



August 27, 2024

MEMO: COMMENTS ON CLEAN HEAT STANDARD COMPLIANCE

This memo further articulates the concerns over how fuel sellers and contractors that deliver and install Clean Heat Measures demonstrate compliance with a proposed Clean Heat Standard (CHS). It also proposes how obligated parties should remit the proposed Clean Heat Fee (CHF).¹

This memo follows a lengthy discussion of the CHS Technical Advisory Group (TAG) on August 8 and in written comments filed by Meadow Hill on July 29 in response to the PUC's July 10 Straw Proposal regarding credit fulfillment plans and criteria, noncompliance, and waiver process. There are at least three major concerns that are identified in this memo for fuel sellers and heating service providers, including:

- I. How do obligated parties pay the CHF?*
- II. How do obligated parties account for Clean Heat Credits (CHCs) that they have either delivered or acquired to avoid paying all or some of the CHF?*
- III. How do heating service contractors monetize CHCs that they acquire?*

These questions are inextricably linked. As stated frequently at the TAG and Equity Advisory Group (EAG), the proposed CHS is not a funding mechanism for a thermal efficiency utility. Nor is it an electrification program. If that were so, the design and implementation of a CHS would be simple. It isn't easy because the CHS is attempting something far bolder and more ambitious. It strives for a rapid transformation of the thermal energy marketplace by providing market signals for the competitive heating fuel and service sector to supply Vermonters with energy products, services, and equipment that reduce greenhouse gas emissions. For that to happen, the heating fuel and heating service sector needs a straightforward pathway to earn credits, trade credits, and pay the CHF in lieu of credits.

¹ Fuel sellers understand the Clean Heat Fee (CHF) as the payment required in lieu of Clean Heat Credits (CHCs) received by the Default Delivery Agent (DDA) under the regulatory oversight of the Public Utility Commission. Under Act 18 (2023), failure to pay the CHF in lieu of CHCs or failure to accurately predict the acquisition of CHCs (as described in the PUC Straw Proposal) would result in a penalty of up to 2x the CHF.

I) Paying the CHF

The consultants hired by the PUC have issued detailed reports about the CO₂e reductions creditable to Low Flow Faucet Aerators and the variances associated with a 1.5 GPM versus a 2.2 GPM in both kitchen and bath faucets. However, there has been virtually no discussion about the most fundamental part of the CHS. *How and when is the CHF paid?* This is the concern of more than half a million Vermonters who depend on fossil fuel for heat and hot water. It is also of considerable interest to fuel suppliers and any potential Default Delivery Agent (DDA). As of August 26, 2024, it is still undetermined how the DDA will be paid, who will pay, and what it will cost.

The authors of Act 18 created the concept of a DDA to ensure clean heat measures are delivered to Vermonters. In a perfect market, heating fuel and service contractors would provide products and services that reduce greenhouse gas emissions in accordance with Act 153 (2020), making a DDA wholly unnecessary. This would reduce program costs and save consumers money. However, since we don't have a perfect market, we have a DDA to help move the market when emissions reductions are not independently achieved by heating fuel and service providers.

If the Vermont legislature approves the CHS before the end of the 2025 session, the PUC will choose a DDA soon after. The DDA will then be required to submit a three-year budget and seek approval from the PUC by September 1, 2025.² This is presumably how the PUC will establish the CHF, or the amount that obligated parties will have to pay the DDA for a unit equivalent of a CHC to satisfy its obligation. This will effectively create the ceiling price under which credits will trade. This needs to happen much sooner than September 1, 2025, if a gallon sold on January 1, 2026, is obligated. Most obligated fuel sellers are small, locally owned family businesses. They need to know, at least 12 months in advance, what the CHF will be so they can price it into their product or make the necessary investments to acquire CHCs. If fuel sellers don't know the price of the CHF until September 2025, they can not plausibly offer pre-buy or guaranteed fuel price contracts to Vermonters in the winter of 2025-2026.³ Simply put, fuel sellers can not comply with Vermont's fuel price contract law if

² As per Act 142 (2024)

³ VFDA Comments, Case No. 23-2220-Rule, Fixed Price Contracts (April 25, 2024)

they do not know their fixed costs.⁴

This also leads us to the question of how the CHF is collected from obligated parties. There is a short window of time before a rule is developed for consideration by the Vermont Legislature. Creating an entirely new payment system for a universe of businesses that the regulators do not fully understand will come at a significant expense.

