERC ever decides to order refunds based on a given complaint, those refunds could cover a period beginning sixty days after the filing of that complaint, and no earlier. This is a permissible construction of the statute, and is supported by our prior decision regarding the California proceeding, in which we found that the "key question is whether the SDG & E complaint afforded sufficient notice to alert market participants that sales and purchases might be subject to refund." *Pub. Utils. Comm'n*, 462 F.3d at 1046. That opinion made clear that FERC has some discretion in setting " 'the earliest refund effective date allowed in order to give maximum protection to consumers,' " *id.* (quoting December 19, 2001 Order, 97 FERC ¶ 61,275 at 62,198), as long as that protection is balanced against fairness to market participants by providing them with the notice necessary to change their practices prior to the date refunds might start to accrue.

[9] In sum, we reject the procedural challenges raised by the Refund Opponents and hold that Puget's complaint requested a refund effective date, FERC's dismissal of Puget's complaint did not disturb FERC's ability to set the refund effective date, and FERC was not required to formally set the refund effective date prior to instituting a § 206 refund proceeding. We also hold that Puget's complaint was not withdrawn as a matter of law because the Refund Proponents timely opposed Puget's notice of withdrawal. Accordingly, FERC had the authority to order refunds for transactions in the Pacific Northwest spot market during the permissible time period, although it declined to do so on the merits.

IV

The California Parties challenge FERC's decision to exclude from the Pacific Northwest refund proceeding purchases of energy made by the California Energy Resources Scheduling ("CERS") division in the Pacific Northwest spot market. CERS, a division of the California Department of Water Resources, began purchasing wholesale power on behalf of California consumers in the California and Pacific Northwest spot markets during the energy crisis. *See Pub. Utils. Comm'n*, 462 F.3d at 1042. FERC ruled that the CERS transactions were outside the scope of the Pacific Northwest refund proceeding because the Puget complaint, on which the proceeding was based, focused on sales of energy "into" the Pacific Northwest, whereas purchases made by CERS were actually purchases "into" California, where the energy was consumed. November 10, 2003 Order, 105 FERC ¶ 61,183 at 61,964 n.43. In addition, FERC adopted the ALJ's finding that the CERS deliveries of energy took place in California, not in the Pacific Northwest. *Id.* FERC reaffirmed this decision when it denied the California Parties' request for rehearing. February 9, 2004 Order, 106 FERC ¶ 61,109 at 61,368 ("Clearly, Puget's complaint focus was on transactions into the Pacific Northwest, and as the ALJ explained, the bilateral transactions involving CERS were sales into California and not into the Pacific Northwest."). The February 9, 2004 Order also claimed that the ALJ had found that a witness for CERS testified that deliveries actually occurred in California, not in the Pacific Northwest. *Id.*

[10] We cannot accept such a constrained reading of the Puget complaint. First, FERC's factual finding that the energy purchased by CERS was delivered in California is not supported by substantial evidence. The ALJ never explicitly found that a CERS witness admitted that the energy deliveries took place in California. The section in which the ALJ discusses the CERS witness is actually a recitation of arguments made by the Refund Opponents. September 24, 2001 ALJ Report, 96 FERC ¶ 63,044 at 65,312. By contrast, the ALJ's recommendations focus solely on the scope of the Puget complaint. *Id.* at 65,331. The ALJ's proposed findings of fact state that deliveries took place in California without mentioning the CERS witness and without clarifying the basis for this proposed finding. *Id.* at 65,385-86 (Proposed Findings of Fact 2 and 28). FERC, on the other hand, cites to pages in the transcript of the ALJ evidentiary proceeding where a CERS employee confirmed that physical delivery is taken within the control area of the Los Angeles Department of Water and Power. The record shows, however, that even if physical delivery of the energy took place in California, the legal change of ownership of the energy occurred, pursuant to the Confirmation Agreement, at interconnections located within the Pacific Northwest. There is no evidence in the record suggesting that the change of ownership occurred in California, rather than in the Pacific Northwest.

Furthermore, FERC's attempt to distinguish between the location where a change of ownership of electricity occurs and the location where that electricity physically changes hands is not supported by either the law or the governing contractual agreements between CERS and energy sellers in the Pacific Northwest.

Having established that FERC could not have found, on this record, that the CERS purchases occurred in California, we must determine whether sales to CERS were outside the scope of the Pacific Northwest refund proceeding even if the legal change of ownership occurred in the Pacific Northwest. In so doing, we are mindful that we owe deference to FERC's interpretation of the scope of Puget's complaint. *Amerada Hess Pipeline Corp. v. FERC*, 117 F.3d 596, 604 (D.C. Cir. 1997); *Burlington N. R.R. Co. v. ICC*, 985 F.2d 589, 595 (D.C. Cir. 1993).

[11] We conclude that FERC's interpretation of the scope of Puget's complaint is arbitrary, capricious, and an abuse of discretion. On its face, Puget's complaint provides no indication of an intent to exclude refunds for energy purchased in the Pacific Northwest spot market for consumption outside the geographical area. The complaint petitioned FERC to cap prices at which sellers subject to FERC's jurisdiction "may sell capacity or energy into the Pacific Northwest's wholesale power markets. [Puget] seeks an order that prospectively caps the prices for wholesale sales of energy or capacity into the Pacific Northwest . . . ." This language indicates that the complaint was concerned with (1) sellers who were (2) selling energy in the Pacific Northwest market. The complaint is silent as to any constraint on the identity of the buyers or where the energy ultimately would be consumed.

