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May 10, 2012

The Honorable Martin O'Malley
Governor of Maryland
State House
100 State Circle
Annapolis, Maryland 21401-1991

Re: Senate Bill 1004

Dear Governor O'Malley:

We have reviewed Senate Bill 1004, titled "Renewable Energy Portfolio Standard – Renewable Energy Credits – Thermal Biomass Systems," for constitutionality and legal sufficiency. While we approve the bill we note that a severable portion may violate the Commerce Clause of the United States Constitution.

Under Maryland's renewable energy portfolio standard (RPS) program, a certain percentage of electricity sold at retail in the State must come from either Tier 1 or Tier 2 renewable sources. The program is implemented through the creation, sale or transfer of renewable energy credits (RECs). A REC is equal to the generation attributes of 1 megawatt hour of electricity produced from a Tier 1 or Tier 2 renewable source, as defined in the RPS statute. RECs are obtained by generating electricity from Tier 1 or 2 renewable sources or by purchasing or otherwise obtaining REC's from Tier 1 or Tier 2 renewable sources or suppliers. To be eligible to meet the Maryland RPS standard, Tier 1 and Tier 2 renewable sources must be located in the PJM region or in a control area that is adjacent to the PJM region if the electricity is delivered into the PJM region. However, as discussed below, this geographic limitation has been further narrowed by legislation in recent years for certain Tier 1 renewable sources, including solar, poultry litter-to-energy, waste-to-energy, and refuse-derived fuel.

Since the initial enactment of the Renewable Portfolio Standards Act, Chapter 487, Laws of 2004, the Office of Attorney General has examined the constitutionality of qualifying renewable energy credits. Limitations imposed by the statute narrow the geographical area from which credits may qualify to meet energy suppliers' RPS

requirements. Senate Bill 1004 qualifies a thermal biomass system as a Tier 1 renewable source under Maryland's renewable energy portfolio standard.

Under Maryland law, energy is eligible for inclusion in the renewable energy portfolio standard only if it comes from a source located in the PJM region or in a control area that is adjacent to the PJM region, if the electricity is delivered into the PJM region. Public Utilities Article ("PUC") § 7-701(i). The PJM region is the control area administered by the PJM Interconnection, Inc., and currently includes all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.[1] Some Tier 1 sources are subject to the further requirement that the source be "connected with the electric distribution grid serving Maryland." PUC § 7-704(a)(2)(i)1. A difference between the Tier 1 sources already in PUC § 7-704(a)(2)(i)1 and a thermal biomass system, as defined under Senate Bill 1004, however, is that the system must be one that "is used in the State." Further, the energy produced from the system must be "used on site." Thermal biomass systems produce energy in the form of heat, not electricity. The heat is measured in BTUs (British Thermal Units), which is converted to KWh (Kilowatt Hours) for purposes of calculating the number of Renewable Energy Credits produced by the system. Thus, to qualify as a Tier 1 renewable source that can generate RECs which can be used to meet Maryland's RPS requirements, the thermal biomass system must be located in Maryland, and the energy it produces must be used on site.

Renewable energy credits are commodities transferred in interstate commerce, and Senate Bill 1004 would prohibit thermal biomass systems located in other states from qualifying to receive renewable energy credits and participate in the market for Maryland RECs. As described in the Public Service Commission's annual RPS report to the General Assembly, "Under the RPS Program, electricity suppliers are required to meet a renewable energy portfolio standard. This is an annual requirement placed upon Maryland electricity suppliers, which includes competitive suppliers and the electric

[1] In the Bill Review Letter on House Bill 1308 and Senate Bill 869 of 2004, which adopted the renewable source portfolio standard, we concluded that while those bills on their face appeared to discriminate against some interstate commerce, the practical effect would be minimal because, "under the regional system developed by FERC, most of the electricity consumed in the State is generated within the PJM region, and very little is produced in states that are the farthest away."

companies that provide Standard Offer Service."[2] Further, a renewable energy credit "is equal to one megawatt-hour (MWh) of electricity generated using specified renewable sources. As such, a renewable energy credit is a tradable commodity equal to one MWh of electricity generated or obtained from a renewable energy generation resource. Generators and electricity suppliers are allowed to trade renewable energy credits using a Commission-approved system known as the Generation Attributes Tracking System (GATS)."[3] Also illustrating the interstate nature of the renewable energy credit market, "Pennsylvania-generated RECs, followed by Virginia and New York, were used in the largest aggregate amounts by Maryland electricity suppliers for 2010 RPS compliance" and "[r]enewable energy generated in Maryland can be used in other states for RPS compliance purposes."[4] Finally, the potential impact on the renewable energy credit market of the in-state restriction for thermal biomass systems in Senate Bill 1004 may not be insignificant. According to the Fiscal and Policy Note, such systems have the potential to produce millions of BTUs per hour and, accordingly, a significant amount of renewable energy credits.

