Efficiency Vermont

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September 19, 2024

Holly Anderson, PUC Clerk
Vermont Public Utility Commission
112 State Street
Montpelier, VT 05620-2701

Re: Case No 23-2220 - RULE - Proceeding to design the potential Clean Heat Standard, Efficiency Vermont Comments Regarding Clean Heat Standard Market Formation in Advance of Draft Commission Rulemaking

Dear Ms. Anderson,

On August 29, 2024 the Vermont Public Utilities Commission ("Commission" or "PUC") issued an order stating that there will be no additional straw proposals or requests for comment in Case No. 23-2220-RULE, the proceeding to design the potential Clean Heat Standard, until the Commission's draft rule is released for review in early October. Efficiency Vermont appreciates the Commission's tight deadline to produce a draft rule and has identified some topics for consideration before the draft rule is written in full. Specifically, Efficiency Vermont wishes to recommend Commission consideration for how existing programs will interact in the Clean Heat Standard, specifically in market formation, monetizing credits, and accounting for supplemental revenue from clean heat credits.

i. The Clean Heat Standard Rule under development should protect the role of existing programs and services, which serve as a backbone for achieving the requirements established by Act 18.

Included within the final Clean Heat Standard Thermal Sector Carbon Reduction Potential Study were various scenarios; a technical potential scenario, max achievable scenario, optimization scenario, and an economic potential scenario. For Efficiency Vermont, as the statewide Energy Efficiency Utility ("EEU"), a program or market achievable scenario would have been desirable to identify what within the Clean Heat Standard market and existing programs is achievable. This would have also helped to better elucidate the programs that are currently in effect across the state, and the incremental lift that is required above and beyond the existing programs to achieve the requirements of Act 18.

Efficiency Vermont recommends the Commission's draft rule clearly acknowledge the role and impact of existing programs managed by the EEUs, the Weatherization Agencies, and the Distribution Utility Tier III programs. The existing programs make substantial investments in delivering clean heat measures to Vermont homes and businesses today and invest in far more than just incentives. The existing programs also invest in workforce development, worker training programs, midstream delivery channels, marketing, education, and a host of other programs and services that not only help to develop the market for clean heat measures, but also reduce barriers for participating and making the process comparatively easier for customers. For all these reasons, Efficiency Vermont strongly recommends that the Commission develop a Clean Heat Standard rule that does not undermine the existing regulated and state-sponsored programs that are the backbone to the clean heat market's future success. The most effective way for the Commission to do this is to ensure that existing programs can participate in the clean heat credit market in a fair and efficient manner.

ii. The Clean Heat Rule must squarely address the complexity and necessity for a fair and efficient market that enables the exchange of clean heat credits among customers, existing parties, the DDA, and Obligated Parties.

As a general matter, credit ownership is the initial basis for a clean heat credit market. Efficiency Vermont appreciates the clarity the Commission provided through the July 16, 2024 Order Adopting Interim Standard Credit Ownership Methodology. Under the order, the initial ownership of an installed credit begins with the customer, unless "the measure is implemented at no cost to a participant under a program authorized by the Commission, the entity administering the program will be the initial owner of the credits".[1] Efficiency Vermont's form of regulation usually requires at least some form of customer cost-share for an installed measure, and as such

[1] July 16, 2024 PUC Order Adopting Interim Standard Credit Ownership Methodology

would not be the initial owner of a credit. Instead, Efficiency Vermont expects that a transfer of the credit from the home or business owner to a third party would occur in exchange for direct services, incentives, or both.

Efficiency Vermont can anticipate that such arrangements for transfer of credits will necessitate bilateral or potentially complex multilateral agreements between customers, the EEU, Distribution Utilities, contractors, installers, midstream dealers, and could even include upstream manufacturers. The complexity of these arrangements also give rise to concerns over the veracity of projects claiming credits and the rigor of their completion. For this reason, credits must be "minted" under the State's supervision and under the same oversight and rigor as existing regulated programs. Much like currency, credits should be able to be split into non-integer values to accommodate fractional distribution among partners under shared-credit agreements. Credits should also be immutable in nature once created, and capable of being tracked across ownership of multiple parties until they are retired. Efficiency Vermont has already received questions from stakeholders and partners regarding clean heat credit ownership, and how credits from existing program actions will be made available to existing market participants through shared credit or complete transfer agreements. This is illustrative to the effect that market participants are eager for fully defined rules for transferability of credits and monetizing credit ownership. Currently, Efficiency Vermont is waiting to initiate these complex negotiations until more is known about the credits and the market or exchange that brings value to an individual owner.