FERC's interpretation of Puget's complaint is also inconsistent with its prior interpretation of the complaint filed by SDG & E in the California proceeding. That complaint similarly petitioned FERC "for an emergency order capping . . . the prices at which sellers subject to its jurisdiction may bid energy or ancillary services *into* California's two large bulkpower markets . . . ." (Emphasis added.) In contrast to its interpretation of the Puget complaint, FERC did not interpret the California complaint as limiting refunds to entities that purchased energy for ultimate consumption in California, and in fact some parties who benefitted from refunds in the California proceeding did not consume the fruits of their purchases in California. FERC's interpretation of the California complaint is the better one, and one upon which we relied, and its conflicting interpretation of a similar complaint in a similar refund proceeding renders its subsequent interpretation unworthy of deference. *Koch Gateway Pipeline Co. v. FERC*, 136 F.3d 810, 815-16 (D.C. Cir. 1998) ("[W]here an agency treats similar situations differently without reasoned explanation, its decision will be vacated as arbitrary and capricious."). Both complaints served to notify all sellers of energy in the respective markets that they may be liable for refunds for sales of energy in those markets, regardless of where the energy would be consumed.

In addition, FERC argued in the SDG & E case that the CERS transactions were the subject of other regulatory proceedings. *Pub. Utils. Comm'n*, 462 F.3d at 1064. Other entities pointed to the Pacific Northwest proceeding to argue that the CERS transactions were outside the scope of the California proceeding. We accepted these arguments and excluded the CERS transactions from that case. *Id.* at 1063-64. It would be inconsistent with our reasoning to exclude the transactions from the California proceeding based in substantial part on the existence of this proceeding involving the Pacific Northwest market, and then to exclude the transactions from this proceeding based on the argument that the transactions were conducted in the California market.

[12] We therefore conclude that FERC must, on remand, include the CERS transactions when it determines whether refunds are warranted for sales in the Pacific Northwest spot market.

V

Finally, we must determine whether FERC was required to take into account evidence of market manipulation filed by the parties after the ALJ hearing. FERC permitted the Refund Proponents to submit new evidence of market manipulation that emerged after the ALJ's evidentiary proceeding. December 19, 2002 Order, 101 FERC ¶ 61,304 at 62,221 ("We will allow the movants and other parties in this proceeding to conduct additional discovery for the period January 1, 2000 to June 20, 2001."). The Refund Proponents argued that new evidence had emerged as a result of various investigations into the practices of Enron. *Id.* at 62,219. *See Lockyer*, 383 F.3d at 1015 (explaining many of Enron's manipulative tactics). Despite a great deal of new evidence submitted to FERC in the spring of 2003, however, FERC failed to take any of it into account, relying instead on the ALJ's factual findings from September 2001, which were made prior to the Enron revelations. *See* June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,366-70. Regarding the new evidence, FERC's subsequent order denying rehearing stated merely: "In reaching its decision to terminate the proceeding, the Commission considered the complete record, including the material submitted in the March 2003 filings." November 10, 2003 Order, 105 FERC ¶ 61,183 at 61,960.

[13] In order for an agency to avoid making an arbitrary and capricious determination, it must "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.' " *Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)). An agency's ruling will be deemed arbitrary and capricious where the agency "entirely failed to consider an important aspect of the problem [or] offered an explanation for its decision that runs counter to the evidence before the agency." *Id. See also La. Pub. Serv. Comm'n v. FERC*, 184

F.3d 892, 898 (D.C. Cir. 1999) (requiring FERC to examine submitted data); *Laclede Gas Co. v. FERC*, 997 F.2d 936, 948 (D.C. Cir. 1993) (requiring FERC to provide adequate explanation). Moreover, an agency must account for evidence in the record that may dispute the agency's findings. *Universal Camera Corp. v. Nat'l Labor Relations Bd.*, 340 U.S. 474, 488 (1951) ("The substantiality of evidence must take into account whatever in the record fairly detracts from its weight.").

[14] Given these requirements, FERC's failure to consider or examine the new evidence showing intentional market manipulation in California and its potential ties to the Pacific Northwest was arbitrary and capricious. The Refund Proponents argue that the new evidence suggests, among other things, that: sellers of electricity in the Pacific Northwest were involved in schemes to withhold energy and to assist Enron in creating false congestion; Enron used markets outside of California in order to advance its tactics in California; Enron may have implemented fraudulent schemes outside California markets; and utilities in the Pacific Northwest violated posting requirements in transactions with Enron. Even assuming all of these transactions occurred in the California spot market, the fact that Pacific Northwest sellers were apparently involved in Enron's manipulation indicates that FERC must at least consider the possibility that the Pacific Northwest spot market was not, as the ALJ found, functional and competitive. June 25, 2003 Order, 103 FERC ¶ 61,348 at 62,366-67. FERC's findings, based on the record established by the ALJ in 2001, "that other factors related to supply and demand fundamentals contributed to the dramatic prices in the region," *id.* at 62,367, and that "no evidence of such 'lawlessness' has been shown with regard to any specific transaction in the Pacific Northwest spot market," November 10, 2003 Order, 105 FERC ¶ 61,183 at 61,966, must be reevaluated in light of this evidence.

[15] Moreover, we reject the contention by the Refund Opponents that FERC need not consider the new evidence because FERC already is addressing market manipulation in separate proceedings focusing on misconduct. Not only did FERC fail to rely on this reasoning below, *see Laclede Gas Co.*, 997 F.2d at 945 (FERC order "must stand or fall on the grounds articulated by the agency in that order") (internal quotation marks omitted), but we have already held that FERC's prosecutorial investigations cannot justify the denial of relief in contested adjudications before the Commission, *Pub. Utils. Comm'n*, 462 F.3d at 1048-51. Accordingly, we remand to permit FERC to examine this new evidence of market manipulation in detail and account for it in any future orders regarding the award or denial of refunds in the Pacific Northwest proceeding. FERC may also find it necessary to call for additional fact-finding if the record evidence of market manipulation is not sufficient to enable FERC to make a reasoned decision. In view of this remand, we offer no opinion on FERC's findings based on the record established by the ALJ.

