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## Are Lock-In Contracts for Heating Oil Unconscionable Under the Uniform Commercial Code? A Teaching Exercise in Contract Law

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<sup>82</sup> *Id.* at 1.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at 1-2.

<sup>86</sup> *Id.* at 2.

<sup>87</sup> See e.g., Linda Galler, *Problems in Defining and Controlling Unauthorized Practice of Law*, 44 Ariz. L. Rev. 773, 777 (2003) (Noting that accountants and accounting firms often engage in UPI, despite federal regulations under Circular 230 that permit CPAs, enrolled agents, and enrolled actuaries to practice before the IRS such as when in transactional planning accountants give an opinion as to probable tax consequences).

<sup>88</sup> Susan D. Hoppock, *Enforcing Unauthorized Practice of Law Prohibitions: The Emergence of the Private Cause of Action and its Impact on Effective Enforcement*, 20 Geo. J. Legal Ethics 719, 723.

" *Id.*

<sup>90</sup> Soha Turfler, *A Model Definition of the Practice of Law: If Not Now, When? An Alternative Approach to Defining the Practice of Law*, 61 Wash & Lee L. Rev. 1903, 1916.

<sup>91</sup> [http://www.abanet.org/cpr/model-def/model\\_def\\_definition.html](http://www.abanet.org/cpr/model-def/model_def_definition.html) (Last visited November 14, 2010).

Are Lock-In Contracts for Heating Oil Unconscionable Under  
the Uniform Commercial  
Code?  
A Teaching Exercise in Contract Law

by

Sharlene A. McEvoy\*

ABSTRACT

There has been a trend in recent years for heating oil companies to encourage customers to "lock in" a price for a season as a hedge against an increase in oil prices. This paper analyzes the issue in light of the unconscionable contract provision of the Uniform Commercial Code.

INTRODUCTION

In the past few years the cost of home heating oil has increased dramatically as the price of a barrel of oil skyrocketed to nearly \$150.00 a barrel during the summer of 2008.<sup>1</sup>

Because some analysts had predicted that oil might go as high as \$200.00 per barrel, many consumers became anxious about their ability to pay for home heating oil during the winter of 2008-2009.

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As a result, some entered into contracts during the summer of 2008 with heating oil companies when the price per gallon was between \$3.80 and \$4.28 which was the going rate as late as September 2008.<sup>2</sup>

In the eight weeks before the Presidential election and in the months that followed, the price per barrel of oil fell dramatically which resulted in lower prices for gasoline and heating oil. Those who believed that it was prudent to lock in a price are now dismayed to learn that their neighbors who did not enter such contracts are paying as little as \$2.00 - \$2.50 per gallon.

For example, Barbara Daley, who is '76 and lives on Long Island, entered into a contract with a heating oil company with whom she has done business for 30-35 years. Her lock-in price was \$4.22 per gallon. Ms. Daley regrets entering the contract and would like to modify it. However one proviso of the agreement states that it will cost her \$599.00 to terminate the contract, which is approximately the price of a single oil delivery.<sup>3</sup>

While it is not known how many consumers entered such agreements, estimates are that thousands of homeowners signed contracts during the summer 200 - . Some signed on in July when the price peaked at \$4.78 per gallon.<sup>4</sup>

Others have entered agreements which "cap the maximum price they must pay but permits them to pay less if the price drops."<sup>5</sup> While these consumers are in better shape than those who entered the fixed price deals, the oil companies included provisions in the contracts which allow them to charge ten to twenty cents more than the going rate as a hedge against, any further sharp drop in oil prices.<sup>6</sup>

Are these contracts unenforceable under the Uniform Commercial Code provision 2-302 which covers the concept of unconscionability? The landmark case on such provisions in adhesion contracts is Jones v. Star Credit Corp.<sup>7</sup>

Cliffon and Cora Jones, both welfare recipients, agreed to purchase a home freezer from Your Shop at I-Tome Service, Inc. For \$900.00 with the addition of such charges as credit life insurance, credit property insurance and sales tax. The total price came to \$1439.69. The Jones' paid \$619.88 toward the freezer. The defendant claimed that with all the added chares there was a balance due of \$819.81.8

At trial evidence showed that the freezer had a maximum retail value of \$300.9 The issue in the case was whether this contract would be considered "unconscionable" under 2-302 of the Uniform Commercial Code which provides:

If the court, as a matter of law, finds the contract or any clause to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.<sup>10</sup>

The Supreme Court of New York held that contract was unconscionable and ordered the contract reformed so that the \$619.88 already paid by the Jones would constitute the entire purchase price."