The Solution

The PUC must establish an initial Clean Heat Fee in conjunction with the submission of the proposed Clean Heat Standard Rule to the Vermont Legislature in January 2025. If the CHS becomes law, this will allow the CHF to be priced into gallons sold on and after January 1, 2026, when the first obligation period begins. Providing at least twelve months' advanced notice before the fee is implemented or adjusted will reduce price volatility for consumers and allow fixed-price or pre-buy contracts to be offered the following winter. In the event a CHF is established after September 2025 based on a proposed budget submitted by a yet-to-be-appointed DDA, the CHF should not be implemented until January 1, 2027, at the earliest.

The PUC can develop a CHF collection method using an existing system, which has advantages from a cost and compliance standpoint. The Motor Fuel Excise Tax is collected and enforced by the Vermont Department of Motor Vehicles. This is the "distributor model" in which the entity bringing gasoline or diesel fuel into Vermont pays the motor fuel excise tax online directly to the DMV on the Distributor Fuel Tax Return using Form CVO 102. This payment, which is backed by a surety bond,⁵ is an efficient collection method that reduces the number of taxpayers. However, this is difficult to replicate in the heating fuels market, which has a different distribution network than motor fuels. This is why the "retail model" was adopted by the Legislature in 1990 for the collection of the Fuel Tax using Form FGR-615.⁶ Under either system, the CHF would be collected on the 25th of the month for gallons sold the prior month. Whether the PUC adopts its own CHF collection method or adopts a system already in use, statutory authority is needed. It may also require reconsideration of the definition of

⁴ Guaranteed price agreements are regulated by Title 9, Chapter 63, § 2461e.

⁵ The amount of the Surety Bond is the sum of the highest two months' payment during the preceding year or \$1,000, whichever is greater, but is capped at \$700,000. Source: dmv.vermont.gov

⁶ The 2-cent per gallon Fuel Tax is paid to the Vermont Department of Tax and funds Vermont's low-income weatherization program.

obligated parties that was established by Act 18 (2023). This is because the existing Fuel Tax is imposed “on the retail sale of heating oil, propane, kerosene, and other dyed diesel fuel delivered in Vermont.”⁷

Whether the PUC develops its own CHF collection method or incorporates the CHF into one of the existing fuel tax collection models, the decision needs to be made during the rule's design, as it will likely require a change in statute to implement.

II. Accounting for CHCs

The Public Utility Commission (PUC) Straw Proposal released on July 10 creates a compliance mechanism that is familiar to the handful of utilities regulated by the PUC. However, it is entirely foreign to the hundreds of businesses that provide fuel and heating services in Vermont. As noted in Meadow Hill’s filing from July 29, the Straw Proposal will require these businesses to declare every August how many CHCs they will deliver, install, or otherwise obtain in the next calendar year to account for their obligation from the previous calendar year. These legally binding declarations will be predictions of future actions that are ultimately unknowable. Heating fuel dealers are not like electric utilities. Vermont’s utilities receive a guaranteed rate of return on their investment and a monopoly in exchange for a regulatory structure. Through the rate-making process, they can recoup expenses, such as those incurred with Tier III compliance. The CHS does not offer a similar safety net or other protections for Vermont’s fuel dealers.

Furthermore, Vermont’s regulated utilities have developed complex integrated resource plans to help create accurate measurements for demand management that can assist in meeting their Tier III obligations under the Renewable Energy Standard. Such complex planning tools to project future demand are not reasonably available or too costly for many of the small “mom-and-pop” fuel dealers that will become regulated as obligated parties under a CHS. Most fuel dealers cannot accurately predict the market for clean heat measures 15 days ahead of time, never mind 15 months in advance. These decisions are made every morning when a truck driver in Wilmington compares the per gallon cost of renewable fuel sold in Albany versus fossil fuel sold in North Walpole. The decision to go east or west depends on the price at the day and time it is picked

⁷ 33 V.S.A. § 2503 Wholesalers of heating oil, kerosene, dyed diesel, or propane do not pay the Fuel Tax. The tax is paid when delivered to the end user, regardless of use.

up at the terminal. Maintaining this flexibility to decide when, where, and how many gallons to purchase is essential for these local businesses to remain viable in a competitive marketplace.

