

What's the Difference Between a Fuel Collar, Cap, and Adjustment Clause?

The signs of summer abound. The little leaguers have taken to the field, children are frequenting the local swimming holes, and fuel prices are climbing. This is also the time of year that towns are drawing up their fuel and salt contracts to send out to bid. Asphalt bids have already gone out the door.) With the memory of highway budget deficits fresh in everyone's mind, towns – and their taxpayers – would be well served to insert the following control measures in their contracts for fuel, salt, and many other materials to protect against rising costs.

Fuel Cap. A fuel cap is just what it sounds like: it's a ceiling that is placed on fuel prices. In addition to limiting a town's exposure in the face of rising markets, caps allow towns to reap the benefit of lower prices when the market falls. If the market price climbs above the ceiling price, the town buys at the predetermined ceiling price. If the market price falls below the ceiling price, the town buys at the lower market price.

Fuel Collar. A fuel collar is similar to a fuel cap in that it has an upper range (a price ceiling), but different in that it also has a lower range (a price floor). Essentially, both parties would agree on a base price and set a fixed price range in which the price may move up or down. For example, using U.S. Department of Energy estimates, diesel fuel is at \$2.40 a gallon on average in New England. Under a fuel collar, that figure would become the base, and any fuel-related prices are fixed and stay fixed as long as the price stays within "x" percent of that per gallon figure. If the price goes higher, a town could look at adjusting the contracted amount upward. If the price goes lower, then it could consider an appropriate downward adjustment. Fuel collars bring the added advantage of limiting a town's exposure to rising markets at a lower cost than fuel caps.

Fuel Adjustment Clause. Much like a fuel collar, a fuel adjustment clause has an agreed upon price range. But whereas the price range for a fuel collar is anchored by a fixed base point, the base point for a fuel adjustment clause acts more like a buoy that rises and drops with the shifting market tides. As with a fuel collar, the upper and lower limits of the range are set by a predetermined percentage of deviation from a baseline price. However the marker in a fuel adjustment clause fluctuates, creating a price range that, much like the market itself, looks like a wave.

Predicting what fuel prices will do is a bit like trying to predict the weather in Vermont – it's an uncertain enterprise based on available information, all of which is subject to change on seemingly a moment's notice. That is why municipalities should give due consideration to these hedging strategies to help protect against volatile fuel prices that can quickly wash out a highway budget. If you want to find out more about these types of clauses, contact Trevor Lashua, Senior Associate, Advocacy and Information Services, at 800-649-7915.

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