

WHITE PAPER

6 RULES

to Create a Reasonable Bunker Adjustment Clause

ABOUT

Founded in 2007 in Germany, OCCON is a leading boutique management consulting company offering tailor-made solutions to its customers around the world.

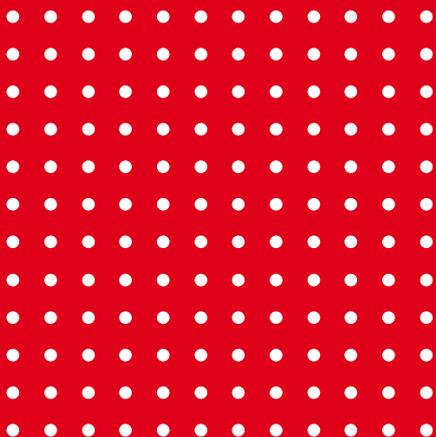
From logistics to procurement: We make you the strongest link in your supply chain.

We advise you as if it was about our own procurement and supply chain.

Always with these goals:

- Less risk in globalisation, centralisation and M&A processes
- More control, security and transparency in your processes
- Cost optimisation of processes and increased quality

Our team of consultants at OCCON consists of experienced logistics and procurement experts coming from a variety of industries. We believe in diversity and teamwork. Together with our customers to solve all challenges successfully. Only together great changes can be achieved and sustainable competitive advantages be maintained in time.



„We started working with OCCON in the procurement of our logistics services back in 2013.

With OCCON, our procurement organization has evolved to the next level. With their help we have been able to master volume growth and become a respected customer for our suppliers.

OCCON always challenges us and let us benefit from their experience - they always bring in other perspectives to shape the right strategy for all modes of transport.

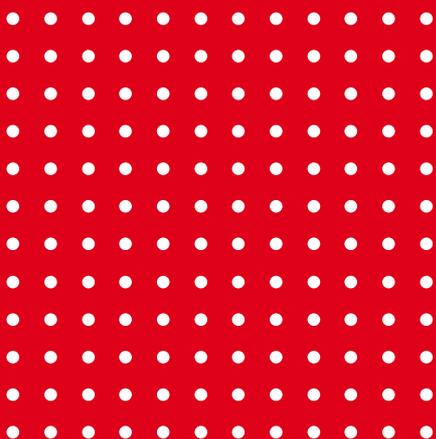
With OCCON we can discuss new thoughts & approaches but also validate if new ideas fit to the market and can become successful."



Triton

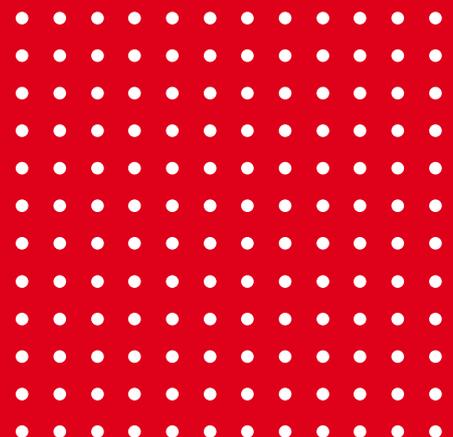
Beate Dillmann

Head of Global Purchasing Services,
West Park Management Services
GmbH - Triton Partners



CONTENT

I) Reasons for a Fuel Adaption Clause	1
II) Bunker Adjustment Methodology	3
1) Rule 1 - Set Up Market Adequate Geographical Distinction	4
2) Rule 2 - Use the Relevant Cost Drivers	5
3) Rule 3 - Define a Clear Mechanism and Be Always Fair	6
4) Rule 4 - Define Reasonable Frequency	7
5) Rule 5 - Define Reasonable Implementation Time	8
6) Rule 6 - Make an Example So Everybody Gets It	8
III) Conclusion	9
IV) Next Steps	10
IV) Contact	11



REASONS FOR A FUEL ADAPTION CLAUSE

Fuel Adaption Clauses make sense in all modes of transport. In this whitepaper we focus on the sea freight market and on how to implement a bunker clause.

Sea freight rates are influenced by several cost drivers such as ship cost, personnel cost, insurance cost and fuel cost - just naming some of them.

