Q: Re: Brattle Group, Embedded and Marginal Cost of Service Review, May 3, 2019, page 36-37 (40-41 pdf)

> **Fifth, a useful piece of evidence to consider when evaluating the classification split between demand and energy in a power purchase agreement is the agreement itself. <u>Importantly, under the agreement the payments that Hydro makes to the Muskrat Fall[s] Corporation are not related to the amount of energy Hydro purchases.</u> The Muskrat Falls power purchase agreement calls for a 50-year Base Block Capital Cost Recovery payment schedule. Each month Hydro pays the Muskrat Falls Corporation a pre-determined amount that recovers the original investment cost of the Muskrat Falls generation and LTA assets. The schedule of monthly payments reflects an internal rate of return approach to derive a payment schedule that escalates annually at a rate of 2% per year. There is an additional component that recovers the Operating and Maintenance (O&M) costs, as well as for sustaining capital for the assets over the 50-year supply period, which also does not vary in relation to the amount of energy that Hydro purchases. (underlining added)**

Please elaborate on the significance Brattle sees in the fact that the payments that Hydro makes to the Muskrat Falls Corporation are not related to the amount of energy taken by Hydro. More specifically:

a) Does Brattle conclude from this fact that, apart from the O&M component, the contract is essentially for capacity, with no additional cost for energy taken?

b) What is Brattle's understanding concerning the ownership of the Muskrat Falls energy not taken by Hydro, and of the export revenues it generates? If Hydro takes possession of all the energy and exports the portion it does not use, should the contract be thought of as a "take or pay" contract for power and energy? Conversely, if MFC retains ownership of the energy not taken by Hydro, should the contract be thought of as a firm capacity contract in which energy is provided at no additional charge? Please elaborate.

A. a) We believe the contract provides both energy and capacity to Hydro. The cited passage is the fifth reason to justify our preference for the system load factor approach to classification compared to the equivalent peaker approach.

b) It is our understanding that the Muskrat Falls Corporation owns the external market energy sales and sells it on behalf of Hydro, known as "Residual Block Sales." The Muskrat Falls Corporation is obligated to maximize the price received when entering into Residual Block Sales outside of Newfoundland and Labrador, as described in the November 29, 2013 Power Purchase Agreement between Newfoundland and Labrador Hydro and Muskrat Falls Corporation, Section 4.5. We believe the contract provides both energy and capacity to Hydro.