The same is true with installed measures. Fuel dealers cannot predict how many heat pumps they will install or how many credits from heat pump installations will be acquired in advance of the work being done. Nor is it possible to purchase forward contracts from heat pump installers, weatherization contractors, or biomass appliance distributors. These contracts do not exist. If they emerge as a result of the CHS becoming law, a regulated exchange would be necessary to prevent a CHC generator from selling the same CHC to different obligated parties. While a CHC market is being contemplated as a result of this rule-making process, it will take time for an exchange to be established where buyers and sellers can negotiate directly.

A CHS could create another set of unintended consequences. Under the PUC Straw Proposal, a fuel seller could declare their intention to purchase sustainably sourced biofuels and forward contracts for weatherization and heat pump installations in order to avoid paying the CHF. However, it won't be known if the obligated party fulfilled this prediction for another two years. If the CHS becomes law, hundreds of fuel sellers are expected to tell the PUC as early as August 2025 what clean heat measures, both delivered and installed, will be acquired during the following calendar year. These delivered measures will not be reported until June 30, 2027, in accordance with Act 142 (2024). This reporting will reveal whether more than 200 fuel sellers purchased and sold renewable fuels consistent with their intentions two years prior and commensurate with their obligation in the calendar year 2026. Then, on October 15, 2027, just weeks before the heating season begins, the PUC will determine whether or not the fuel seller is in compliance with a filing that is more than two years old. If the fuel seller is not, the PUC must then determine what the correct fee should be and whether to add a 2x penalty payment for failing to deliver as promised 26 months prior.

This could result in several undesirable outcomes. Depending on the CHF per gallon cost, a 2x penalty could be more than the value of the company itself. Under this scenario, fuel dealers could seek bankruptcy protections if they are unable to meet their financial obligation to the DDA. Fuel sellers could also sell their trucks and exit the marketplace, especially those with no fixed assets in Vermont. This would leave Vermonters with fewer choices and less competition.

Under Act 18 (2023), the PUC is permitted to waive the 2x penalty payment, but that would put those fuel sellers that acquired CHCs at a competitive disadvantage to those that failed to follow the law. If the PUC Straw Proposal were adopted and the CHS passed by the legislature, Vermont could face a heating crisis in the winter of 2027-2028 as small fuel dealers are forced out of the market and consumers are left with few options for heat and hot water.

There is a provision in the PUC's Straw Proposal that attempts to provide some fiduciary oversight of Vermont's heating fuel companies to determine whether they have the financial viability to obtain clean heat credits. The PUC has neither the staff nor the expertise to provide this analysis for the hundreds of fuel companies operating in Vermont. Partisans in the debate over this policy frequently state incorrectly that the CHS is only a burden on large suppliers of fossil fuels. This is false. All fuel sellers are regulated, no matter how many gallons are sold. Since the law states that the obligation is with the entity that transports fuel into Vermont, even the smallest retail providers will become obligated under a Clean Heat Standard. The average retail heating fuel company in Vermont has just 12 employees and sells approximately 2.4 million gallons of fuel.⁸ Nearly all purchase some or all of their fuel from outside of Vermont and are thus "obligated." What metric will be used to determine if these "mom-and-pop" fuel companies have the "financial resources" to pay? How will the balance sheet of the largest fossil fuel corporation in the state compare to the locally owned fuel provider? Both are competing in the same CHC marketplace on an uneven playing field that benefits the largest energy conglomerates at the expense of Vermont-owned businesses.

The Solution

Rather than provide the PUC with a guesstimate of how many CHCs will be obtained through future actions or purchased in a futures market, CHCs should be counted only after they are physically delivered and installed. An obligated party should provide proof of CHCs after they have been delivered, acquired, or otherwise obtained. These CHCs could be reported on a quarterly, bi-annual, or annual basis to the PUC. Once verified by the PUC, the obligated party's future CHF payments would be adjusted accordingly. A Clean Heat Standard should not put fuel sellers in the difficult position of guessing how to comply when failure to accurately predict the future could result in a penalty payment that

⁸ Vermont Center for Rural Studies: vermontfuel.com/uvmstudy

could force them to close their doors weeks before winter begins. In order to avoid a heating crisis, reduce price volatility in the credit and fuels market, and limit fraudulent CHC claims, the PUC should design a rule that counts clean heat measures after they are delivered, not before.