Fuel is one of the most volatile rate elements. While checking the fuel price development from 2019 to 2020 you will see many fluctuations that easily exceed +/- 10%.



Illustration 1: IFO 380 Development Jan 2019 - Dec 2021 (OCCON Market Mode, Data from Ship & Bunker)

In the past 10 years before the C-crisis the fuel price was owning a high share of the total rate. Depending on the distance the share could be between 8% and 38% of the total rate (see below example trades). Imagine a fuel increase of 25% and you have a frequently used destination with 30% fuel cost share, it is clear why it makes sense to implement a fuel adaption clause.



Illustration 2: Bunker Shares NWEU to NAEC & WMED



Now during the C-crisis rates have been skyrocketing and we see a +300% and even higher rate increases in 2021. At the same time the fuel price development in 2021 has increased by 30% on average only.



Illustration 3: VLSFO Development 2021 (OCCON Market Mode, Data from Ship & Bunker)

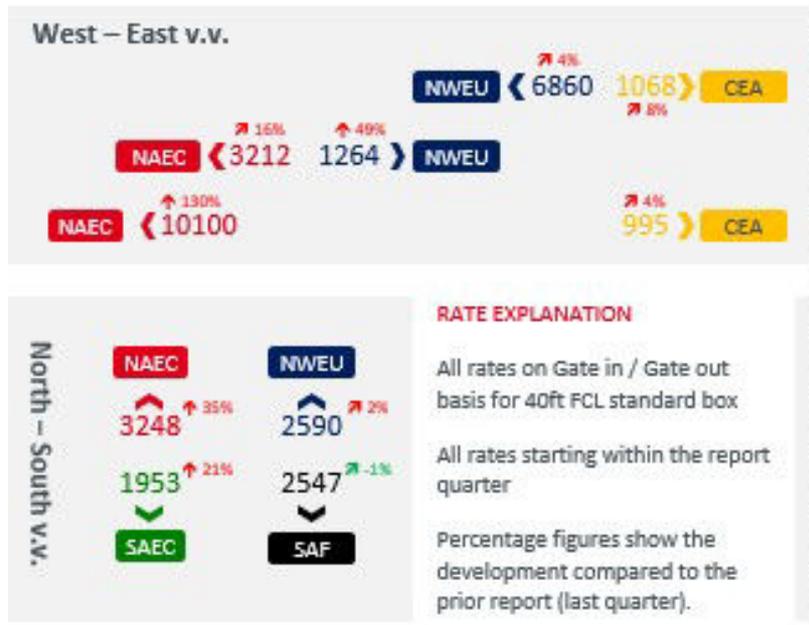


Illustration 4: FCL Rate Development Q3 compared to Q2 (OCCON Quarterly Market Report)

That said it is clear that the rate increases have nothing to do with the fuel development.

Seeing the change of influencing price elements the definition of a new bunker formula is necessary. Even the option to have none could be discussed for the time being.

However, it makes sense to set up a bunker formula proactively instead of accepting the different formulas that are used by each shipping line. Also it can be expected that rates will go down in the long run which will make the importance of bunker shares more significant again.

The following chapters will guide you through the 6 rules to set up a reasonable bunker clause.

BUNKER ADJUSTMENT METHODOLOGY

A fuel adaption clause can never be 100% accurate. But if it is reasonable it is most likely that all your suppliers will accept it.

The following 6 rules are decisive for success. We will explain these rules by a real example for the Europe – China Trade (see graphic 1). The same methodology can be applied for all other trades.

In order to build a reference database you need a representative port pair for each region (2). In our example it is Antwerp to Shanghai via the Suez Canal with an average cruise speed of 17 kn.

With those details plus the fuel price per ton it is possible to calculate the total fuel consumption for the whole trip and break it down to TEU-level by considering the average vessel size on the selected region. In our example it is 107 USD per TEU. Besides the calculation as such it is also important to align on all side conditions (3).

