

1 Q. **Reference: CA-NLH-166**

2 Does Hydro accept the principle that economic efficiency requires that the price of electricity be
3 equal to the short-run marginal cost of supplying the last unit of electricity? Does Hydro
4 consider the marginal cost of energy only and the short-run marginal cost as the same thing?

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7 A. Newfoundland and Labrador Hydro ("Hydro") agrees with the general economic principle that
8 efficiency is maximized when the price of electricity equals the short-run marginal cost of the
9 last unit supplied. However, pricing all electricity solely at the short-run marginal cost of the last
10 unit supplied would not ensure Hydro is able to recover its substantial fixed and sunk capital
11 costs associated with the generation, transmission, and distribution of electricity.

12 Hydro's marginal energy cost is not based on an internally calculated short-run production cost.
13 Rather, it is based on the opportunity cost of energy, as reflected by the forecast value of
14 surplus energy exports to the New England electricity market. This approach recognizes the
15 economic value of energy that could otherwise be sold externally.

16 To encourage efficient electricity usage and load management, Hydro has implemented a tiered
17 energy charge for Newfoundland Power Inc. This pricing structure provides an incentive for
18 managing load within the utility's control while maintaining alignment with the economic value
19 of energy.

20 Hydro's electricity pricing methodology therefore balances two key objectives: (i) recovery of
21 the utility's fixed and sunk costs through overall revenue requirements, and (ii) incorporation of
22 marginal energy costs into rates to promote more economically efficient consumption decisions.
23 This approach supports both financial sustainability and efficient use of the province's electricity
24 resources.