Why Electric Power Contracts Need to be Read Carefully And Negotiated Carefully

OR—Will Somebody Please Tell Me What I've Signed?

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A consultant often hears questions such as these:

- "Would you look at our power contract and tell me what we have signed?"
- "I don't know what this power contract means. The guy who was here before me signed it. What's it all about?"
- "Our local utility wants to give us a lower rate if we will sign a new 5-year power contract. Should I do it?"

Many large users of power have assumed for years that because the friendly marketing representative from the Down Home Power Company came by with a power contract it was okay to sign the document. After all, who would one buy electric power from other than Down Home Power? It was *never true* that one should simply sign the power contract because Down Home's name was printed boldly across the top of page one. It certainly *is not true today* that a power contract should be signed simply because the power company marketing representative places it on your desk.

WHAT IS A CONTRACT?

A contract is a written agreement between two or more parties that specifies that someone (or several parties) will take certain actions at a certain time in a certain manner. Some of the parties to the agreement may be agreeing to pay others a specified amount of money for these actions taken.

Contracts can take many forms. We may sign a sales contract with an automobile dealer. This contract may provide that we will receive a new automobile if we give the dealer $20,000 plus our old jalopy. If we are agreeing to buy the new car before we go to the bank or credit union, we may include a clause that cancels the sales contract if a certain action fails to occur. The certain action in this case is securing the loan.

Let's assume all goes well and we qualify for the $20,000 loan at the credit union. We will then sign a contract with the credit union that if they give (loan) us the $20,000 we will give it back (repay) it over a sixty month period at a given interest rate. In addition, we will likely add a clause (at an additional cost) that will forgive the loan upon our death or disability. Actually we are buying an insurance policy (a contract again) to pay off the loan if we die or become disabled.

In spite of all the kilowatts, voltages, phases, power factors, etc. in an electric power contract, many power contracts are no more complicated than an automobile sales contract. No more complicated that is if one knows what the kilowatt numbers mean, how the numbers on the power contract can affect one's electric billing, and how long a time one's company is agreeing to a business relationship with the utility.

WHY ARE THERE ELECTRIC POWER CONTRACTS?

A Contract Names the Parties—Valuable to the *customer* in describing its various assets and liabilities. Valuable to the *utility* in the event the customer sells his property or files for bankruptcy.

A Contract Describes the Electrical Delivery Point—Valuable to both *the utility and the customer* in that it leaves no doubt as to where maintenance responsibility and legal liability begin and end.

A Contract Describes the Character of Service—Valuable mainly to the *customer* in that the utility is under contract to supply a certain voltage, phase, and character of service (delta or wye) and can't change it arbitrarily.

A Contract Describes the Amount of Power to be Delivered—Valuable to the *customer* because it requires the utility to be able to deliver at least the contracted kilowatts. It also valuable to the *customer* in the event of an emergency situation—whether a technical, natural, or national emergency. Power rationing could depend upon the amount of kilowatts specified in the contract. Valuable to the *utility* for electric sys-

tem planning and minimum electric revenue billing purposes.

A Contract Identifies the Rate Schedule—Valuable to the *customer* for use in verifying that the utility is billing under the proper rate. Often a *utility* can be contracted to notify the customer one-on-one prior to any rate filing with its regulatory body. This is in contrast to the usual legal notices filed when a utility approaches a PSC for a rate increase.

A Contract Describes the Length of the Business Relationship—Valuable to the *customer* since it gives its financial people a handle on various liabilities associated with the power contract. Valuable to the *utility* for financial purposes (Wall Street credit ratings) and electric system planning purposes.

A Contract Defines a Force Majeure—Usually the *utility* describes a force majeure in terms to benefit only *themselves* A *customer* can ask for and can often negotiate a two-way street, force majeure clause that will release the customer from taking power or paying for power if certain uncontrollable events occur.

A Contract Can Deal with Future Events—Any contract negotiation between an industrial customer and a utility should include discussions about *what will happen if and when the particular state authorizes retail access.* Some sort of retail access get-out mechanism should be part of the negotiating strategy.

WHAT KINDS OF PROBLEMS COULD WE GET INTO?

The above section describes the reasons for entering into an electric service contract. All of the reasons are good ones. However, one has to be careful of the details of the agreement. The details are not intended to cause a large power user to fall into an onerous situation, but it can happen.

Here is a listing of some items that could cause problems for your company:

Contract Capacity

Let's say you are building a new pipeline pumping station. Your staff should have a reasonable idea about the amount of kilowatt (kW) demand your facility will require. Assume your calculations predict 7,800 kW. At a 90% power factor this is about 8,700 kVa. Your contract capacity should generally be in the range of 7,000 to 8,000 kilowatts. If

the utility tells you that a 15,000 kVa substation is the smallest size they will install and your contract capacity will be 10,000 kW, then you need to go up the chain of command at the utility. Unless you have specifically asked for extra capacity you should not be asked to pay for it. In many electric utility rates some sort of minimum billing (or ratchet billing) is based on the contract capacity (the numerical figure) written into the contract.

Initial Term of Contract

Let's say your company is building a new industrial plant. The utility builds a half mile of transmission line and a new substation. The utility should be entitled to about a 5-year contract. This ensures that your company will make them whole on their investment and that other ratepayers won't be burdened with the cost should you leave the area before 5 years.