VI

At this juncture we find it preferable to reserve judgment on other issues raised by the parties. As such, we decline to reach the merits of FERC's ultimate decision to deny refunds but urge the Commission to further consider its decision, on remand, in light of the related decisions of this court that followed FERC's final orders in the Pacific Northwest proceeding.

PETITION GRANTED IN PART; DENIED IN PART; REMANDED. Each party shall pay its own costs on appeal.

McKEOWN, Circuit Judge, concurring:

I concur in the opinion and the result, with the exception of the question of whether Puget Sound Energy is an "aggrieved party." Puget lacks standing because it was granted all the relief it sought (i.e., FERC granted price mitigation in the Pacific Northwest proceeding), and thus Puget is not "aggrieved" within the meaning of 16 U.S.C. § 825*l*(b). On this point, I agree with FERC's position. A party seeking appeal must establish, at a minimum, "injury in fact" to a protected interest. *Shell Oil Co. v. FERC*, 47 F.3d 1186, 1200 (D.C. Cir. 1995). Puget has not done so.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

WINGS FIELD PRESERVATION ASSOCIATES, L.P., Petitioner	:	
v.	:	No. 503 M.D. 1999 Argued: March 8, 2000
COMMONWEALTH OF PENNSYLVANIA, DEPARTMENT OF TRANSPORTATION, MONTGOMERY COUNTY and WHITPAIN TOWNSHIP, Respondents	:	

BEFORE: HONORABLE ROCHELLE S. FRIEDMAN, Judge
HONORABLE JAMES R. KELLEY, Judge
HONORABLE JOSEPH F. McCLOSKEY, Senior Judge

OPINION BY JUDGE KELLEY[1] FILED: May 2, 2001

Wings Field Preservation Associates, L.P., (Wings Field) has filed a motion for partial summary judgment (Wings Field Motion) in connection with the petition for review in the nature of a complaint for declaratory judgment (Petition) previously filed by Wings Field in this Court's original jurisdiction. The Commonwealth of Pennsylvania, Department of Transportation (DOT), also has filed a motion for summary judgment (DOT's Motion) with respect to the Wings

[1] The instant case was reassigned to the author on October 3, 2000.

Field Petition. Both motions are presently before this Court for disposition.[2] We grant summary judgment in favor of Wings Field.

The following material facts are undisputed. Wings Field is the owner of Wings Field Airport (Airport), a seventy-year-old privately owned, public use airport located in Whitpain Township (Township), Montgomery County. In June 1999, Wings Field submitted a pre-application to DOT seeking a grant to pay for a runway project at the Airport. DOT would not consider the request because Wings Field lacked the township and county approvals required by Section 2210 of the County Code.[3] On July 29, 1999, the Township voted not to approve the project,

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[2] After the pleadings are closed, as here, "any party may move for summary judgment in whole or in part as a matter of law … whenever there is no genuine issue of any material fact as to a necessary element of the cause of action or defense which could be established by additional discovery or expert report." Pa. R.C.P. No. 1035.2(1).

[3] Section 2210 of The County Code, Act of August 9, 1955, P.L. 323, added by Section 4 of the Act of June 18, 1998, P.L. 619, 16 P.S. §2210, states:

> No Federal or State money from the Aviation Restricted Revenue Account in the Motor License Fund or any other State money may be expended for airport operations or airport development in any county of the second class A having a population in excess of 675,000 persons without the approval of the municipality or municipalities wherein such airport is situated.

Section 1 of the Aviation Code, 74 Pa. C.S. §5103, establishes the Aviation Restricted Account. Section 530 of the Act of April 9, 1929, P.L. 177, added by Section 2 of the Act of July 11, 1996, P.L. 619, 71 P.S. §210, regulates the funding of the Aviation Restricted Account.

and, because of the Township's action, Montgomery County decided not to consider the project.[4]

On September 3, 1999, Wings Field filed its Petition in this Court's original jurisdiction, seeking a declaratory judgment.[5] Specifically, Wings Field asked this Court to declare Section 2210 of the County Code unconstitutional because: (1) it is special legislation prohibited by Article III, Section 32 of the Pennsylvania Constitution;[6] (2) it violates Wings Field's equal protection rights

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[4] The Township argues in its brief that the averments in the Wings Field Motion are based improperly on testimonial evidence. Township's brief at 6-9. However, the facts set forth here are based solely on admissions contained in the pleadings. See Petition, paras. 2, 22, 33, 35, 41-42, exh. B; Township's Answer, paras. 2, 22, 33, 41-42; County's Answer, paras. 2, 33, 35, 42; DOT's Answer, paras. 2, 33.

[5] Wings Field also filed an Application for Special Relief in the Nature of a Preliminary Injunction. After a hearing on the matter, this Court issued a Memorandum Opinion and Order, dated October 29, 1999, denying the application.

Subsequently, the Township filed preliminary objections to the Petition, asking this Court to strike certain portions of the Petition and claiming that Wings Field was precluded from seeking a declaratory judgment because it did not appeal the Township's disapproval of the runway project to the Court of Common Pleas of Montgomery County. On December 1, 1999, following argument, this Court issued a Memorandum and Order striking a portion of the Wings Field Petition and overruling the Township's remaining preliminary objections.

