

1 Q. RE: Pre-filed Testimony of Dr. J.W. Wilson (June 1, 2015), page 22: Dr. J.W.
2 Wilson asserts that" ... it could very well be the case that even with the Labrador
3 interconnection on line, the long-run marginal cost of Labrador energy will still be
4 greater than Hydro's marginal cost at Holyrood" as " ... a large portion of the cost
5 of Labrador purchased power costs, and the capital cost of the interconnection as
6 well, will logically have to be considered an energy cost rather than a capacity cost."
7 How does Dr. Wilson conclude that sunk capital costs form a component of
8 marginal costs? If the costs do not vary in relation to use (e.g., capital costs that are
9 already spent), how are the costs to be considered to be on the margin?

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12 A. This question confuses the concepts of long run marginal cost ("LRMC") and short run
13 marginal cost ("SRMC"). While it is true that, in the short run, sunk costs are not
14 variable, in the long run all costs are variable.

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16 When it comes to questions of building and paying for major capital investments like the
17 Labrador interconnection and the generation that will flow over it, it is clearly LRMC
18 that is the relevant marginal cost. No doubt that is why a large portion of the costs of
19 capital-intensive generation facilities such as hydroelectric and nuclear power plants are
20 customarily charged to customers as energy costs. These costs, as well as the costs of the
21 Labrador interconnection and the generation related to it, are incurred to meet energy
22 requirements over many hours in each year. They could not be justified and would not be
23 incurred in order to meet only peak hour demands. The capital costs of the Labrador
24 interconnection and the generation supplying it make up the major share of the long run
25 marginal cost of future power supply to Newfoundland.