Massachusetts Oilheat Council
118 Cedar Street, Wellesley Hills, MA 02481

Testimony of Michael J. Ferrante
President, Massachusetts Oilheat Council
Before the United States Senate Committee on Small Business & Entrepreneurship:
"Examining Solutions to Cope with the Rise in Home Heating Oil Prices"
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Good morning Senator Kerry, Senator Snowe and members of the Committee. My name is Michael Ferrante, and I am the President of the Massachusetts Oilheat Council (MOC). Thank you for the opportunity to address your Committee today on the current status of the heating oil industry, and to offer you some insight into how current market conditions have affected home heating oil dealers, especially in light of the fact that many of them are second and third generation family-run small businesses. I have been employed with the Council since 1990, and I must preface my remarks by saying that in my 17 years on the job, I have never seen such a cascading confluence of factors so severely impact so many small business owners.

- **About MOC**

Established in 1955, the MOC is a business trade association for home heating oil, propane and petroleum resellers. The association represents more than 300 companies across the state, including retail and wholesale/supplier operations. Collectively, our members store, sell and deliver nearly 70 percent of the heating oil used statewide. In Massachusetts, about one million homes rely on Oilheat for their source of energy. Several of our members also deliver propane for space heating and many are now marketing bioheat fuel to their customers. The MOC also represents about 2000 licensed Oilheat equipment technicians in Massachusetts, and all of the major Oilheating equipment manufacturers.

Our association is also a key member of the New England Fuel Institute (NEFI), a 60-year-old trade association based in Watertown, Massachusetts which collectively represents over 1,100 heating fuel dealers in the six New England states. As the largest heating oil trade group in the nation, NEFI is a public policy advocate regionally, in the northeast and also on the national level. With all that is happening in the energy markets today, NEFI has developed an expertise in speculative energy trading and the lack of oversight in the energy futures markets, and it leads a broad national coalition that advocates for greater transparency, accountability and oversight in the commodities trading markets.

- **Retail Home Heating Oil Industry Profile**

According to data collected by the National Oilheat Research Alliance – NORA – an organization I will speak more about later in my testimony, Massachusetts is the third largest heating oil state in the country in terms of volume of fuel sold.

About 2 billion gallons of heating oil is used in Massachusetts on an annual basis for residential, commercial and industrial use. About 800 retail home heating oil dealers deliver that fuel statewide and they employ over 6000 people across the Commonwealth. On a national level, there are approximately 9000 retail operations that deliver about 10 billion gallons of home heating oil annually.

There are two kinds of retail operations: full service and discount or cash-on-delivery companies. According to research done in 8 states by the accounting firm of Gray, Gray & Gray in Westwood, Massachusetts the average full service operation has about 1800 retail customers, sells about 1.9 million gallons of home heating oil annually, employs 17 people, has several delivery trucks and service vans, and has a total annual revenue of just under $4 million dollars. Discount or cash-on-delivery retailers are usually one truck operations with one or two employees, many of whom operate out of their homes.

- **The Impact of Rising Energy Costs on Oilheat Retailers in Massachusetts**

1.) High Crude Oil & Commodity Costs:

The historic run-up in the cost of crude oil, and hence the cost of the core refined product that our members sell – heating oil – has had a dramatic impact on almost every aspect of these small business operations. Crude oil pricing has more than doubled over the past three years with prices hovering between $60.00 and $75.00 per barrel in 2005 and 2006, hitting $103.00 per barrel in February 2008, and escalating to a record high of over $139.00 per barrel on June 6, 2008.

These unprecedented crude prices have fueled a commensurate, steady rise in the wholesale price of heating oil. On June 6, for example, heating oil was selling for nearly $4.00 per gallon wholesale on the New York Mercantile Exchange (NYMEX), the world's largest physical commodity futures exchange and the preeminent trading forum for energy and precious metals. The statewide average retail price for a gallon of heating oil delivered by a full-service heating oil dealer in Massachusetts today, according to the state's Division of Energy Resources, is $4.59. It is very important to note that other home energy sources are also edging higher. Over the past month, natural gas prices on the NYMEX have risen almost 40%, and that rise will be reflected in gas heating rates this fall.