[6] Article III, Section 32.1 of the Pennsylvania Constitution states, in pertinent part, as follows:

> The General Assembly shall pass no local or special law in any case which has been or can be provided for by general law and specifically the General Assembly shall not pass any local or special law … [r]egulating the affairs of counties, cities, townships, wards, boroughs or school districts….

(Continued....)

under the Pennsylvania and United States Constitutions, and; (3) it violates Wings Field's due process rights under the Pennsylvania and United States Constitutions.

On December 23, 1999, Wings Field filed its motion for partial summary judgment,[7] and DOT subsequently filed its motion for summary judgment.

I. Special Law

The first issue presented is whether Section 2210 of the County Code is unconstitutional because it is special legislation prohibited by Article III, Section 32 of the Pennsylvania Constitution.[8]

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[7] The Township and DOT have filed briefs opposing the Wings Field Motion; however, Montgomery County has stated in its brief that it takes no position on the merits of the Wings Field Motion. The Aircraft Owners and Pilots Association, the National Air Transportation Association, the National Business Aviation Association and the Aviation Council of Pennsylvania have filed an amicus brief in support of the Wings Field Motion.

[8] An act of the General Assembly cannot be declared unconstitutional unless it clearly, palpably and plainly violates the constitution; hence, a heavy burden befalls a constitutional challenge to legislative enactments. Danson v. Casey, 382 A.2d 1238 (Pa. Cmwlth. 1978), aff'd, 484 Pa. 415, 399 A.2d 360 (1979).

Our Supreme Court has referred to Article III, Section 32 of the Pennsylvania Constitution as the equal protection portion of the constitution. See Kroger Co. v. O'Hara Township, 481 Pa. 101, 392 A.2d 266 (1978). In fact, our Supreme Court has analyzed Article III, Section 32 and federal equal protection claims simultaneously. See Harristown Development Corp. v. Department of General Services, 532 Pa. 45, 614 A.2d 1128 (1992). However, the Court has also stated that the language of Article III, Section 32 is substantially different from the equal protection clause of the federal constitution, and that we are not free to treat that language as though it was not there. See Kroger. Thus, our analysis will focus on the language of Article III, Section 32 of the Pennsylvania Constitution.

A. Article III, Section 32

Article III, Section 32 of the Pennsylvania Constitution states that the General Assembly shall pass no "special law" regulating the affairs of counties or townships. Our Supreme Court has explained that:

> [A] special law is the opposite of a general law. A special law is not uniform throughout the state or applied to a class. A general law is. It is well known that the Legislature has classified cities and counties.[9] A law dealing with all cities or all counties of the same class is not a special law, but a general law, uniform in its application. But a law dealing with but one county of a class consisting of ten, would be local or special.

Appeal of Torbik, 548 Pa. 230, 241, 696 A.2d 1141, 1146 (1997) (quoting Heuchert v. State Harness Racing Commission, 403 Pa. 440, 446-47, 170 A.2d 332, 336 (1961)).

When Article III, Section 32 became part of Pennsylvania's constitution in 1873, its purpose was to prevent the General Assembly from creating classifications in order to grant privileges to one person, one company or one county.[10] However, Article III, Section 32 was not intended to prevent the

[9] The General Assembly has divided the counties of the Commonwealth into nine classes based on the population figures of the United States census. Sections 210 and 211 of the County Code, 16 P.S. §§210 and 211. Second class counties A are those counties having a population of 500,000 and more but less than 800,000 inhabitants. Section 210(2.1) of the County Code.

[10] See Dale F. Rubin, Public Aid to Professional Sports Teams – A Constitutional Disgrace: The Battle to Revive Judicial Rulings and State Constitutional Enactments Prohibiting Public Subsidies to Private Corporations, 30 U. Tol. L. Rev. 393, 399-400 (1999); see also Robert E. Woodside, Pennsylvania Constitutional Law 576-77 (1985) (stating that, in the period

(Continued....)

General Assembly from creating statutory classifications to meet diverse needs. Danson v. Casey, 382 A.2d 1238 (Pa. Cmwlth. 1978), aff'd, 484 Pa. 415, 399 A.2d 360 (1979); Higher Education Assistance Agency v. Abington Memorial Hospital, 356 A.2d 837 (Pa. Cmwlth. 1976), aff'd, 478 Pa. 514, 387 A.2d 440 (1978). Thus, Article III, Section 32 allows a legislative classification that has some rational relationship to a proper state purpose.[11] Danson; Tosto v. Pennsylvania Nursing Home Loan Agency, 460 Pa. 1, 331 A.2d 198 (1975). Our Supreme Court has explained that:

> Classification is allowed because of necessity [that springs] from manifest peculiarities clearly distinguishing those of one class from each of the other classes and imperatively demanding legislation for each class separately that would be useless and detrimental to the others.

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leading up to 1873, most of the local or special acts conferred a direct benefit on an individual or corporation); and Higher Education Assistance Agency v. Abington Memorial Hospital, 356 A.2d 837 (Pa. Cmwlth. 1976), aff'd, 478 Pa. 514, 387 A.2d 440 (1978) (stating that the purpose of Article III, Section 32 was to put an end to the flood of privileged legislation for particular localities and for private purposes).

[11]

> [C]lassification is a legislative question, subject to judicial revision only so far as to see that it is founded on real distinctions in the subjects classified, and not on artificial or irrelevant ones, used for the purpose of evading the constitutional prohibition. If the distinctions are genuine, the courts cannot declare the classification void, though they may not consider it to be on a sound basis. The test is not wisdom, but good faith in the classification.

In re Annual Audit and Financial Report of Township of Penn, Westmoreland County, Pennsylvania for the Year 1984, 543 A.2d 171, 173 (Pa. Cmwlth. 1988) (citation omitted).

