

- 1   **Q:**    Page 64 of the Brattle Group report notes that “*rates based upon marginal costs*  
2           *provide good economic price signals for consumers and producers and help*  
3           *ensure that scarce resources are being utilized efficiently.*” In the view of the  
4           **Brattle Group, how does the fact that most of the Muskrat Fall costs for Hydro**  
5           **will be fixed impact upon economic price signals and marginal cost?**  
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- 7    A.     In industries with fixed costs, pricing at marginal cost fails to recover fully the total  
8           costs of the firm. This implies that pricing at marginal cost, while optimal from a  
9           price signal perspective, is sub-optimal from a total cost recovery perspective. As  
10          a result, prices must increase above marginal costs in order to recover fully the  
11          firm’s total (average) costs. Economic theory suggests that prices should deviate  
12          from marginal costs in a manner that is least distorting as possible. In practice,  
13          however, many considerations are at play in the rate design process when designing  
14          electricity prices.