These high energy prices have translated into several other major challenges for the retail fuel dealer including:

A.) Severely Strained Bank Credit Lines:

Retail heating oil dealers, like other small businesses, must have a secure relationship with a bank and a line of credit in order to help finance operations. Lines of credit are based on a number of business factors and it can be difficult to get approval for a higher level of credit. With the volatility in the world energy markets over the past year in particular, one can easily see how a limited line of credit for a retail heating oil dealer is quickly exhausted when the wholesale price for heating oil more than doubles. Remaining financially sound is a daunting day-to-day challenge because of the price volatility plaguing crude and heating oil, but nevertheless, this financial strength is crucial in assuring that retailers are able to obtain the product they need for their customers on a timely basis.

In a survey I conducted last week of our Board of Directors, comprised of 35 retail operations in various parts of the state, owners universally report they have had to at least double their bank credit lines to accommodate the higher wholesale cost for heating oil, and meet the prompt payment terms from suppliers. Here are some examples: a small retailer in Needham, Massachusetts has doubled her credit line from $250,000 in 2007 to $500,000 for this year, while a mid-size retailer in Braintree has moved his credit line from $1 million last year to $1.8 million this year, and in Worcester one of the largest retailers in the state has increased his credit line from $1.2 million last year to over $5 million for this year.

B.) Overwhelming Customer Receivables:

High energy prices obviously impact the consumer as well, and most retail heating oil dealers are facing a huge drag on cash flow because customers cannot afford to pay their entire heating oil bill. Customer receivables are at all time highs this year for retailers, and these companies need the cash flow to help pay their business expenses (bank charges, employee salaries/benefits, business insurance, overhead costs, etc.), and to finance future purchases of heating oil from wholesale suppliers who require prompt electronic payment for the fuel.

My survey showed the dramatic change in receivables in a one year period. A Northboro, Massachusetts retailer reported March 2008 receivables of $912,000, compared to $749,000 in 2007 and $615,000 in 2006. A South Weymouth, Massachusetts retailer reported receivables for May 2008 at $1,934,000 versus $426,000 for the year before, while a Stoughton-based retailer reported receivables for this May at $672,000 versus $372,000 in 2007.

In an effort to help ease this problem, most of those surveyed have instituted 12 month budget plans for customers or are in the process of converting all of their customers to 12 month plans.

And of course, bad debt – customers who will not be able to pay the balance of their heating bills – will also have a severe impact on some retailers' bottom lines. Unlike the gas and electric utilities, however, who can and will stop providing energy to customers with payments in arrears, retail heating oil dealers prefer working to retain a customer with debt. As a result, heating oil retailers often times find themselves in a catch-22 situation of delivering more fuel at the risk of losing even more money.

C.) Lack of Price Protection Programs for Heating Oil Consumers:

The current state of the home energy markets has also almost completely halted the offering of price protection programs by retailers to customers. Over the past ten years or so, price protection programs have been one method for a retailer to help ensure that heating oil prices remain stable for customers during the heating season. Typically, a retailer would buy heating oil contracts – a contract is 40,000 gallons – during the spring and summer months when wholesale heating oil prices are lower due to less demand. The dealer could use the commodity market to "lock in" or "cap" a price for a customer with the hope of removing any price volatility.

But for the past two years, we have seen wholesale heating oil prices remain high during the warmer months because of high crude oil prices. Most retailers today are fearful of entering into these oil contract buying mechanisms with their suppliers because of market volatility, and because the price for buying "downside protection", or insurance on the investment, has become cost prohibitive. Last year for example, retailers report that the cost per gallon to protect against falling prices hovered around 20 to 25 cents per gallon. Today, the same insurance protection costs between 45 to 60 cents per gallon.

D.) Credit Card Fees:

Our members also report that credit card fees are adding further stress to their bottom lines. With processing fees of up to 3%, credit card transactions are eating into retail margins by as much as 15 cents per gallon. Unless those fees come down, some retailers say they will have to start adding a surcharge to cover the costs.

E.) Customer Relations Woes and Negative Public Relations:

With prices high for consumers, retail heating oil dealers and their employees have had to spend an inordinate amount of time trying to assist customers with payment plans, and explain the often times unexplainable volatility in the energy markets. Heating oil dealers must take the time to answer customer questions and complaints; otherwise they may lose these customers to a competitor whose price may be just pennies less per gallon. Additionally, retail heating oil dealers have had to increase their customer communications efforts in order to stave off unwarranted negative public relations regarding the image of "oil" and the misperception that because of higher prices, retail heating oil dealers are amassing vast profits like the major oil companies.

