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Request from: CLF and Sierra Club

Question:

How does the Company define the marginal cost to serve customers who install heat pumps? In your response, explain: (a) whether the Company is using the absolute marginal cost to serve customers who install heat pumps, the incremental marginal cost to serve these customers, or something else; and (b) the Company's rationales for its selected approach.

Response:

Serving the customer who installs heat pumps means ensuring that the facilities used to serve the load have sufficient capacity, both at the local and upstream level. The Company also needs to continue providing customer-related services, as any other customer. Therefore, the marginal costs associated with serving the customer include:

- Marginal customer costs
- Marginal / incremental local facility capacity costs
- Marginal distribution substation and feeder capacity

These marginal unit costs are obtained from the MCOS study, provided in Exhibit CLP–MCOS-2 Confidential, at worksheet T.1 MC Comparison to Rates, which summarizes the marginal unit cost for each component.

a. The Company designed a heat pump rate considering the full load of the customer, since this rate does not separately meter the heat pump load. Therefore, the rate makes sure that the customer is paying no less than marginal cost associated with full service.
b. The rationale in designing the winter energy charge for the block 2 usage was to ensure that the customer will pay through that charge:

   i. the marginal year-round per-kWh cost associated with distribution substation
   ii. a mark-up above marginal unit cost, to contribute to recovery of existing costs, just like Rate 1 recovers revenue above marginal cost in the per-kWh charge towards sunk costs)
   iii. the marginal local facilities costs, which would ideally be recovered as a monthly fixed charge, but the Company is proposing at this time to continue recovering this cost in the kWh charge.

In setting the mark-up over the marginal cost for the winter block 2 charge, the Company applied a reconciliation factor that yields has a lower figure than the year-round energy charge, recognizing the much lower contribution of winter load to annual coincident system peak.

Ultimately, the Company uses the marginal Customer Cost to calculate the proposed fixed charge; the marginal Facilities Cost is recovered in the energy charge. The Company computes what component of the proposed Distribution energy corresponds to the monthly facilities charge, i.e., this is 3.89 cents/kWh (calculated dividing annual marginal local facilities cost by customer's annual energy usage). This means the proposed rate charge (9.4 cents/kWh), would recover the marginal facilities costs and the residual (5.537 cents/kWh) is higher than the "floor" level, which is the system-wide average marginal distribution unit cost (0.258 cents/kWh). The delta between the marginal cost and the ultimately proposed winter block 2 rate reflects the mark up or reconciliation factor.