Allegheny County v. Monzo, 509 Pa. 26, 44, 500 A.2d 1096, 1105 (1985) (quoting Commonwealth ex rel. Brown v. Gumbert, 256 Pa. 531, 100 A. 990 (1917)); see also Appeal of Ayars, 122 Pa. 266, 16 A. 356 (1889). It is such manifest peculiarities within a legislative class that provide the only permissible justification for a legislative override of the uniformity required by Article III, Section 32.

Uniformity is a foundational principle upon which our Constitution is based, both generally, and specifically in relation to local government.[12] This uniformity is the crux of the issue at hand. When dealing with distinctions based upon population, Article III, Section 20 of the Pennsylvania Constitution makes clear that only "laws passed relating to *each class* . . . shall be deemed general legislation." (Emphasis provided). The classes referenced in that language are those that Article III, Section 20 empowers the General Assembly to establish, namely, those dividing the counties of Pennsylvania into nine population-based classes as established in Sections 210 and 211 of the County Code. The establishment of those classes by the General Assembly, pursuant to the grant of authority of Article III, Section 20, enables the General Assembly to employ flexibility in addressing the unique needs of diversely populated counties throughout the Commonwealth in such a way as to treat similarly populated counties with the uniformity that our Constitution requires.

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[12] In addition to our Supreme Court's explanation of Article III, Section 32's uniformity requirement, Article IX, Section 1 of the Pennsylvania Constitution expressly mandates that the General Assembly's provision by general law "shall be uniform as to all classes of local

(Continued....)

Any argument that legislation such as Section 2210 is necessary to provide the General Assembly with added flexibility in dealing with diverse needs among municipalities serving varying population levels is refuted by an examination of the prior provisions of the earlier constitutional section corresponding to Article III, Section 20. Former Section 34 of Article III empowered the General Assembly to classify municipalities within our Commonwealth with language identical to present Section 20 of Article III, with one notable exception: former Section 34 specifically restricted the number of classes that could be employed by the General Assembly in dividing the various municipalities within the Commonwealth. By replacing former Section 34 with current Section 20 in 1923, the General Assembly eliminated the restrictions on the number of legislative classifications, thereby freeing the General Assembly to divide counties and other municipalities into as many classes as the General Assembly deemed necessary. The requirement of uniformity within those classifications was also part of the content of former Section 34, and remains in current Section 20. If the General Assembly were to find that a particular class's needs were not being met by the current classifications contained in Sections 210 and 211 of the County Code, they are, since 1923, free to amend those Sections. With Section 2210, however, the General Assembly's treatment of the class established in Section 210 of the County Code fails on its face to meet Article III,

government regarding procedural matters."

Section 32's clear mandate to uniformly relate Section 2210 to the class to which it applies.[13]

B. Section 2210 of the County Code

On April 22, 1998, the General Assembly enacted House Bill No. 2281 as the General Appropriation Act of 1998 (Appropriation Act), Act of April 22, 1998, P.L. 1341. Section 821 of the Appropriation Act stated that local approval would be required for the expenditure of federal or state money for airports "in a county of the second class A." Thus, as of April 22, 1998, all three counties of the second class A possessed the right of local approval for airport funding. However, less than two months later, on June 18, 1998, the General Assembly enacted Senate Bill No. 220, which repealed Section 821's local approval provision and added Section 2210 to the County Code.

Section 2210 of the County Code prohibits the expenditure of federal or state money for airport operations or development "in any county of the second class A having a population in excess of 675,000 persons without the approval of the municipality or municipalities wherein such airport is situated." 16 P.S. §2210. The parties have stipulated that Montgomery County is the only county of the second class A with a population in excess of 675,000 persons. Memorandum

[13] The Township argues that Article III, Section 20 creates an exception to the prohibition against special laws. Township's brief at 9. We disagree. Our Supreme Court has recognized that the General Assembly has constitutional authority to classify counties and townships by population; however, despite that authority, the Court has made clear that the General Assembly may not distinguish between counties within a class without a valid reason. Appeal of Torbik; Heuchert.

Opinion of 10/29/99 at 2. Bucks County and Delaware County are also counties of the second class A, but they have fewer than 675,000 persons.[14]

In the case *sub judice*, then, our initial mandate is to simply inquire whether the law in question is " not uniform . . . [as] applied to a class." Appeal of Torbik, 548 Pa. at 241, 696 A.2d at 1146 (citations omitted).

Section 2210 does not establish a new class such as those defined in Section 210 of the County Code. Additionally, Section 2210 does not modify the classes established in Section 210 as provided for in Section 211 of the County Code. What Section 2210 does do is to vest in one county a singular and unique power that cannot be exercised by all of the members of the class to which that one county has already been legislatively assigned. That the classification in the instant case concerns a single county that is a member of a class comprised of three counties, as contrasted with our Supreme Court's articulation that "a law dealing with but one county of a class of ten would be local or special", Id., does not distinguish this case. A law's special or general nature is not dependent upon the size of the class which is not treated uniformly – it is determined by that treatment's uniformity, or lack thereof, in relation to the entire class, notwithstanding the number of members therein. In granting to Montgomery

[14] This Court has taken judicial notice that the population of Bucks County in 1990 was 541,174, and, according to the July 1, 1998 estimates of the U. S. Bureau of the Census, the population of Bucks County has risen to 587,942. With respect to Delaware County, its 1990 population of 547,651 has declined to 542,593 as of July 1, 1998. Memorandum Opinion of 10/29/99 at 4-5.

County the exclusive power to control the approval of the expenditure of federal or state money for airport operations or development, without granting that same power to the other members of the same class, the General Assembly has enacted a law that is not uniform in its application to the class at issue.