2.) Gas Utility Encroachment:

Amidst all the challenges, the Oilheat industry is also facing an increased onslaught of competition from the gas utilities. For years, the Oilheat industry has had to battle the gas utilities who seek to convert Oilheated homes to gas heat with free or discounted heating systems that are subsidized by existing natural gas customers. This year in Massachusetts, the state's largest gas utility has wasted no time in capitalizing on the historic rise in home heating oil prices. With the statewide average price currently around $4.60 per gallon from a full-service heating oil dealer, National Grid, who recently absorbed KeySpan, has launched an aggressive multi-media ad campaign targeting Oilheat customers. The ads, which encourage conversion to natural gas, make some very deceptive if not outright false claims as to the benefits of natural gas versus Oilheat.

Unfortunately, while the Oilheat industry has made significant progress in manufacturing more efficient equipment and significantly reducing greenhouse gas emissions with low sulfur fuels and bioheat, we lack the collective financial resources necessary to combat super-sized utilities with multi-million dollar rate-based sales and marketing campaigns.

3.) LIHEAP – State Margin-Over-Rack Leveraging Programs a Strain:

The Low Income Home Energy Assistance Program (LIHEAP) has been invaluable in providing home energy cost assistance to elderly and low-income households. Since the inception of the federal LIHEAP program in 1981, the Oilheat industry has been a staunch supporter of LIHEAP and the Weatherization Assistance Program (WAP). MOC, along with NEFI has advocated for a fully funded LIHEAP in the amount of $5.1 billion and WAP at $700 million. Additionally, MOC has consistently worked with state officials in order to ensure a healthy and effective energy assistance program in Massachusetts. MOC and its member companies have also teamed with local charities, non-profit programs, and other efforts to help needy households in the face of insufficient government fuel assistance resources. MOC is proud to have helped former Massachusetts Congressman Joe Kennedy launch and implement his successful Citizens Energy heating oil assistance program.

However, the very structure of LIHEAP is placing disproportionate strain on heating oil retailers in states like Massachusetts where "leveraging" is used to garner additional federal funds. In Massachusetts, the leveraging program for fuel oil and propane (often called "deliverable fuels") is a discount program called Margin-Over-Rack (MOR). For retail heating oil dealers involved in the LIHEAP program, the MOR program pays the fuel dealer the lesser of either a set margin per gallon or their regular retail price on the date of delivery. By accepting a lower profit margin, retailers must take a hit on their already marginalized bottom lines. MOR places tremendous financial risk on fuel dealers and makes it more difficult to remain competitive and profitable amidst volatile oil prices.

Although state regulated gas and electric utilities also contribute to the leveraging program, they can recoup any loss by running the contributions through their individual state ratemaking process, in essence passing the cost along to all of their customers. Heating oil retailers do not share this ability, thus placing them at a competitive disadvantage. Additionally, MOR puts the oilheat retailer at odds with the fuel assistance program administrators they have supported for decades. And finally, since LIHEAP only pays a portion of a recipient's household energy cost, the Oilheat dealer must then shift the customer to a more realistic market-based cost-per-gallon when LIHEAP benefits end. This shift unfairly creates a new class of customers for retail heating oil dealers.

The Burden Federal Regulations Place on Small Business Oilheat Dealers

1.) HAZMAT Registration Fees:

On top of the previously mentioned obstacles our retail dealers face today, there is additional weight from overly-burdensome federal regulations. Most heating oil retailers pay an annual fee to the Department of Transportation (DOT) for their company's annual HAZMAT registration. Currently most pay either $275 or $1,000, depending on the size of their business. The DOT is planning to drastically increase the latter fee for "large companies" by as much as $2,000. Due to a glitch in the way those heating oil dealers are currently classified, many may be subject to this increase and forced to pay the larger amount. The fee also makes it more difficult for dealers to receive federal loans and increased lines of credit with their banks and suppliers. Currently, the Small Business Administration (SBA) classifies heating oil dealers as large businesses if their gross receipts exceed $11.5 million per year. MOC and NEFI have communicated the inadequacy of this threshold, due mainly to the rising cost of product, and have requested that the SBA reclassify heating oil dealers (and propane dealers, which are subject to a $6.5 million threshold) to an employee-based threshold. The SBA has begun the rulemaking process, but it is delayed.