THE FOLLOWING LOGIC APPLIES PER TRADE

Trade	NWEU - CEA
Representative Vessel Size (TEU)	19.220
Representative Port Pair	BEANR - CNSHA
Distance (sm)	10.530
Cruise Speed (kn)	17
Cruise days	26
Fuel Consumption ship per day	138 tons / day
Fuel Consumption whole trip	3.562 tons
VLSFO cost per ton	580 USD
Cost for trip	2.065.738 USD
Cost per TEU	107 USD

ADAPTION MECHANISM

Adjustment Factor = absolute USD amount per TEU
 The Factor is applied for all rates as a surcharge to the original rate.
 The Factor is applied in both ways (increases and decreases)

Baseline =	107 USD / TEU
Adjustment Factor baseline	0 USD / TEU

Illustration 5: Bunker Adjustment Mechanism for NWEU to CEA



RULE 1 - SET UP MARKET ADEQUATE GEOGRAPHICAL DISTINCTION

In this market it does not make sense to have the same parameters for the whole world. We need to distinguish between geographical areas. However, it also does not make sense to set the rule on port-level what would result in handling thousands of port pairs.

So here the so-called trade level makes sense, in our example North West Europe (NWEU) to Central East Asia (CEA).

There is no real standard existing but all shipping lines see these trades / regions at least similar.



Illustration 6: World Trade Map OCCON

RULE 2 - USE THE RELEVANT COST DRIVERS

In the liner shipping market the relevant drivers are ship size, kind of fuel used, distance and speed. Ideally, the sources of this parameters are publicly available.

Since 2019 the relevant fuel for the container shipping market is VLSFO (very low sulphur fuel oil) and no longer IFO 380 (intermediate fuel oil).

For the ship size you need a representative ship size per trade pair which is e.g. ca. 19k TEU from NWEU to CEA.

The shortest distance for the representative port pair from Antwerp to Shanghai is 10.530 sm with an average speed of 17 kn.

In the next picture you will find some selected examples out of a very detailed database with more than 500 trade pairs and more than 1000 representative vessel information to feed bunker adjustment agreements for very complex networks.