To be certain, Efficiency Vermont will negotiate ownership arrangements of credits with its partners, and has filed multiple rounds of comments on this issue under the presumption that Efficiency Vermont's current incentive agreements will transfer early action credits and future clean heat credits resulting from EEU activities from the customer to the EEU.[2] Nonetheless, before engaging in these negotiations, Efficiency Vermont seeks certainty for what market process, or processes, would be expected to monetize credits through a transfer of ownership to obligated parties or third-party aggregators of credits. It is not intuitive nor technically defined how such a market is intended to work or benefit the suite of existing programs in practice

[2] December 8, 2023 Efficiency Vermont Comments Regarding Clean Heat Credit Ownership; https://epsb.vermont.gov/?q=downloadfile/696284/190907

throughout Vermont. The EEUs, Weatherization Agencies, and Tier III programs are all anticipating early action credits and future credits, but without knowing how a credit is bought, sold, or traded via market process, Efficiency Vermont is unsure of the efficiency or efficacy of monetizing credits. Market formation to monetize and transfer ownership of credits is therefore a critical component that the Commission should consider in determining the draft rule.

For example, in an unorganized and unregulated market where multiple entities hold credits (i.e., supply from existing parties), and multiple entities seek credits (i.e., demand from obligated parties), there are a seemingly infinite number of combinations that may result in obligated parties acquiring the appropriate amount of credits that is equal to their specific compliance obligation. However, of those infinite number of possible transactions, only one such unknown combination represents the least-cost for Vermont households and businesses. The risk of an unregulated market, therefore, is that while compliance may ultimately be achieved after several years, the buying and selling of credits itself becomes grossly inefficient, asymmetrical, and potentially more costly for all parties. Efficiency Vermont recommends the Commission's rule reflect the essential functions of a regulated Clean Heat Credit market to achieve the policy objectives of Act 18 and have the explicit function of preserving the backbone of existing programs, services, and fuel deliveries that are essential services for Vermonters during the long-term transition to clean forms of heat. In the following comment, Efficiency Vermont suggests several examples of regulated markets that are familiar to this region and may be comparable to the exchange of clean heat credits.

iii. A market-driven clearing price would be the most readily available market model for existing participants, program administrators, and existing clean heat credit forming entities.

The principal element that Efficiency Vermont recommends for rulemaking is that a regulated market mechanism be defined, and that it have the opportunity to serve both supply (credit-forming entities like DDAs, EEUs, WAPs, and Tier III), and demand (obligated parties seeking credits from third parties). Efficiency Vermont believes the clean heat market should reflect the following principles:

- An open and regulated market designed to be fair for supply and demand parties, and finds the lowest cost means to procure credits;
- The market for credits should be strictly controlled, and limited to facilitating the exchange of credits necessary for achieving policy objectives pursuant to Act 18;
- The market should be open for existing market participants to participate and monetize early action and future program credits; and
- Market rules should help facilitate a role or function for one or more DDA to meet demand for credits incremental to what existing programs create.

Efficiency Vermont believes that the Commission should consider a clearing price market that is common in energy markets. Strictly speaking, a single clearing price may not be the only mechanism for achieving a least-cost result, but it could be the most efficient for participants. In a market where there is one single clearing price for all implementers, there is an ease to the administrative burden for regulated entities and implementers by assuring a known price at an explicit quantity of credits and allows for greater forecasting of budgets and future regulated revenue streams.

The alternative would be an open-market unregulated model, where the DDA and credit-forming entities are responsible for project completion and credit formation directly. Where investments in workforce development and market development are wholly left to individual entities, and not coordinated among existing regulated entities. Each party would also be responsible for finding an obligated party or credit aggregator directly, and contracting individually to monetize credits through a potential unlimited number of bilateral and multi-lateral contracts.

