

# Retail Energy Contracts: Choices for Customers

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Retail energy choice is slowly, but certainly becoming an option for businesses seeking another means of controlling their costs. Although a number of consumers have gone through several cycles of choosing and negotiating a purchase contract with an energy supplier, this process is still new to most.

In rare cases the customer will have the expertise to perform this task itself, but more often it is advisable to obtain specialized assistance for both the supplier selection process and the actual contract negotiation and documentation process. It is possible that, over time, the needs and desires of customers expressed throughout the marketplace will force a uniformity of supplier proposals and contracts. With such a uniformity, the selection process can become much easier and universally understood like any other not commodity or production input.

That point has not yet been reached. Retail energy proposals often appear to be (or are) offerings of apples and oranges that can only bewilder the energy buyer. And retail energy contracts still come in a great variety and contain important provisions unique to the energy contracting field. Consequently, it is necessary that the contract review and negotiation involve not only a good contract attorney, but one that is familiar with energy purchasing matters.

To assist the energy consumer in successfully addressing these new challenges, this article discusses the general availability of retail choice (from both the regulatory and practical perspectives), the means by which customers can take advantage of such choice, and some of the important contract terms and concepts.

## AVAILABILITY OF RETAIL CHOICE

State laws and regulatory policies now allow competition in retail gas markets in numerous states and in retail electric markets in a handful of states. Other states increasingly are considering electricity competition or even setting dates for consumer choice of retail electricity suppliers. The nature of choice today and the context for retail energy contracting is a result of how retail choice has evolved.

It is interesting to compare the evolution of competition in both the gas and electric industries. In the gas industry, the first step toward choice in both retail gas and electric markets were the federal initiatives to open the wholesale markets to competition. Those initiatives provided the first piece of the regulatory structure needed for retail choice.

Just as significantly, however, this started the market momentum and consumer demand for choice. After the federal wholesale initiatives, focus shifted to the states for retail choice. In the gas industry, efforts began in several states about a decade ago through regulatory commission mandates to local distribution companies (LDCs) to provide transportation service (enabling consumers to obtain physical delivery to the burnertip of the gas supplies that had just become available on an unbundled basis.)

This has been a slow process which has even now, barely reached the residential level. Even for any of the LDCs that normally are open to retail competition, tariff and regulatory impediments to comprehensive retail choice exist.

Usually the first hurdle is the level of the LDC transportation tariff. Initially, the rates were so high that transportation was not feasible. Even after the prices were reduced, the terms and conditions under transportation tariffs (e.g., balancing terms and penalties) often created obstacles.

Regulatory battles are still being fought to resolve these issues. Also, the larger issues associated with retail gas competition such as the market structure, the proper rule of the LDC, and the means of capacity release are still being worked out even in the states where some degree of retail choice in gas markets exists. Resolution of these global issues, most notably and immediately the type of capacity release available to marketers, will have a significant impact on the availability of true choice for customers on some LDC systems.

For example, where an LDC has mandatory capacity assignment of "slices" of its capacity contract, it becomes much more difficult and

costly for marketers to serve customers on that LDC's system. Consequently, marketers may avoid doing business on those LDC's systems or may raise their prices to cover the additional costs of taking capacity they cannot use efficiently. When the Massachusetts Department of Telecommunications and Energy required mandatory assignment for a 3- to 5-year transition period, several marketers announced a cessation of retail efforts in Massachusetts. The resolution of these issues will take time. Until then, there will be uneven availability of real choice for retail gas customers.

The development of the retail electricity market has begun with the highest cost states. Retail markets have begun in various states, including California, Rhode Island, Pennsylvania, New York, and Massachusetts. This approach has yielded a more comprehensively restructured industry in a much quicker time frame.

Yet the resulting structure, particularly as to price, that was necessary to obtain consensus on the legislation (notably including the issue of stranded cost recovery) currently limits the extent of competition. To achieve the legislatively required total rate, utilities must reduce their commodity price to a level so low that marketers have difficulty competing. As a result, real retail choice has been limited to date. However, as the regulated electric utility companies have sold their electric generation plants, pursuant to divestiture requirements of industry restructuring legislation or regulation at multiples of book value, they reduce stranded costs and can keep the required low total charges even with more realistic commodity prices.

## ALTERNATIVES FOR RETAIL CHOICE

Before discussing some important legal and business issues associated with retail electric and gas contracts, it is useful to put in perspective the context in which the consumer will be presented the contract. One fairly common structure, particularly in early stage electric markets and pilot programs, has been contracting with members of pre-existing groups (e.g., dairy farm association in upstate New York, member of a High Technology company group in eastern Massachusetts) or bringing together groups of related entities (e.g., non-profit hospitals and universities in Massachusetts or governmental entities in Rhode Island).

Such aggregations of customers are quite attractive for marketers, so they are often willing to give a better deal than that offered to individual customers. The customer may get a better price and contract terms, as well as the security of knowing that the contracting process was prudent. Smaller or lower load factor customers benefit from the more attractive load profile of the group.

This same factor, however, drives some larger customers out of an aggregated group on the theory that they can find a better deal on their own. The marketer, of course, gets favorable exposure and efficiencies of dealing with a group.

