

NAVIGATING VOLATILITY: CONTRACT TIPS FOR FLUCTUATING FUEL COSTS

Authors: [Ian Breneman](#), Associate Counsel and [Johann Annisette](#) Associate

Global Fuel Price Volatility

World events, particularly the ongoing recovery from the COVID-19 pandemic and the war in Ukraine, are sending shockwaves through global energy markets and supply chains. Among other impacts, these circumstances have caused fuel costs to become highly volatile.

What does this volatility mean for brokers, carriers, shippers, and other market participants that rely on transportation services?

Price volatility may force a carrier to disproportionately absorb surging fuel costs, or leave the customer dissatisfied because the cost of transportation has increased dramatically. These factors can result in financial difficulties, unhappy customers, and costly disputes.

Below, we highlight some of the advantages and disadvantages of addressing fuel cost volatility in different types of contracts.

Risky Business: Problems with Fixed-Price Contracts

It is common practice in the transportation industry to enter into fixed-price contracts for a set rate of freight, which may include a percentage or weight-based fuel surcharge that does not account for fuel price volatility.

The primary advantage of fixed-price contracts is that it provides parties with predictability. Subject to third party costs and inspection fees, all parties involved know the amount that will be paid for the carriage of goods.

While fixed-price contracts create certainty for the shipper, they sacrifice flexibility and place disproportionate risk on the carrier or broker. If fuel prices spike, the carrier or broker will suffer the financial impact. If prices plunge, the customer may perceive that they overpaid.

One way to mitigate these circumstances is to ensure that quotes or estimates remain open for a limited time, or to ensure that they are subject to change until the carriage is confirmed. Otherwise, one party may accept a quote that has become unreasonable.

Floating Price Reimbursement Model

Another fairly common practice is to pass some or all of the carrier's fuel cost on to the broker, which may be further flowed through to the shipper, such that the carrier is reimbursed for the actual cost of fuel.

While this model reduces uncertainty for the carrier, it places disproportionate risk on the broker or shipper. The downside to this model is that shippers and other users of transportation services may be reluctant to absorb this business risk. Further, this

contractual structure places an administrative burden on the parties that are required to process such reimbursements.

Fixed Increase Structure

One option in longer-term contracts is to establish a fixed percentage or price increase on the assumption that costs of fuel will rise steadily over time. While a fixed increase structure may permit parties to build predictable cost increases into their contracts, those increases do not account for price volatility during the term of the contract. Parties may become dissatisfied, or unprofitable, if price increases that they agree to at the outset do not reflect actual fluctuations in the market price of fuel.

Contractual Price Adjustment Mechanism

A hybrid approach that shares the risk of fuel price volatility is also possible. This is often accomplished through a more complex fuel surcharge arrangement or price adjustment clause, which typically includes:

- a) a **benchmark source** to determine the market cost of fuel, such as the American Energy Information Administration's [U.S. On-Highway Diesel fuel price](#) or the [Fuel Index](#) published by the Freight Carriers Association of Canada;
- b) a **base fuel price** to be paid until a change in the market cost of fuel occurs; and
- c) a **price adjustment mechanism** that defines when and how the base fuel price will be adjusted if market fuel costs fluctuate.

These clauses should also address the timing and frequency of adjustments and set out a clear formula for permissible adjustments. The clause should also clearly specify whether both upward and downward price adjustments are permissible.

While this approach provides flexibility and shares the risk of fluctuating fuel costs, the cost of transportation may remain unpredictable. Given their complexity, these contractual clauses could result in more time negotiating terms such as the base fuel price or the price adjustment mechanism.

Conclusion

Although it may be difficult to predict fuel prices, the impact of volatility can be managed and mitigated. The key is to determine whether and how to account for fuel price volatility and to clearly reflect those decisions in a written contract.

If you have any questions about this article, please contact [Ian Breneman](#) and [Johann Annisette](#).¹

¹ Many thanks to Nicholas Rosati for all of his research and drafting contributions.