In his opinion, the judge reviewed the fact that when "caveat emptor" reined, the parties had "unbridled latitude" to make their own contracts, which allowed "exploitive and callous practices which shocked the conscience of the legislature and the courts".<sup>12</sup>

The judge cited the importance of preserving the integrity of contracts allowing parties "to deal, trade, bargain, and contract." Another concern, however, is for the

uneducated, illiterate and the poor, .who are the most likely victims of merchants who would prey on them.'<sup>3</sup>

The judge cited 2-302 of the UCC as enacting "the moral sense of the community into the law of commercial transactions".<sup>4</sup> Section 2-302 allows a court to find that a contract or clause in it "was unconscionable at the time it was made, permitting the court may do one of three things: refuse to enforce the contract, eliminate the offending clause or limit the impact of the clause" to avoid an unconscionable result."<sup>16</sup>

The Official Comment to 2-302 states that its purpose is to prevent "oppression or unfair surprise"<sup>17</sup>

The judge commented that 2-302 covers the price term of a contract. "Indeed, no other provision of an agreement more intimately touches upon the question of unconscionability than does the term regarding price."<sup>18</sup>

The judge stated that the mathematical disparity between \$300, which presumably includes a reasonable profit margin and \$900, which is exorbitant on its face, carries the greatest weight."<sup>19</sup>

The judge cautioned that price disparity is not the only factor governing unconscionability. Other factors include the "limited financial resources" of the buyers which can weigh in the court's decision.<sup>20</sup>

From the perspective of the heating oil customer, the lock-in contracts would appear to meet the "Jones" test of being unconscionable. Many of these contracts were entered into in the summer of 2008 when oil prices reached their high water mark and when some analysts were predicting that heating oil might go to \$6.00 per gallon if the price per barrel of oil soared to over \$200-\$250. Elderly consumers who live on fixed incomes were fearful that if they did not lock in at the summer price, cold weather in the fall and winter would cause prices to rise even more, thus making their financial situation even more precarious.

By late fall 2008 however, some oil dealers were

selling heating fuel for under \$2.50 a gallon. Those who locked in are paying 55% more per gallon in some cases,<sup>21</sup>

From the oil companies' point of view these agreements are not unreasonable. They argue that they are being blamed for a situation over which they have no control. They believe that large oil refiners and wholesalers set the prices and when customers signed the contracts during the summer 2008, by law in some states dealers had to purchase 80% of the oil from the wholesalers at then prevailing prices to cover the contracts or purchase a surety bond to cover re-buy and fixed price agreement obligations.<sup>22</sup> Therefore, if they were to cut prices in response to the current market, they would lose money and possibly their business because they are already locked into their

costs .<sup>23</sup>

The problem became so acute in November 2008 with consumers clamoring for rescission of their contracts, that the Independent Connecticut Petroleum Associates (ICPA) joined with other oil heat associations in the Northeast to ask the Secretary of the Treasury for loans to help buy out the contracts of those who signed on at the high price and exchange them for less expensive agreements.<sup>24</sup> Such an arrangement would permit consumers to get the lower prevailing prices and preserve the profits for the oil dealer who would be reimbursed for the oil they had purchased at the high price.

The saga of the "locked in" heating oil contracts provides an excellent case study to teach students about the principles of contract law as well as the concept of unconscionable agreements under 2-302 of the Uniform Commercial Code. Since many textbooks offer an edited version of *Jones v. Star Credit Corp.*,<sup>25</sup> the case provides an excellent springboard for teaching about unconscionable contracts and individuals who might be particularly

vulnerable.

Among the questions that might be posed to students are:

1. Is a heating oil contract covered under the UCC or is it a contract for a service i.e. delivery of a commodity?
2. Ask students to compare the facts of Jones with that of Barbara Daley, an elderly woman who lives on a fixed income?
3. Did Daley and others have all the facts when they decided to enter a "lock in" contract? Who does have such information? The oil dealers? Economists? Refiners?
4. If Daley and others were to sue, claiming unconscionability under 2-302, would they be successful and what counter arguments would the defendant dealers make?
5. Are lock-in contracts ethical if neither the consumer nor the dealer has perfect information? Is there an argument for fraud, mutual mistake, or economic duress which would offer the possibility of rescission?
6. Ask the students to apply the judge's reasoning in Jones to the "lock in" cases. Is that decision applicable to this situation?
7. Did state law make the problem worse by forcing dealers to buy oil when contracts were made?
8. The Independent Petroleum Dealers Association appealed to the Secretary of the Treasury to get relief from the rescue package, TARP? Should taxpayer money be allocated to dealers to buy out customers who locked in?
9. Is this the kind of relief Congress intended when it passed the bailout package?