For an example of a well-known and well-defined clearing market that affects Vermont, the Commission need only look to the Regional Green House Gas Initiative ("RGGI") market, or the Forward Capacity Market ("FCM") administered by the ISO-NE. In the RGGI market, large electric generators are required to purchase and retire an emission allowance for every ton of carbon dioxide emitted. The RGGI region of participating states has a fixed number of emission allowances that are entered into an auction in a year. While quarterly auctions may vary, the allowances generally are reduced year-over-year, which drives the cost of allowances and fossil fuel emissions higher, putting downward pressure on the use of fossil fuels at large electric power generators, and ultimately reducing emissions. If a similar market could be administered for the Clean Heat Standard, the PUC would establish a market with a finite number of credits, sold at a single clearing price in regularly scheduled auctions throughout the year. Revenue from such auctions could be used to distribute among the existing program participants in exchange for their early action or future credits generated through program activities. Any incremental credits sold above what current providers can generate could be used to pay for incremental DDA services.

In a similar vein, if the Commission were to regulate an FCM-style auction, obligated parties might be expected to contract with an entity administering a single clearing auction and agree to pay the clearing price per credit that is assured to meet the credit requirements for a defined time frame. In this example, the DDA as an active bidder might offer to generate 100,000 credits at $Y price, but if the total credit supply at price $Y is more than what's needed for efficiently meeting the policy objective (i.e., a higher clearing price would generate *too many* credits), the administrator of the auction would initiate a second round of bidding with a lower price, $X. Multiple rounds of bidding could take place at intervals of lower credit costs, with suppliers of credits reducing their credit volume accordingly until the targeted volume of credits is attained via the auction. This auction model is designed to achieve the optimal supply of credit at the lowest cost. In this example, entities with existing credits or owners of early action credits would primarily be price takers and receive the clearing price for all credits in their ownership. As credit requirements increase over time, the supply of early action credits will be largely exhausted, and the cost of a credit will increase – prompting greater investment in incremental programs. The market's role, in effect, is to determine a clearing price consistent with driving the appropriate level of incremental programs above what would have been achieved through current program activities alone.

The examples of clearing auctions that Vermont is already familiar with could be illustrative for how a clean heat market might function to monetize the trading of credits. Efficiency Vermont urges the Commission to consider these and other forms of regulated market models, and how best to secure the resources that achieve the Act 18 goals for all market participants at least cost for Vermont households and businesses.

iv. *Once credits are monetized, PUC rulemaking should be clear with how a regulated entity should re-invest these funds into existing services.*

Once credits are monetized, Efficiency Vermont presumes the incremental revenue should be used to create additional projects for existing programs. The incremental revenue should be incorporated into the EEU's budget, and just as with other incremental funding from regulated sources the additional funds should be under performance regulation. However, Efficiency Vermont anticipates that making precise forecasts on auction clearing prices would be challenging due to the variability of those prices, and suggests the Commission build this into the Demand Resource Plan ("DRP") rather than a more frequent true-up that could generate disruptive changes to programing.

v. *If Efficiency Vermont's request for a regulated market is rejected, Efficiency Vermont suggests the Commission return to the recommendations outlined in the Act 62 Final Report on All-Fuels Energy Efficiency, as it relates to existing programs' needs for generating and completing additional projects.*

If the suggestion to regulate the clean heat market is not accepted by either the Commission or Legislature, Efficiency Vermont asks the Commission to consider the role of existing regulated services in the context of the new Clean Heat Standard, and the fundamental uncertainty of a clean heat credit market. If such considerations should arise, Efficiency Vermont suggests that the Commission might find the recommendations in the Act 62 Final Report to the Legislature on All Fuels Energy Efficiency [3] useful for addressing the requirements of the Clean Heat standard. Specifically, the State's energy efficiency utilities are best suited and capable for scaling specific efficiency services to a level required for meeting aggressive targets, and under a form of performance regulation already familiar in the State.

[3] January 15, 2021 Act 62 – Final Report on All-Fuels Energy Efficiency; https://puc.vermont.gov/sites/psbnew/files/doc_library/act-62-final-report-amendment-020321.pdf

Conclusion

As the Commission addresses credit ownership, transfer of credits, and monetizing of credits in the Clean Heat Credit Market, Efficiency Vermont recommends the Commission's Clean Heat Rule reflect that the market should preserve existing programs, services, and fuel deliveries that are essential services for Vermonters. In the formation of the market, the Commission should consider a market-driven clearing price as the most readily available market model for existing participants, program administrators, and existing credit forming entities to participate. If these market-oriented s suggestions are not adopted, Efficiency Vermont believes the form of regulation proposed by the Commission in the Act 62 Final Report remain relevant for consideration and may be scaled appropriately.

Please do not hesitate to contact me if you have any questions regarding the comments and would like to discuss further with me.

Sincerely,

David C. Westman

Director, Regulatory and State Agency Affairs