In general terms, the contract structure for such arrangements includes both a contract between the marketer and the group itself (or a special purpose affiliate) and the specific energy sale agreement between the marketer and the individual customer. The "aggregator" may be required to do some promotion and education, and the marketer will be required to give all parties the same deal. A customer may negotiate some provisions with the marketer, but because the contract has been negotiated once, generally there will be limited changes made.

Purchasing arrangements for individual customers, as opposed to for aggregated groups, can take a wide variety of forms. Smaller customers' purchases or simple commodity purchases will often be documented by a form contract prepared by the marketer.

Here again, limited changes are likely. In a relatively competitive area, however, the form of contract may be a marketing point where the simpler form is more desirable to customers. The following section describes common contract terms and their implications, as well as the broader division of risks between a retail energy purchaser and the marketer.

In contrast, larger or more customized deals are more likely to be the product of more extensive negotiation. For example, a sales arrangement bundled with provision of energy services requires customization, because of the variety of energy services (e.g., lighting retrofits or many other conservation measures). Contracts for such deals, however, will have the same starting position and contain the same core terms as the other contracts referenced above.

## SIGNIFICANT CONTRACT TERMS

### Price

“*Show me the money*” is as important in retail energy contracts as it is in the movies. The price terms in such contracts can involve several critical issues. First, the unit price itself may be fixed or variable, or may be set by a percentage off the utility pricing. A fixed price for a given period seems to be the norm in retail gas contracts, although, some contracts include a “guarantee” that such price will be less than that of the local utility.

Retail electric contracts generally seem to be priced at a percentage of the local electric distribution company’s standard offer. In any event, if the customer is relying on a particular level of savings, efforts should be made to have that reflected in the contract.

### Quantity

The contract quantity is also critical. All requirements service with the marketer assuming responsibility for the customer’s variations in demand is obviously most desirable for the customer, assuming no price differential.

### Failure To Deliver

Many marketers will provide in their contracts a provision ensuring that if they fail to deliver, the marketer will be responsible for any difference in price between that specified in the contract and the price available for the replacement supplies. This is obviously very important to the customer. While the marketer may legally have such an obligation under a contract without specific provision, this is a provision that should be inserted. Also, it is beneficial to the customer to have the right to net that difference against future invoices. Should such a provision be included, it is reasonable that the customer’s remedy be limited to a price differential where the replacement supply was prudently obtained and where the marketer can confirm the accounting for the differential. The extent of the marketer’s liability under such a provision generally will be limited, however, by *force majeure* events.

### Force Majeure

Virtually every energy sales agreement will have a *force majeure* provision. In many cases the differing provisions from contract to con-

tract will simply be immaterial variations on the same theme. *Force majeure* provisions are intended to excuse a party's performance when an event beyond the reasonable control of that party occurs. Payment obligations arising before a *force majeure* event are generally not excused. While this is standard "boilerplate," parties should be sure that the events for which performance is excused are not overly broad and that the party claiming *force majeure* must take reasonable actions to try to resume performance. A purchaser should ensure that the *force majeure* does not excuse a failure of performance which results from a controllable event, e.g. if a supplier relies on a single source power supply without specifying that in the contract and then claims an outage at that plant is a *force majeure*. Also, both parties should beware of "price majeure" provisions and "regulatory out" provisions.

### **Taxes and Other Charges**

It is typical that the supplier will require that the purchaser bear any taxes and similar charges, at least at or after the point of delivery. This is unavoidable, but the purchaser should be aware of that cost. Other charges such as balancing charges are more generally the responsibility of the marketer, unless the customer has failed to inform the marketer of significant changes in usage.

### **Conclusion**

Retail choice for electric and gas supplies is becoming a reality, though it is coming much more slowly than many hoped and anticipated over the last few years. Some legislative and regulatory initiatives have been encouraging, yet much remains to be accomplished, particularly in terms of implementation. Nonetheless, many exciting deals are being struck and retail choice is arriving through both aggregations and through individual contracts. Especially in the early stages of this market, where retail energy contracts are relatively new, customers and marketers should be careful that their contracts reflect their intent and that they have considered the various risks that they are undertaking.

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### **ABOUT THE AUTHOR**

**Eric J. Krathwohl**, a member/shareholder of the firm of Rich, May, Bilodeau & Flaherty, P.C., concentrates on energy, telecommunications and regulatory matters, including corporate and finance work for en-

ergy and telecommunication companies and electric, gas and water utility companies. For nearly twenty years, Mr. Krathwohl has had an active practice before the Massachusetts Department of Telecommunications and Energy, having represented utility companies in dozens of adjudicatory and rulemaking proceedings.

Also, his practice has included numerous proceedings before the New York Public Service Commission and the Federal Energy Regulatory Commission and transactions throughout the northeastern United States. He has been active in matters relating to restructuring of the electric, gas and telecommunications industries, increasing competition in those industries, and unbundling the service offerings of public service corporations.

Mr. Krathwohl has represented clients in several matters before the Massachusetts Supreme Judicial Court and has been a speaking panelist with top industry and government officials at conferences on electric restructuring and increasing competition in the utility industry and telecommunications matters. Mr. Krathwohl has also considerable experience in a variety of corporate and contractual matters in the telecommunications and energy fields.

He is the chairman of the Boston Bar Association Energy Law Committee and is a member of several other energy and bar associations. Along with two of his partners, Mr. Krathwohl authored the portion of an administrative law treatise dealing with public utility regulation.

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