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Locking in: Save a lot -- or pay the price

By David Koenig
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DALLAS—At TXU Energy, the biggest electric company in Texas, the fastest-growing billing plan is one that lets customers lock in the price of power for one or two years.

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"It's easier to plan that way, and I think you're saving money," says Brian Bell, an advertising salesman who signed a 2-year, fixed-price contract for electricity at the 1,500-square-foot Dallas town house he bought last year.

Other homeowners across the country are locking in prices now on electricity for summer cooling and heating oil for next winter. Heating oil prices are nearly 60 percent lower than they were at this time last year, according to Energy Department figures.

Natural-gas prices have fallen as well, which not only affects the price homeowners pay for gas but the price of electricity produced by power plants that run on gas.

Homeowners are doing what many large companies do to guard against sharp increases in prices for commodities ranging from crude oil to chicken feed.

They hedge.

Locking in an electric rate or hedging against oil price spikes bring a degree of financial certainty, hopefully reducing the chance of a budget-busting surprise. But as with many strategies in these days of financial turmoil, the results don't always work out as expected.

Airlines try to hedge fuel costs by making offsetting financial transactions, such as buying futures contracts on related commodities like crude and heating oil.

One of the most acclaimed of all hedgers is Southwest Airlines Co. For several years, Southwest had a huge advantage over competitors because it aggressively struck financial deals to guard against rising oil prices. Southwest estimates that hedging saved it $4.5 billion since 1999.

But as Southwest learned, hedging can lead to huge losses if markets move in the other direction.

Last week, Southwest reported a first-quarter loss due to $71 million in charges to cover the falling value of its fuel hedges after oil prices collapsed late last year. That was on top of $360 million in charges to write down the value of its fuel hedges in the last two quarters of 2008.

Despite those setbacks, the airline says it is hedging fuel again after seeing oil

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prices rise nearly one-third since February.

Few ordinary homeowners can hedge gas or electricity costs like Southwest hedged fuel, but they too can seek protection from rising costs by locking in some prices. And just like the airlines, they could end up paying too much.

At Dead River Co., a heating oil supplier in New England, some customers signed up last summer to buy fuel at the going rate of more than $4 a gallon. The price fell by half by the middle of winter, but they were stuck -- the company wouldn't cut the agreed-upon price because, it said, it had struck similar fixed-price deals with wholesalers to guarantee enough fuel.

"We've heard from some of our customers," said Claudette Townsend, a regional manager in Maine for Dead River. "I wish we had an out, but our suppliers are holding us to our agreements, and we have to do the same."

Christopher Abts, a financial planner in Reno, Nev., said a good alternative for seniors and people of modest income is paying utility bills in 12 equal monthly installments during the year instead of facing high air-conditioning bills in summer or budget-busting heating bills in winter. Many utilities offer such plans.

"If you're on a fixed income, that can be a great option because you don't want any surprises," he said.

Whether it meets an economist's definition of hedging, any attempt to lock in prices can be affected by factors ranging from commodity prices or stock markets to simple, raw emotion.

Jennifer Lerner, an experimental social psychologist and director of the Decision Science Laboratory at Harvard University's John F. Kennedy School of Government, said the desire to lock in prices is often driven by the kind of fear that increases during a recession.

"When people are afraid, they want to do things that will provide more certainty," Lerner said. "Fear motivates locking in."

The fear of uncertainty is so strong that even people burned by price declines after they locked in -- as happened with heating oil customers last summer -- often feel better despite having spent more money than if they'd done nothing.

Dan Ariely, a professor of behavioral economics at Duke University, and author of the book "Predictably Irrational: The Hidden Forces That Shape Our Decisions," said many people resist hedging because it seems like betting on a bad thing, such as a sharp increase in heating oil prices.

Ariely said hedging can feel like betting against your favorite football team because you fear they will lose.

And it turns out, he said, that football fans "don't enjoy the game as much if they bet against their team."

Associated Press writers Mark Jewell in Boston and Marc Levy in Harrisburg, Pa., contributed to this report. ■

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