



New Standard Contract for Energy Purchasing: An Idea Whose Time Has Come

About the Author

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This seminal document developed by the North America Energy Standards Board team, in cooperation with retail energy buyers and suppliers, should serve as a model for how to efficiently develop standard contracts for other industries—enabling more business to be transacted more easily, and saving time and money in the process.

BY JACK MASON

THE COST OF ENERGY TYPICALLY IS ONE OF THE TOP FIVE operating costs for businesses. And, according to the Institute for Supply Management, energy has been the top concern of procurement executives in their semiannual forecast of business for the last two years. With today's rising costs and wild price fluctuations, the cost of energy is having significant impact on the financial performance of companies in the United States and across the globe.

One way to control rising energy costs and energy pricing volatility is to take advantage of fast-breaking energy pricing opportunities in competitive energy markets. But to take advantage of these fast-breaking deals, companies must be able to respond immediately, and quickly negotiate contracts within a very finite window of time.

Until very recently, this has not always been an option. Why? Because contracts for the purchase of natural gas and electricity differ widely from each other, are very complex, are

unfamiliar to most business legal staffs (especially those with limited or infrequent experience in energy contracting), and negotiations can drag on for days or weeks—resulting in significant legal costs and sometimes causing companies to miss the market opportunities that can come and go in a week's time.

With all of this in mind, it became clear that companies everywhere would benefit from a standardized energy contract designed to speed energy procurement negotiations, and also lower transaction costs.

Because of all of these reasons, we saw a major need for a standardized energy contract for retail energy purchasing, and took a leadership role in the development of this new contract.

Energy Competition

When energy markets are deregulated (similar to telecommunications), the delivery mechanism (the pipes and wires that bring the energy to your facility) remain regulated, but the actual

commodity supply (natural gas and electricity) is available from multiple suppliers.

Natural gas deregulation started in the 1990s and is well developed. For natural gas for businesses, most states and Canadian provinces are deregulated, i.e., you can buy natural gas from competitive suppliers.

Electricity deregulation started in the late 1990s, and there are 13 U.S. states, the District of Columbia, and two Canadian provinces that are deregulated and have active competitive markets for businesses.

Why We Need a Standard Energy Contract

At the time natural gas and electricity were first deregulated, there already were many different rules, regulations, tariffs, contracts, and terms in existence.

Adding another layer of complexity to the situation, now there are more than 100 competitive natural gas suppliers in the United States and Canada. In addition, there are close to 50 competitive electricity suppliers serving hundreds of distinct local utility commodity markets in the United States and Canada.

All these entities have big differences in contracting policies. Buyers and their legal teams have little or no experience dealing with the idiosyncrasies of energy contracts, and they may be uninformed about what is common practice and what is unique to the supplier or situation. Reviewing different contracts for each competitive energy supplier takes time, and legal fees can mount quickly.

However, if the energy contract adheres to a pre-determined set of standards, with only a few items up for negotiation, then companies can save time and money, focus on the important business issues, and, even more importantly, move fast enough to take advantage of fast-breaking, deadline-oriented opportunities for lower prices on natural gas and electricity.

The Wholesale World

In the mid-1990s, the Gas Industry Standards Board (GISB) was formed to develop standard contracts and standards for the conduct of natural gas transactions.

GISB developed a standard contract called the GISB Base Contract for Sale and Purchase of Natural Gas (most recent version is September 5, 2006).

This base contract was developed primarily for *wholesale* energy transactions but because there was such a need for standardization of energy contracts in the retail world (where companies are buying energy to power their facilities), many retail energy buyers started to use the wholesale energy contract, even though it really didn't fit the needs of retail energy buying.

From a survey we conducted, some 50 natural gas suppliers and buyers revealed that 75 percent used the standard contract without modification and all but a handful used it with only minor special provisions.

(Of note, GISB was re-chartered as the North American Energy Standards Board, or NAESB, in 2001.)

Development of the Standard Energy Contract

As the volume of transactions of electricity, in particular, expanded substantially for retail purchases, it became clear to us that there was a critical need to develop a similar standard contract appropriate for *retail-level* electricity purchasing.

In January 2005, we conferred with Rae McQuade, the executive director of NAESB, and suggested that NAESB spearhead the development of a standard contract for retail electricity purchasing. McQuade agreed wholeheartedly and asked her staff to assist us in submitting a formal request to NAESB.

Both the retail electricity and retail gas executive committees of NAESB accepted the request from us to embark on the project, and formed a joint contract subcommittee to develop a standard retail contract that would be applicable both for retail electricity and retail natural gas transactions.