III. Establishing Ownership of CHCs

Even if the above solutions are adopted, they will only be meaningful if heating service and fuel providers can create and trade their CHCs. It is essential to restate the purpose of this energy policy. The goal of the Clean Heat Standard, as envisioned by the authors of Act 18 (2023), is to ensure the continuity of a competitive marketplace while providing incentives for market actors to sell energy and equipment that reduces greenhouse gas emissions in the thermal sector. This means that heating contractors and fuel sellers should have an economic incentive to diversify their services in order to create CHCs. And those CHCs should become tradeable so obligated parties can obtain them. This is the grand idea embedded into this complex policy. Otherwise, the authors would have passed a fee to fund a heat pump rebate program.

However, this bold and ambitious idea will not work if the PUC accepts the assertion made by the Vermont Energy Investment Corporation (VEIC) that they “own all of the environmental attributes” for actions in which they have provided an incentive.⁹ Under their current midstream rebate program, neither customers nor contractors receive a direct payment for installing “clean heat eligible” equipment or service. As per the terms of existing contracts with VEIC, the payment is received by the supply warehouse with the rebate itemized on the contractor's invoice and then again on the customer's invoice. These legal contracts essentially state that the “environmental attributes” reside with VEIC, not the customer or the installer of the clean heat equipment. Suppose a CHC is defined as an “environmental attribute” for which existing legal contracts affirm is owned by VEIC. In that case, there is little economic incentive for heating service providers to install CHC-eligible equipment. In order to effectively empower a labor force to sell, install, and service CHC-eligible equipment, the heating fuel and service sector should have the opportunity to monetize these credits themselves.

⁹ Comments made by David Westman, VEIC's Director of Regulatory Affairs, at the TAG Credit Ownership meeting on August 19, 2024

Equipment manufacturers, wholesale supply distributors, and heating contractors can and do provide financial incentives to customers in addition to those offered through VEIC. While the PUC does not regulate these incentives, this does not mean they are less impactful on a consumer's decision to install a clean heat measure. Depending on the value of a CHC, a manufacturer or supplier of CHC-eligible equipment will quickly recognize the arbitrage opportunity of rejecting VEIC's midstream rebate in favor of selling the credit directly to an obligated party. A vertically integrated for-profit corporation could seize the opportunity to control this space, harming not only the viability of a Default Delivery Agent but also VEIC's ability to deliver Tier 3 credits on behalf of electric utilities. This is what Mr. Westman likely meant when he stated the CHS should "do no harm" to existing rebate programs.¹⁰

Neither pathway supports locally owned heating fuel and service businesses. Whether they are forced to compete for CHCs against an efficiency utility or an energy conglomerate, the hundreds of small fuel sellers and service providers that provide heat and hot water to a majority of rural Vermonters will face an increasingly challenging economic and regulatory environment. This problem will be particularly acute in rural areas, which depend on these family-run businesses to deliver products, equipment, and services that provide energy for heat, hot water, and cooking.

The Solution

Create a CHC market in which obligated parties and heating contractors have an equitable opportunity to acquire CHCs. The PUC cannot allow any single corporation, including the DDA or any entity that has existing contracts with equipment suppliers for programs unrelated to the CHS, to obtain a CHC monopoly. The benefits should be equitably divided between the market players. These questions need to be addressed by the PUC as soon as possible to ensure continuity, choice, and competition in the thermal sector. The small family-owned businesses that deliver heating service and fuel in rural areas of Vermont will not be able to continue operating under a regulatory rubric designed by and for the largest energy corporations operating in Vermont. Nor can they provide value to customers in a credit market monopolized by a multi-million-dollar efficiency utility.

¹⁰ Ibid.

Conclusion

The competitive fuel delivery marketplace needs a familiar system for reporting gallons, paying the CHF, and accounting for credits. The PUC should work expeditiously to ensure that the rule provides a straightforward process to pay the CHF in lieu of CHCs while preserving the ability of heating fuel and service companies to mint and trade CHCs. Finally, all obligated parties, regardless of size, should have the opportunity to demonstrate compliance after a CHC is installed or delivered and not be required to haphazardly predict how many CHCS will be acquired many months in advance.

Thank you for your consideration. I look forward to discussing this memo with the CHS Technical Advisory Group and PUC staff.

Sincerely,



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