Fuel Stabilization Authority

Proposed Legislation

Amend existing law to remove the "sunset" date and provide local governments with clear and permanent authority to enter into and renew fuel stabilization contracts with a financial institution; provided the term of any single contract does not exceed two years.

Benefits

Ending the practice of sunsetting and extending fuel stabilization authority and, instead, providing local governments standing authority to enter into and renew fuel hedging contracts will afford budget certainty and protect against the effects of fluctuations in fuel prices.

Background

In June of 2008, the General Assembly authorized municipalities and counties, upon the approval of the local governing body, to enter into contracts with other local governments and financial institutions for the purpose of stabilizing the net expense incurred in the purchase of gasoline and/or diesel fuel during the 2008-09 fiscal year only. In 2009, lawmakers voted to extend this contract authority until June 30, 2011.

As a general rule, these contracts cover a period of at least two years and provide a local government with certainty when budgeting for a portion of its anticipated fuel consumption, thereby helping to counteract the potential effects of what can be a volatile market. This measure of certainty allows a municipality or county to avoid incurring unanticipated costs associated with fluctuations in the price of fuel.

These contracts provide that if the price of fuel, as determined by an index, exceeds the price agreed upon and fixed in the contract, then the participating local governments are protected from the effects of this increase, as the financial institution would be obligated to pay the difference between the cost of the fuel and the contract price. Conversely, if the cost of fuel falls below the price fixed in the contract, then the participating local governments would pay the difference between the index price and the fixed price. At no time are the local governments that are parties to the contract liable for any costs above the price fixed in the contract.

Problem

As the market requires a minimum contract term of at least two years, the practice of sunsetting and extending this authority creates a finite period in which this authority may be exercised.

The extension adopted by the General Assembly in 2009 was enacted on May 12 and provided only for those contracts that were to terminate on or before June 30, 2011. Therefore, any municipality seeking to enter into a contract with other local governments and a financial institution for the purpose of stabilizing the net expense of fuel purchases would have had from May 12 to June 30, 2009, or just 20 business days, to exercise this authority.

Local governments seeking to enter into one of these contracts after June 30, 2009, would

require a contract that covered less than the standard industry minimum of 24 months and, thus, would have been unable to find a willing partner in the financial industry. This would have precluded local governments from exercising this authority until after June 30, 2011.

It would be a mistake to attempt to remedy the problem by expanding the window, or the period of time that local governments are provided clear authority to enter into such contracts. The problem lies not in the length of time permitted but rather the very existence of a window. Neither the General Assembly nor the law can anticipate or dictate the price of fuel during the period of time that local governments are afforded to enter into these fuel purchasing contracts. Therefore, in creating a finite period of time in which local governments must exercise this authority, no matter how long that period might be, the practice of sunsetting and extending forces interested local governments to choose between the lesser of two evils: entering into these contracts under less than optimal market conditions or missing an opportunity to utilize this budgeting tool for at least two years.