If the utility has told you they plan to charge your company a contribution-in-aid-of-construction (known as CIAC in the trade) then the initial term of the power contract probably ought to be less than 5 years. A CIAC *and* a 5-year term may be needed but only under an unusual set of circumstances. CIAC is designed to be used for those items that are above and beyond the normal items for rendering service, i.e. things that aren't recovered in the utility's rate base. For example, a university may want 2,000 feet of transmission line relocated so they may build a new dormitory and parking lot. This relocation of electric lines has nothing to do with providing electric service to the dormitory and is a legitimate CIAC charge on the part of the utility. Watch the CIAC concept carefully. Some utilities may try to charge both a CIAC and a guaranteed dollar monthly minimum bill to cover their construction costs. They seldom need both.

If we are moving into an existing building and the utility has only to close-in some circuit breakers or install a meter to serve the building, a 1-year to 2-year electric service agreement should suffice. If the utility rep tells you, "It's in the rate and all new customers of your size have to sign a 5-year contract," then get an energy consultant, your legal counsel, or both. It may be printed in the rate, but this requirement is ridiculous!

Termination of the Contract After the Initial Term

Normally a power contract will read, "for 5 years and thereafter unless terminated in writing by a 60-day notice." The 60-day figure can

vary and still be okay. Be careful of a power contract that reads something like this, "for 5 years and thereafter unless terminated in writing 30 days prior to the expiration date in which case the contract will renew for a like term." In other words, if one misses the 30-day window at the end of the initial term, your company is married to the electric utility for another 5 years.

Change of Rate Schedule

Ensure that once you have achieved the initial term under the specified rate (or its state-approved successor rate) you will have the option to change your billing to a more economically attractive rate schedule at least once each year. If the pre-printed power contract submitted to you doesn't have this language in it, then ask for an addendum that will specify this right.

Notice of Rate Changes

To accomplish a rate change, the vast majority of investor-owned electric utilities file new rate schedules along with supporting documents with their respective public service commission. The public service commission will let the application for new rates "lie on the table" for the number of days specified by state law prior to holding hearings on the changes. In some cases a legal notice will be published in area newspapers. Normally, unless your company is an extremely large power customer, the utility won't notify you of planned rate changes. If you want to be forewarned of rate changes, ask for a contract addendum to specify that the utility will notify your company in writing of any rate change filing at the same time they file with the public service commission. Having this early-on knowledge may enable your company or trade association to challenge successfully a burdensome rate increase or a shifting of costs among rate classes.

Force Majeure Article

Practically every utility will include an article in their contracts that holds them harmless in the event they can't deliver electric service. This article (known as the force majeure article) typically mentions strikes, fires, floods, etc. Many large power users overlook this important power contract article. Ask that this article be rewritten so that it is a two-way street. What if your unionized employees go out on strike? What if you have a disastrous fire? You would want to be excused from minimum bills during the time the force majeure condition existed.

Future Events

Nobody knows what the utility industry will look like in 2 to 5 years. Certainly it will be different from today. In 1996 federal rulemaking was completed to address competition on the generation level and transmission system level of utilities. The retail level competition picture is still cloudy. However, it is a good bet that some states will implement some form of retail electric service competition soon after the Federal wholesale competitive rules are implemented. Where that happens, larger users of electric power will see a mix of traditional electric utilities and power marketers offering electric service to them. Today, more than ever, *is not* the time to sign an electric power contract without thoroughly reviewing it and negotiating it in a firm but fair fashion.

No matter if yours is a new facility or one that has taken electric service for 15 years from the local utility, you should be very careful at the first mention of the words "electric power contract." Two of the things you should consider because of the potentially competitive retail electric service environment are:

- Why is the utility asking me to sign a new 5-year contract when the old one is continuing on a year-to-year basis? Answer: They want a piece of paper that, to a degree, says you belong to them in the event retail competition comes to your state.

- Can I get out of my power contract if retail competition is permitted in my state? Answer: Maybe. Ask for a clause that at least opens the contract for renegotiation if the legislature or public service commission permits retail access during the life of the contract. Another method might be to negotiate for a percentage of "free agent kilowatts." For example, let's say the utility wants you to renew an expired 10,000 kW power contract for two additional years. You might agree to do so if you can be free to purchase 50% of your power requirement (5,000 kW) on the open market if retail competition is permitted by the state within the 2-year contract renewal term. This way the utility gets some of what they want and so do you.

CONCLUSION

From the big picture viewpoint an electric power contract may not be any more complex than an automobile sales contract. As with many business arrangements, it will be the details that count. Anything that is ethical, that is legal, and that can be agreed upon by the involved parties can be placed into an electric power contract. Money spent today with an energy consultant and your legal counsel may pay dividends for you tomorrow. The words to remember are—read carefully and negotiate carefully.

ABOUT THE AUTHOR

Robert W. Chatham, P.E., is the principal at Precision Strategies, Inc., a management services consulting firm based in Long Beach, Mississippi. His firm provides consulting services to large industrial and large commercial users of electric power in all aspects of their business dealings with electric power suppliers.

Before accepting an early-out package in late 1994 from Mississippi Power (a part of the Southern Company), he had completed a long career in electric utility marketing. During his career he was involved in work with all classes of customers—particularly large industrial customers, federal accounts, and national commercial chain accounts. He has had experience with cogeneration projects and demand-side management projects. He also represented his former employer's interests with a state-level quasi-regulatory body.

His academic credentials include a bachelor's degree in electrical engineering and a master of business administration degree. He is a registered professional engineer, a senior member of the Association of Energy Engineers, and is a member of both the Atlanta and Houston pipeliner's clubs.