Another possible avenue of relief for disgruntled consumers is to examine their contracts to determine if they

are in compliance with Connecticut law<sup>26</sup> which states:

"A contract for the retail sale of home heating oil that offers a guaranteed price plan including fixed price contracts and any other similar terms shall be in writing and the terms and conditions of such price plans shall be disclosed. Such disclosure shall be in plain language and shall immediately follow the language concerning the price or service that could be affected and shall be printed in no less than twelve point boldface type of uniform font."

Students can be asked to examine samples of "lock-in" contracts to determine if they are in compliance with this law. (See Appendix) Some of the agreements contain "liquidated damages" provisions. Ask the students to examine these clauses and decide if they are "reasonable". The Office of the Attorney General of Connecticut "encourages customers to contact their fuel oil dealer and discuss the possibility of working out another price with the understanding that the dealer is not obligated to do so."<sup>27</sup> Students can discuss the ethical responsibilities of the oil dealers. Would it be "good business" for the oil company to do so to win customer loyalty even though letting customers rescind will cause the companies to lose profits? Do states have an ethical or legal obligation to step in and lessen the burden on oppressed customers especially when an essential commodity like heating oil is involved? Should the states buy out these contracts?

#### CONCLUSION

It would seem that the 2-302 would not apply to these oil contracts. In essence, consumers bet on the market, namely,

that the price of oil would go up and that they would be protected. As it happened, that wager did not pay off in 2008. The oil delivery companies did not take advantage of their customers because they had to purchase oil at high prices to fulfill the agreements.

Consumers must realize that a signed contract means business that they are legally bound and can be sued for breach if they back out. Both customers and dealers were victims of a volatile market.

A possible solution would be for legislators to ban oil companies from offering lock-in contracts. Thus, dealers will not be forced to buy oil before customers seek delivery. Customers will not have to worry that they have made a bad bargain that will come back to haunt them. Students can be asked for their opinion on such a law.

The legislature should allow oil companies to offer "capped price" contracts only with reasonable premiums if the price drops. Those who choose this option know that they will not be liable to pay more than a certain price for the heating oil. Students might offer recommendations for a change in the Connecticut statute to avoid problems in the future.

#### NOTES

<sup>1</sup> Rob Varnen, "Price Drop Now Hurts Oil Dealers," *Conn Post*, Nov 8, 2008 at A1. (hereinafter "Price Drop Now Hurts Oil Dealers")

<sup>2</sup> Ken Belson, "Some Who Locked in a Price for Heating Oil Now Wish They Hadn't," *N.Y. Times*, Oct 23, 2008 at A27. (hereinafter "Some Who Locked in a Price")

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> 59 Misc 2d 189; 298 N.Y.S. 2d 264; 1969 N.Y. Misc LEXIS 1696; 6 U.C.C. Rep. Serv. (Callaghan)76.

<sup>8</sup> 59 Misc 2d 190.

<sup>9</sup> *Id.*

10 2-302 (L.1962 ch553 eff Sept 27, 1964)

<sup>11</sup> 59 Misc 2d 193.

<sup>12</sup> *Id.* at 190.

<sup>13</sup> *Id.* at 190-191.

<sup>14</sup> *Id.* at 191.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 192.

<sup>20</sup> *Id.*

<sup>21</sup> Cara Baruzzi, "Locked In: Heating Oil Contracts Burn Consumers Dealers," *N.I-L Register* Nov 9, 2008 at C 1

<sup>22</sup> Letter from Assistant Attorney General Thomas Saadi, Dec. 4, 2008 at I. (hereinafter Saadi Letter)

<sup>23</sup> *Id.* See also "Some Who Locked in a Price", supra note 2.

<sup>24</sup> "Price Drop Now Hurts Oil Dealers," supra note 1.

<sup>25</sup> 59 Misc 2d 189, supra note 7.

<sup>26</sup> C.G.S. 16a-23n(a)

<sup>27</sup> Saadi Letter, supra note 22.