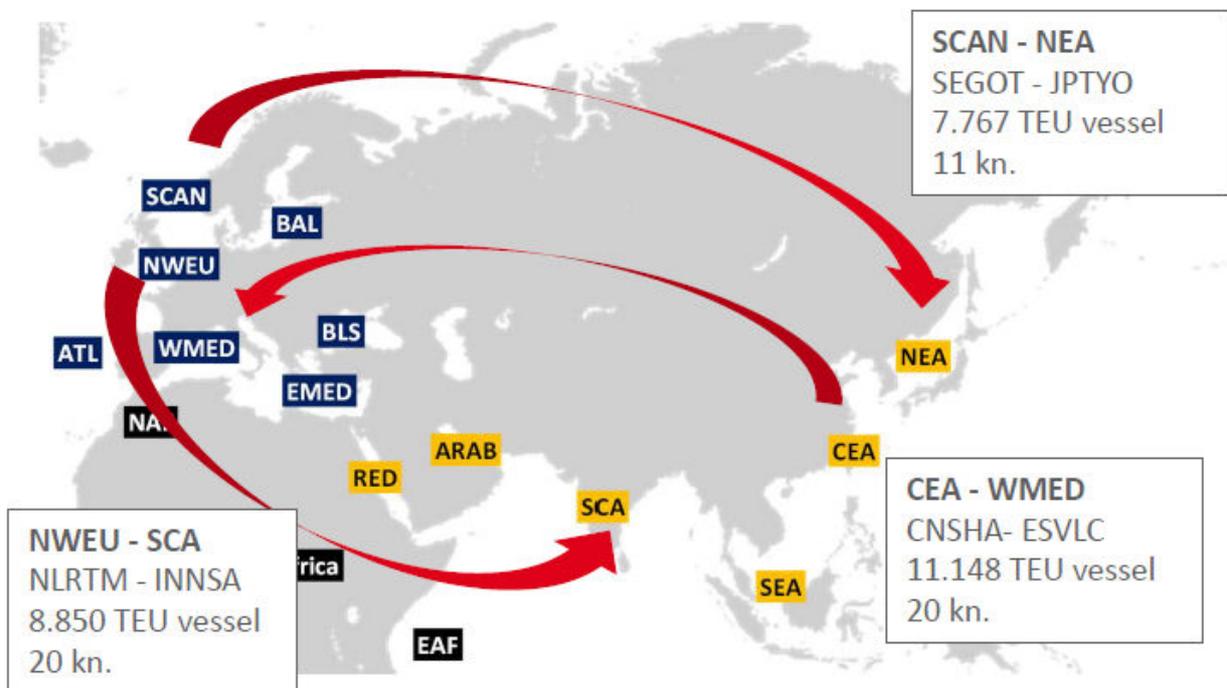


Illustration 7: Cost Driver Examples on Trade Level

RULE 3 - DEFINE A CLEAR MECHANISM AND BE ALWAYS FAIR

The logic of the calculation and adaption mechanism must be clearly defined and has to be applied to all suppliers. Also the fuel baseline and the starting point have to be fixed to avoid any disputes.

In the above mentioned example the baseline is 107 USD per TEU.

Also keep in mind the fairness approach for a trustful partnership which means that the price adjustment clause should never be a one-way street. Adjustments should be possible up and down to be fair for both parties - the shipper and the supplier.

We started working with OCCON in procurement of our logistics services back in 2013,

With OCCON our procurement organization has evolved to the next level. With their help we have been able to master volume growth and become a respected customer for our suppliers.

OCCON always challenges us and let us benefit from their experience - they always bring in other perspectives to shape the right strategy for all modes of transport.

With OCCON we can discuss new thoughts & approaches but also validate if new ideas fit to the market and can become successful.

We use their in-house developed e-sourcing solution u-tender which is able to cover complex rules and analysis. For example, capacity constraints play a big role for EuroChem. With u-tender we are able to optimize offered rates and capacity restrictions. Also, the targets for our negotiations are realistic due to the use of OCCON's market knowledge.



Stefan Nell
Director Supply Chain Management



RULE 4 – DEFINE REASONABLE FREQUENCY

Daily or weekly adaptations are not workable due to the company internal processes which need time.

In order to be fair on the one hand but also being workable on the other hand a reasonable review frequency could be every 3 months.

In case your contracts start on 1st of January you could review the bunker on 1st of March taking into account the average fuel development from contract start to 1st of March. The implementation in case of an adaptation should take place in March and the go live should be in April (see illustration 8, number 4 and 5).

A schedule like below has to be set up and communicated from the beginning.

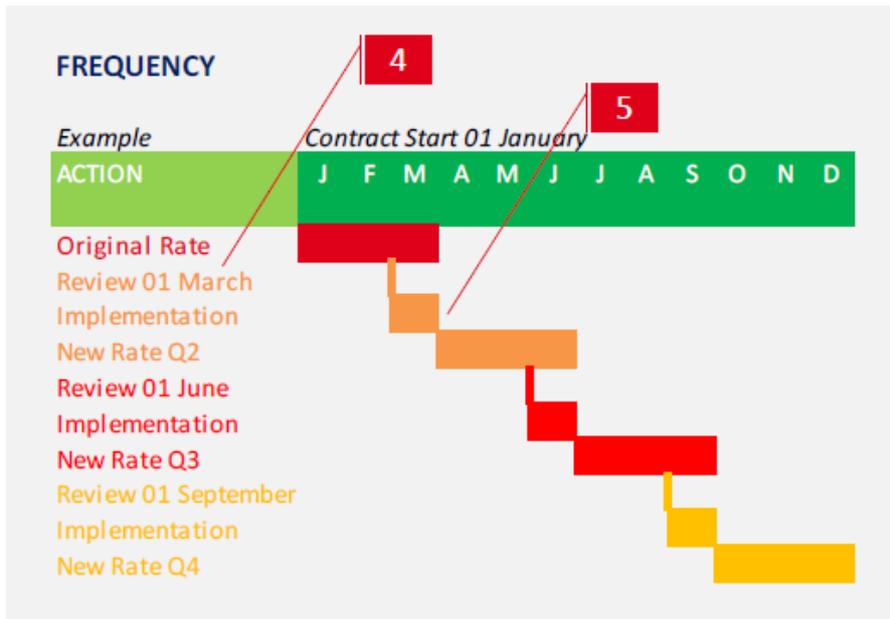


Illustration 8: Mechanism Frequency – Schedule Example

An additional approach to avoid too many changes is to define a certain +/- corridor to avoid the effort for minor movements of the fuel prices.

