



Energy Market Update

DATA-DRIVEN PROCUREMENT & CONSULTING

A Brief Explanation of Pass-Through Costs

At APPI Energy, we often create electricity supply solutions for our customers centered on fixed price, full requirements supply contracts. We thoroughly vet energy suppliers and their supply contracts. Even so, in today's energy market, it is becoming more common for suppliers to pass through some additional supply costs that change during the term of the agreement.

Most suppliers, including some that APPI Energy works with, have the right to pass through supply cost increases approved by the Federal Energy Regulatory Commission (FERC) and/or Independent System Operators (ISO). ISO's manage the regional electricity grid system. Electricity supply contracts typically have language that addresses these cost adjustments, which often relate to supply requirements other than the actual energy itself and are borne by all customers in the affected area, regardless of who supplies the power.

How does a customer know if costs are being passed-through and how significant they are?

Pass-through charges often appear on the bill as a separate line item but may be included in the price per kWh, depending on the electric utility's billing policies. In either case, the underlying energy price has not changed, but the effect is that the customer pays more for the electricity supply when additional costs are passed through by suppliers. Depending on a customer's usage profile and its electric utility, non-energy components can comprise 25-50 percent of total supply costs.

These components may include the following:

- **Capacity costs:** Capacity payments help ensure the reliability of the grid by attracting generation resources to where they are needed the most. Capacity costs can be 25% or more of a customer's electricity supply costs and are based on capacity auction results as well as a customer's peak load contribution, or PLC. Capacity values, known as "tags", are specific to each customer and are determined by your average demand levels on the five days of the year with the highest usage across the utility zone.
- **Transmission fees (NITS & TEC):** Costs such as Network Integration Transmission Services (NITS) and Transmission Enhancement Credits (TEC) are assessed for the maintenance and upgrade of transmission systems and are used for the reliability, security, and redundancy of supply across the electricity grid. Similar to capacity, transmission "tags" reset each year based on the five peak days of the previous year.
- **Renewable energy mandates:** State mandates regarding the amount of electricity required to come from renewable sources can increase the costs of supplying power. Unanticipated changes may cause some suppliers to pass through the increased costs of providing renewable power.

Do suppliers differ in how they treat changes to the various cost components?

Yes. Suppliers differ not only in their contract terms and conditions, but also in how they manage unexpected costs. Customers should review and understand the definitions and scope of regulatory and material change clauses in supplier contracts, including these areas:

Change-in-Law/Regulation(CIL)- Is it limited to laws/regulations that impact specific cost components, or does it have a broader scope? Depending on the contract, it is possible that a customer will receive a reduction in costs in the event of decreases in a particular cost component.

Material-Adverse-Change(MAC)- How is a customer's change to its energy profile or usage amount handled? Is there a penalty or surcharge for usage changes? What circumstances trigger a cost increase? Is there a charge for dropping or adding service accounts?

As consultants with over 24 years experience in the energy industry, we have found that, despite the potential for cost adjustments, fixed price energy supply contracts are often an excellent solution for customers seeking a reliable cost structure and budget assurance. Fixed price contracts generally provide greater budget certainty than variable supply contracts as well as default supply rates from the utility that can change regularly. What matters most is initial and ongoing due diligence of the supply contracts offered by suppliers and an awareness of each supplier's tendencies regarding pass-through costs. We provide that to our customers. We are dedicated to helping them make an informed business decision regarding their electricity supply service and supporting them throughout the term of the supply contract if questions arise regarding supply service.

If you have any questions or would like a complimentary review of your energy options, please contact APPI Energy at 800-520-6685 or visit our website at www.appienergy.com.