We next must inquire whether some manifest peculiarities of Montgomery County clearly distinguish it from the other two counties of its class. Monzo. DOT asserts in its brief that, in counties of the second class A with more than 675,000 persons, the burdens and concerns incident to airport development are greater than or different from other counties of the second class A. DOT's brief at 10. The Township echoes DOT's argument in asserting that the most heavily populated suburban counties need separate legislation because of local environmental concerns, traffic control, fire prevention, policing and other community interests. Township's brief at 17.

We do not agree that such local concerns are unique to Montgomery County, to the exclusion of the other two counties in the same class, and we do not agree that these concerns manifest peculiarities endemic solely to Montgomery County. DOT and Township fail to recognize that every local concern listed by them is already addressed by local ordinances and zoning restrictions. Further, local concerns are amply provided for in the grant analysis procedures under which the state and federal grants concerning airport expansion and maintenance are made.[15] The fact that safeguards regarding these local concerns exist

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[15] See generally, 67 Pa. Code 473.8 (establishing as a factor in the grant selection process the impact of an airport project on the local area in which it is located); 67 Pa. Code 473.10

(Continued....)

independently of Section 2210, and apply to all three counties of the class at issue, further evidence an absence of any articulable manifest peculiarities that distinguish Montgomery County from the other members of its class.

Accordingly, Section 2210 is special legislation under the mandate of Article III, Section 32, the classifications of Article III, Section 20, and the precedents of our Supreme Court. We therefore grant Wings Field's Motion, and deny DOT's Motion, on this issue.

II. Equal Protection

Notwithstanding the previous dispositive analysis and conclusion, we turn now to the second issue before us: whether Section 2210 of the County Code is unconstitutional because it violates Wings Field's equal protection rights.[16]

Because the classification in Section 2210 of the County Code does not implicate a suspect class, a fundamental right, an important right or a sensitive classification, the provision will be upheld if there is any rational basis for the classification. See Curtis v. Kline, 542 Pa. 249, 666 A.2d 265 (1995). In applying the rational basis test, Pennsylvania courts have adopted a two-step analysis. First, we must determine whether Section 2210 of the County Code seeks to promote any

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(requiring the acquisition of all necessary permits and licenses from local agencies as a condition precedent to receiving a grant).

[16] The Fourteenth Amendment to the U. S. Constitution provides that no State shall deny to any person within its jurisdiction the equal protection of the laws. Article I, Section 1 of the Pennsylvania Constitution provides that all are born equally free and independent and have certain inherent and indefeasible rights, among which are those of acquiring, possessing and protecting property and of pursuing happiness.

legitimate state interest or public value. Id. If so, we must next determine whether the classification adopted in Section 2210 of the County Code is reasonably related to accomplishing that articulated state interest. Id.

Section 2210 of the County Code essentially gives municipalities in counties with populations of 675,000 to 800,000 veto power over the expenditure of state and federal government funds for the operation and development of airports located within those municipalities. We can conceive of no legitimate state interest in giving any municipality *total* control over airport funding decisions.

With respect to federal funds, we note with alarm that the Commonwealth's participation in the federal government's state block grant program is governed by 49 U.S.C. §47128. Subsection (a) of that provision authorizes the promulgation of regulations to carry out the state block grant program. The regulation at 14 C.F.R. §156.6(c) states:

> Unless otherwise agreed by a participating State and the [federal] Administrator in writing, a participating State shall not delegate or relinquish, either expressly or by implication, any State authority, rights, or power that would interfere with the State's ability to comply with the terms of a State block grant agreement.

Section 47128(c) of the federal statute requires that, in administering the state block grant program, the Commonwealth must provide for "meeting critical safety and security needs and … [address] the needs of the national airport system…." 49 U.S.C. §47128(c).

Where, as here, the Commonwealth has relinquished some of its power over airport funding to certain municipalities, the Commonwealth has also relinquished its ability to provide for meeting critical airport safety and security needs or to address national airport system needs with respect to particular airports. The municipalities will control funding for their own airports, and Section 2210 of the County Code does not require that those municipalities consider critical airport safety and security needs or national airport system needs in deciding whether to approve airport funding. Unless the Commonwealth has a written agreement with the federal government allowing for the relinquishment of power to municipalities in certain counties, Section 2210 of the County Code appears to violate 14 C.F.R. §156.6(c). Empowering a local municipality to so violate a Commonwealth obligation under a federal statute and regulation is the antithesis of the promotion of a legitimate state interest or public value.

Township attempts to articulate a rational basis for the singular grant to Township of local control contained in Section 2210 by again advancing local concerns, and therefore a need for local control, over environmental, traffic control, fire prevention, and policing matters. As discussed above, however, these local concerns are addressed by pre-existing local ordinances, local zoning restrictions, and federal and state grant analysis procedures applicable to state and federal grants concerning airport expansion and maintenance. No rational basis exists, therefore, for granting further local control to address local concerns that are already addressed by existing ordinances and procedures.

DOT is unable to articulate any rational basis for the classification at issue, averring simply that the General Assembly *could* have determined that the burdens and concerns of airport expansion and development *might* benefit from local input. While the General Assembly theoretically *could* have made such a determination, it is clear that neither DOT nor Township can conceive of, yet alone articulate, what that benefit *might* be. This Court is also unable to conceive of any potential rational basis for the classification established by Section 2210, to the exclusion of the other counties within that class. Such an absence of a rational basis for Section 2210 of the County Code merits a grant of Wings Field's Motion, and a denial of DOT's Motion, on this issue.