A group of energy industry experts from suppliers, utilities, and large energy users began development of a contract document that used the most appropriate facets of the old GISB wholesale contract, and also incorporated facets quite specific to *retail* energy transactions.

After many months of actual development, and time for public comment and polishing of the document, NAESB finalized the new standard contract in late 2006. It was formally accepted by the NAESB industry membership on January 7, 2007. It is now available for use from the NAESB Web site, www.naesb.org, or the EnergyWindow Web site, www.energywindow.com.

An unlimited-use license to use the new contract for retail energy purchases can be purchased for a one-time \$50 fee from NAESB, or from EnergyWindow, which has an agreement with NAESB.

Save Time and Money

The new standardized retail energy contract is structured in four distinct components—all designed to save time and money.

Section 1 of the contract is a cover sheet addressing a variety of choices a retail energy buyer would face (such as what state law governs, transaction procedure, and more). Buyers are asked to make a series of choices, and these choices become their terms for the contract.

Section 2 of the contract covers standardized language, terms, and conditions for the buyer and the seller.

Section 3 of the contract accommodates special provisions that allow the buyer and seller to negotiate different terms than the base energy contract. This is very efficient, and allows buyers and sellers to focus quickly and efficiently on areas of contention and resolve them.

Section 4 of the contract is a transaction confirmation that establishes the business aspects of the deal including actual price, billing, the delivery point for natural gas and electricity, and the volume of energy required.

Once the master terms have been determined up front, this standard contract can reduce the time for a specific transaction to an hour or less—which saves significant time and legal expenses, while allowing buyers to capture short-lived buying opportunities to get better rates and lower their energy costs.

With this approach, there is more common understanding

of terms and conditions, it's easier to administer, and there's less opportunity for misunderstandings that could lead to re-negotiations or contract terminations at a later date.

The Benefits

Benefits of using the new NAESB base contract include:

- Lower transaction costs and effort associated with reviewing and negotiating contracts, and executing electric service agreements;
- Reduced customer service and contract administration cost and effort following a contract during the term of the contract;
- Less lost savings for buyers and less lost revenue for suppliers when deals are delayed in negotiations;
- Fewer missed opportunities as a result of rapidly shifting markets and prices;
- Fewer opportunities for customer misunderstanding, dissatisfaction, and loss;
- Less risk for buyers and energy suppliers;
- Greater ability to judge the value of offerings accurately on important contract attributes without decisions being clouded by legal aspects and language; and
- A framework that allows suppliers to more easily differentiate their offerings and provide new, innovative products for customers.

Speed of Energy E-Procurement

Electronic procurement, or "e-procurement," of energy through Web-based auctions and reverse auctions allows an unprecedented speed of transaction. Simply put, energy e-procurement accelerates the processes of gathering the many data points needed to prepare a request for quote, calculating a threshold for buying decisions, posting the quote online, facilitating bidding by qualified energy suppliers bid on the contracts, and ultimately, awarding the contract to the winning bidder.

These new systems are revolutionizing energy purchasing, and are allowing companies to buy energy easily and quickly in competitive energy markets. Done manually, it would be very difficult for many companies to pursue most of these competitive energy deals. They are far too complex, take too long to research, and require a type of specialized energy purchasing expertise not typically fully available in the majority of procurement departments.

The new breed of energy purchasing technology literally has helped companies save millions of dollars on the energy needed to run their factory equipment, air condition or heat their stores, and power their office equipment. But the various energy purchasing technologies already on the market have been hampered by the slow pace of contract negotiations.

So while Web-based energy procurement systems allow buyers to move fast to buy energy at better rates, the old contract process often slows the process to a snail's pace. As a result, buyers lose opportunities to save thousands and thousands of dollars on natural gas and electricity purchases for their businesses—simply because the contracts take too long to negotiate and the deal is lost.

But with the advent of the new standard contract, the contract negotiation process need no longer prevent buyers from executing competitive energy deals that could literally save millions of dollars over time. It enables online implementation of the contract development, review, and negotiation process commensurate with the speed of other aspects of contemporary e-procurement.

New Standard Retail Energy Contract

The NAESB standard energy contract is an idea whose time has come. This seminal document developed by the NAESB team, in cooperation with retail energy buyers and suppliers, should serve as a model for how to efficiently develop standard contracts for other industries—enabling more business to be transacted more easily, and saving time and money in the process.

In addition, given the accelerating adoption of online electronic procurement of energy in competitive retail markets, the availability of this standard contract is extremely timely. We developed a prototype and tested the use of such a contract online, and fully supported this effort because it is an important step that will reduce energy transaction times, costs, and risks using information technology to buy energy. **CM**

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