

1 Q. **Reference: 2018 Cost of Service Methodology Review Report dated November 15, 2018**

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3 On page 26 (lines 10 – 13) of the CA Energy Consulting Report it is stated with respect to a
4 marginal cost-based allocation that *“The approach presents the technical challenges of 1)*
5 *marginal cost and class load development and 2) the possibly more variable cost shares*
6 *than are found in embedded costing. U.S. jurisdictions demonstrate the feasibility of the*
7 *approach.”* Would a methodology be needed to reconcile marginal costs to embedded
8 costs to ensure the full recovery of the revenue requirement? Roughly, what is the
9 difference between marginal cost-based rates and embedded cost-based rates; i.e., are
10 marginal costs about 75% of embedded costs? How might Hydro apply a marginal cost-
11 based allocation approach to the combined generation and transmission components of
12 Muskrat Falls?

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15 A. This response has been provided by Christensen Associates Energy Consulting.

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17 Marginal cost-based cost allocation does not require a reconciliation step to ensure full cost
18 recovery. The process multiplies marginal costs and class loads to obtain marginal cost-
19 based class revenues for each class over the test period. Summing across classes yields
20 firm-level marginal cost-based revenues. The allocator is each class’s share of firm-level
21 revenue. Applying these shares to the financial (embedded) costs fully allocates financial
22 costs to classes. In this case, the costs would be those costs functionalized as generation.
23 The level of marginal cost-based revenues compared to the total of embedded costs for
24 Hydro’s generation, is not relevant to the cost allocation process. Under this allocation
25 approach, marginal costs are used to determine class allocators. The application of the
26 resulting class allocators to total embedded costs (total financial costs) yields the
27 embedded cost responsibility of each class.