A reasonable threshold for the bunker adjustment clause would be +/-10%.



RULE 5 – DEFINE REASONABLE IMPLEMENTATION TIME

It is also very important that there is a period between the review of rates and the date when the new rates come into effect to take the following actions (see illustration 9):

- Calculation of the adaption
- Publishing of the adaption to all relevant departments (booking, accounting, invoice control internally & supplier side)
- Implementation into internal IT-systems as both parties need some time to update their systems accordingly.

A 1 month period is recommendable.

RULE 6 – MAKE AN EXAMPLE SO EVERYBODY GETS IT

Although everything is clearly defined mathematically – however this still might be too abstract for many people. So nothing is better than a concrete example to make the effects very clear for everyone like in the illustrations shown in the whitepaper.

It is kind of time-consuming to set it up for the first time but the work will pay out and leave no room for any misinterpretations.

EXAMPLE

→ 15% increase

Fuel Consumption ship per day	330 tons / day
Fuel Consumption whole trip	6.581 tons
VLSFO cost per ton	667 USD
Cost for trip	4.389.694 USD
Cost per TEU	219 USD
Adaption Mechanism	
Baseline =	191 USD / TEU
Adjustment Factor	29 USD / TEU

Illustration 9: Bunker adjustment calculation example



CONCLUSION

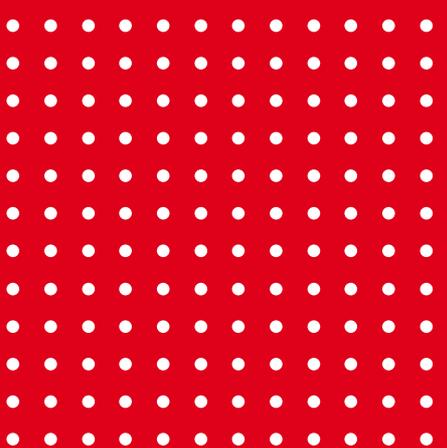
Having an own clause according to the 6 rules mentioned above shows market knowledge, increases the negotiation strength and it is very likely that suppliers will accept your suggestion.

It is recommendable to set up an own bunker adjustment clause to be in control and not dependent on several different rules from different suppliers.

Even if the impact of the bunker is not that high the proceeding is clearly explained and brings security also in case of rate decreases in future.

Make sure that all parameters of your fuel adjustment clause are reviewed regularly and adapted to market developments.

The fuel adjustment should be applied proactively for all suppliers - also in case it would mean an increase for you - to show the fairness approach and keep trust for the future relationship.



NEXT STEPS

The Whitepaper should have given you a quick overview of the reasons to implement a fuel adjustment clause. In case you need more insights or you have further questions do not hesitate to contact us.

You want to implement a company-individual fuel adjustment clause for any mode of transport? Depending on the mode you will need other sources and parameters but the general logic and methodology can be applied everywhere.

Then follow the 6 rules.

In case you are lacking know-how or manpower get in touch with us – we can set it up for you.

Do not hesitate to contact us in case we should proof-read your own result.

CUSTOMER EXPERIENCE

One recent success story was the implementation of an updated bunker adjustment clause for one of the largest chemical companies in the world.

Instead of accepting supplier requests they introduced their own mechanism that had been accepted by all shipping lines.

Whenever the bunker has to be adapted we can just calculate and update the contracts database on our customers behalf.

CONTACT



Managing Director

s.baehr@occon.de



Managing Director

j.stellner@occon.de

INFORMATION PROVIDER

OCCON GmbH
Schillerplatz 12-14
67071 Ludwigshafen

Phone: +49 621 5968 3262
E-mail: info@occon.de
www.occon.de

Managing Directors: Joachim Stellner, Sabrina Bähr
Registergericht Ludwigshafen: HRB 61262
USt-ID Nr.: DE814906056

Responsible for the content according to §5 TMG:
Joachim Stellner, Sabrina Bähr

The information published here reflects opinions and assessments from the perspective of OCCON GmbH.

Forwarding this brochure requires our consent in advance.