III. Delegation

Notwithstanding the previous dispositive analyses and conclusions, we turn now to the final issue before us: whether Section 2210 of the County Code is unconstitutional because it violates Wings Field's due process rights by delegating authority over airport funding to municipalities without providing guidelines or standards.

Article II, Section 1 of the Pennsylvania Constitution states that the legislative power of this Commonwealth shall be vested in a General Assembly. The General Assembly may not delegate its legislative power; however, the General Assembly may confer authority and discretion upon another body in connection with the execution of a law. Chambers Development Co., Inc. v. Commonwealth, ex rel. Allegheny County Health Department, 474 A.2d 728 (Pa. Cmwlth. 1984). In doing so, the legislation must contain adequate standards to guide and restrain the exercise of the delegated administrative function.[17] DePaul v. Kauffman, 441 Pa. 386, 272 A.2d 500 (1971); Chambers Development Co. To determine whether the General Assembly has established adequate standards, this Court must look to the language of the statute, the underlying purpose of the statute and its reasonable effect. Executive Life Insurance Co. v. Commonwealth, 606 A.2d 1282 (Pa. Cmwlth. 1992), aff'd, 533 Pa. 321, 623 A.2d 322 (1993); Chambers Development Co.

The language of Section 2210 of the County Code contains no standards to guide and restrain municipalities in their decisions on airport funding. The provision contains no stated purpose, and the reasonable effect of the provision is that municipalities will make their airport funding decisions based solely on local considerations. This means that municipalities, not the General Assembly, will be making policy choices about airport funding in their localities.[18] Thus, Section 2210 of the County Code permits municipalities to ignore the federal

[17] In setting forth standards for guidance, the General Assembly declares legislative policy. Blackwell v. State Ethics Commission, 523 Pa. 347, 567 A.2d 630 (1989). Thus, where the General Assembly fails to provide standards for guidance, the General Assembly has improperly delegated legislative power. Id.

[18] DOT argues that the General Assembly has delegated authority to municipalities only to gather information about the impact of airport development upon a particular municipality. DOT's brief at 12. Clearly, this is not the case. In Section 2210 of the County Code, the General Assembly has given municipalities the power to establish their own policies with respect to funding for airports located in those municipalities.

DOT also argues that municipal government bodies are bound by their oaths of office to act in accordance with the laws of the state and federal government. DOT's brief at 12. However, Section 2210 is a law of the state, and it gives municipalities absolute power over airport funding.

policy, which has been imposed upon the Commonwealth, that airport funding decisions be based, in part, on safety and security needs and the needs of the national airport system.[19] See 49 U.S.C. §47128(c).

Because Section 2210 is an improper delegation of legislative power to the Township, we grant the Wings Field Motion and deny DOT's Motion on this issue.

IV. Conclusion

Accordingly, we grant Wings Field's motion for partial summary judgment, deny DOT's motion for summary judgment, and enter declaratory judgment in favor of Wings Field in accordance with the foregoing opinion.

JAMES R. KELLEY, Judge

[19] The Township argues that the General Assembly had no need to provide standards because the Township has legislative powers for purposes of local self-government under The Second Class Township Code, Act of May 1, 1933, P.L. 103, 53 P.S. §§65101-68701. Township's brief at 19-21. However, the legislative power here is the General Assembly's legislative power over federal and state funding for airports, not the Township's legislative power to self-govern.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

WINGS FIELD PRESERVATION ASSOCIATES, L.P., Petitioner	:	
v.	:	No. 503 M.D. 1999
COMMONWEALTH OF PENNSYLVANIA, DEPARTMENT OF TRANSPORTATION, MONTGOMERY COUNTY and WHITPAIN TOWNSHIP, Respondents	:	

ORDER

AND NOW, this 2nd day of May, 2001, it is hereby ordered that: the motion of Wings Field Preservation Associates, L.P. (Wings Field) for partial summary judgment is granted; the motion of Department of Transportation (DOT) for summary judgment is denied, and; declaratory judgment is hereby granted in favor of Wings Field in accordance with the foregoing opinion.

JAMES R. KELLEY, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

WINGS FIELD PRESERVATION ASSOCIATES, L. P., Petitioner	:	
v.	:	No. 503 M. D. 1999 Argued: March 8, 2000
COMMONWEALTH OF PENNSYLVANIA, DEPARTMENT OF TRANSPORTATION, MONTGOMERY COUNTY and WHITPAIN TOWNSHIP, Respondents	:	

BEFORE: HONORABLE ROCHELLE S. FRIEDMAN, Judge
HONORABLE JAMES R. KELLEY, Judge
HONORABLE JOSEPH F. McCLOSKEY, Senior Judge

CONCURRING AND DISSENTING
OPINION BY JUDGE FRIEDMAN FILED: May 2, 2001

I respectfully dissent. The ultimate question with respect to the "special law" and "equal protection" issues is whether the General Assembly created a sub-class of counties of the second class A in order to grant a special privilege to Montgomery County or whether the General Assembly did so in order to meet the diverse needs of municipalities with airports located in counties having a population between 675,000 and 800,000. Unlike the majority, I believe there are genuine issues of material fact in this regard, and, thus, I would deny summary judgment as to the "special law" and "equal protection" issues.[20]

[20] I agree with the majority that section 2210 of The County Code, Act of August 9, 1955, P.L. 323, added by section 4 of the Act of June 18, 1998, P.L. 619, 16 P.S. §2210, constitutes an

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Article III, Section 32 of the Pennsylvania Constitution states that the General Assembly shall pass no "special law" regulating the affairs of counties or townships. Our supreme court refers to Article III, Section 32 as the equal protection provision of the Pennsylvania Constitution. See DeFazio v. Civil Service Commission of Allegheny County, 562 Pa. 431, 756 A.2d 1103 (2000); Harristown Development Corp. v. Department of General Services, 532 Pa. 45, 614 A.2d 1128 (1992); and Kroger Co. v. O'Hara Township, 481 Pa. 101, 392 A.2d 266 (1978). "We have repeatedly held that the underlying purpose of [Article III, Section 32] is analogous to the equal protection clause of the federal constitution and that our analysis and interpretation of the clause should be guided by the same principles that apply in interpretation of federal equal protection." DeFazio, 562 Pa. at 436, 756 A.2d at 1105.