The Commerce Clause of the United States Constitution, Article I, § 8, cl. 3, provides that "The Congress shall have Power ... To regulate Commerce with foreign Nations, and among the several States and with the Indian tribes." Although it is stated as a grant of power to Congress, it has long been recognized that the Commerce Clause has a dormant aspect that "prohibits States from 'advancing their own commercial interests by curtailing the movement of articles of commerce, either into or out of the state." *Fort Gratiot Sanitary Landfill v. Michigan*, 504 U.S. 353, 359 (1992). Thus, "where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected. ... But where other legislative objectives are credibly advanced and there is no patent discrimination against interstate trade, the Court has adopted a much more flexible approach." *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978). The sale of electrical power across state lines is commerce among the several states within the meaning of the Commerce Clause. *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

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[2] Renewable Energy Portfolio Standard Report of 2012, http://webapp.psc.state.md.us/intranet/Reports/2012%20Renewable%20Energy%20Portfolio%20Standard%20Report.pdf.

[3] *Id.*

[4] *Id.*

In *Wyoming v. Oklahoma*, 502 U.S. 437 (1992), the Supreme Court found that an Oklahoma law requiring coal-fired electric generating plants in the State to burn a mixture of coal containing at least 10% Oklahoma-mined coal violated the Commerce Clause. Noting that *New Energy Company of Indiana v. Limbach*, 486 U.S. 269, 273 (1988) had held that the "negative" aspect of the Commerce Clause prohibits economic protectionism, "that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors," the Court found the 10% requirement discriminated against out-of-state commerce and was invalid. In doing so, the Court rejected arguments that the statute should be upheld because the burden on commerce was de minimis, stating that the "volume of commerce affected measures only the extent of the discrimination; it is of no relevance to the determination of whether a State has discriminated against interstate commerce." *Id.* at 455. Because the act discriminated against interstate commerce, the Court applied the strictest scrutiny and found that the State had failed to meet its burden to "justify [the discrimination] both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake." *Id.* at 456.

The restriction in Senate Bill 1004 to in-State use for thermal biomass systems eligible to receive renewable energy credits goes beyond the "connected to the distribution grid" restriction for other Tier 1 technologies. Senate Bill 1004 restricts eligible systems to those actually located in Maryland. Out-of-state systems do not qualify for Maryland renewable energy credits and cannot participate in the Maryland RPS market. We have found no reported cases involving a state RPS and a state law restricting participants based solely on geographic in-state eligibility. Nevertheless, it is our view that the geographic restriction in Senate Bill 1004 puts it at risk of being found to violate the Commerce Clause as it arguably discriminates both on its face and in practical effect, in that it excludes thermal biomass systems located and used in other states from participating in the Maryland RPS market. Accordingly, there is a risk that a court would find the restriction as per se invalid, unless the State can successfully show that it advances a legitimate local purpose that cannot be adequately served by other nondiscriminatory means. *See, e.g., Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978); *Wyoming v. Oklahoma*, 502 U.S. 437 (1992); *Department of Revenue of Ky. v. Davis*, 553 U.S. 328 (2008).

If a court finds that the limitation to in-state use for thermal biomass systems is unconstitutional, our view is that that provision would most likely be found to be severable. Maryland law expressly provides for severability. Maryland Code, Art. 1, §23. Moreover, where a provision of a bill is found to be unconstitutional, it is generally

presumed, "even in the absence of an express clause or declaration, that a legislative body generally intends its enactments to be severed if possible." *Davis v. State*, 294 Md. 370, 383 (1982). Thus, "when the dominant purpose of a statute may largely be carried out notwithstanding the invalid provision, courts will ordinarily sever the statute and enforce the valid portion." *Id.* at 384. It is clear that the purpose of the bill can be accomplished without the limiting language. As a result, it is our view that, if the limitation were to be found unconstitutional, it would be severable from the remainder of the bill.

Very truly yours,

Douglas F. Gansler
Attorney General

DFG/SBB/kk

cc: The Honorable John P. McDonough
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