> The essence of the constitutional principle of equal protection under the law is that like persons in like circumstances will be treated similarly.[21] However, it

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improper delegation of legislative power. Therefore, like the majority, I would grant summary judgment on that issue.

[21] The majority transforms this concept into a principle of uniformity, i.e., the "uniform" treatment of counties within a defined class of counties. (Majority op. at 7, 10-11.) In doing so, the majority relies upon Appeal of Torbik, 548 Pa. 230, 241, 696 A.2d 1141, 1146 (1997) (emphasis added), in which our supreme court stated that a "special law is not uniform throughout the state or applied to a class." However, the issue in Torbik was whether a tax law was special legislation under Article III, Section 32. Thus, the question for the court in Torbik implicated Article VIII, Section 1 of the Pennsylvania Constitution, which states that "[a]ll taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws." Pa. Const. art. VIII, §1 (emphasis added). Because the case before us here does not implicate the uniformity clause of Article VIII, Section 1, I believe it is improper to discuss the "special law" issue in terms of

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> does not require that all persons under all circumstances enjoy identical protection under the law. The right to equal protection under the law does not absolutely prohibit the Commonwealth from classifying individuals for the purpose of receiving different treatment, and does not require equal treatment of people having different needs. The prohibition against treating people differently under the law does not preclude the Commonwealth from resorting to legislative classifications, provided that those classifications are reasonable rather than arbitrary and bear a reasonable relationship to the object of the legislation. In other words, a classification must rest upon some ground of difference which justifies the classification and have a fair and substantial relationship to the object of the legislation.

Id. at 436-37, 756 A.2d at 1106 (quoting Curtis v. Kline, 542 Pa. 249, 666 A.2d 265 (1995)) (emphasis added).

The legislation at issue here is section 2210 of The County Code (Code), Act of August 9, 1955, P.L. 323, added by section 4 of the Act of June 18, 1998, P.L. 619, 16 P.S. §2210 (emphasis added), which provides:

> No Federal or State money from the Aviation Restricted Revenue Account in the Motor License Fund or any other State money may be expended for airport operations or airport development in any county of the second class A having a population in excess of 675,000 persons without the approval of the municipality or municipalities wherein such airport is situated.

uniformity.

It is clear from the plain language of section 2210 of the Code that the General Assembly has created a sub-class of counties of the second class A. Our inquiry, then, is whether there is some ground of difference that justifies the sub-classification and has a fair and substantial relationship to the object of the legislation.[22]

The Department of Transportation (DOT) asserts in its brief that, in counties of the second class A with more than 675,000 persons, the burdens and concerns incident to airport development are greater than, or different from, other counties of the second class A. (DOT's brief at 10.) Whitpain Township asserts that the most heavily populated suburban counties need separate legislation because of local environmental concerns, traffic control, fire prevention, policing

[22] The majority states that uniformity of treatment within the class of counties of the second class A is the crux of the matter before us. (Majority op. at 7, 10-11.) However, after concluding that section 2210 of the Code does not provide for the uniform treatment of counties of the second class A, making it an impermissible "special law" under Torbik, the majority proceeds to consider whether there are manifest peculiarities that distinguish Montgomery County from the other counties in its class. (Majority op. at 11.) If the crux of the matter is whether there is uniform treatment within a defined class, and the majority has determined that there is not uniform treatment and that this is a special rather than a general law, then the majority should have ended its inquiry there.

I also note that, in examining uniformity of treatment within a defined class of counties, the majority states that a law's special or general nature does not depend upon the size of the class. (Majority op. at 10.) However, the majority's statement completely ignores classes that contain only one county. For example, the majority would hold that any law relating solely to Allegheny County, the only county of the second class, is a general law because the law is applied uniformly within the class. However, it is clear from Pennsylvania's case law that legislation relating only to Allegheny County may be impermissible special legislation. See Allegheny County v. Monzo, 509 Pa. 26, 500 A.2d 1096 (1985).

and other community interests. (Township's brief at 17.) These are disputed allegations of fact, and I believe that this court should hear evidence relating to them.[23] Certainly, the truth or falsity of these assertions is material to the outcome of this case. Thus, I do not believe that summary judgment is appropriate as to the "special law" and "equal protection" issues.[24]

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ROCHELLE S. FRIEDMAN, Judge

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[23] The majority does not agree that counties of the second class A having a population greater than 675,000 have different concerns or burdens with respect to airport development. (Majority op. at 11-12.) However, this is a finding of fact, and the parties have not been given an opportunity to present evidence on the matter. I would not deprive the parties of a chance to prove their case.

[24] The majority points out that, under 14 C.F.R. §156.6(c), the Commonwealth may not relinquish state block grant control to municipalities unless there is a written agreement to that effect. (Majority op. at 13.) The majority then suggests that section 2210 of the Code violates 14 C.F.R. §156.6(c), and, therefore, section 2210 of the Code does not promote a legitimate state interest. (Majority op. at 14.) However, until this court takes evidence in this case, we do not know if there is a written agreement or if section 2210 of the Code violates 14 C.F.R. §156.6(c). Thus, I fail to see the significance of the majority's discussion of the issue.