2.) TWIC Program:

The Transportation Worker Identification Credential (TWIC), required by the Transportation Security Administration (TSA) has become increasingly burdensome. TWIC requires a background check and worker "ID" for unescorted access to certain secure areas of the nation's maritime transportation system, including the terminals that many heating oil dealers access to obtain product. Therefore, heating oil transporters are not only subject to federal and state mandated background checks for HAZMAT endorsed Commercial Drivers Licenses, but they must also undergo a background check and fee for TWIC. This is both costly and needlessly duplicative.

3.) SPCC Requirements:

The EPA's Spill Prevention, Control and Countermeasure (SPCC) poses a major cost burden and regulatory compliance challenge to small business heating oil dealers that have on-site storage. The rule requires specific bulk storage facilities that meet the federal compliance threshold of 1,320 gallons in aggregate above ground storage (or 42,000 in underground storage) to prepare, amend and implement detailed security and emergency contingency plans and new infrastructure requirements in order to plan for the event of an unintended release of product. New amendments to the regulation passed in recent years will become effective on July 1, 2009, and bulk storage heating oil companies are facing tens-of-thousands in infrastructure upgrades, personnel costs and certified engineer expenses in order to comply with the new rule. Additionally, some EPA enforcement officials are interpreting the rule to include parked oil trucks with storage in the calculation for the above ground storage compliance trigger. The average truck contains 2,800 gallons of product. Therefore, many small companies, some of whom simply park their trucks overnight in order to make early morning or emergency oil deliveries and have no on-sight storage, are at risk of a costly enforcement action. MOC & NEFI have reached out to the EPA to resolve this issue, but so far have been unsuccessful.

4.) Transition to Lower Sulfur Distillate Fuels:

While our industry fully supports the move towards low (500-ppm) and ultra-low (15-ppm) sulfur diesel fuel and heating oil, we are wary of the financial implications of requiring their widespread use at this time. Already, the EPA has begun requiring that low and ultra-low diesel fuel be used in on- and off-road diesel engine vehicles and equipment. By December, 2010, the EPA will require that all diesel engine vehicles use ultra-low sulfur diesel fuel (with the exception of locomotive and marine engines, which have until 2012). This transition has already put a strain on diesel fuel prices nation-wide, as well as the availability of high-sulfur distillate fuel, which is afforded a lower-cost spot price differential, and now can be used as heating oil only. While MOC and NEFI recognize that low and ultra-low sulfur fuels hold the promise of greater efficiency and many environmental benefits, it is important to balance these concerns with those of the small business owner. By moving too quickly to lower sulfur heating oil without ensuring adequate supply and without being mindful of the potentially higher costs, lower sulfur products could put an additional strain on the heating oil dealer and their consumers.

- **Industry Efforts to Bring Down Energy Costs, Help Retailers & Consumers, Increase Energy Efficiency and Improve the Environment**

MOC and NEFI have taken real action to come to the aid of our retail heating oil dealers and consumers in the face of extremely high energy costs, improve energy efficiency and protect the environment. The following can be attributed to those joint efforts in Massachusetts and in Washington.

1.) The 2007 Farm Bill:

On June 18th, 2008 Congress passed the $300 million 2007 Farm Bill by an overwhelming margin over the President's veto for a second time, a step made necessary by a clerical error when the original bill was passed. Included in the bill is language that allows for the closing of the notorious "Enron Loophole" – a loophole that allows for profiteering by speculators who operate in unregulated electronic futures markets. Although the 2007 Farm Bill is just one weapon in the battle against excessive speculation and potential manipulation by traders, it is nevertheless an important one. Passage shows the federal government's readiness to address commodity markets trading issues, and their willingness to hold speculators in these markets up to the light of a more regulated exchange. But more needs to be done, including addressing the Foreign Markets Loophole, which allows trading of U.S. destined goods by overseas exchanges under inadequate or non existent oversight, and the "swaps loophole," which exempts index fund and swaps traders from transparency and anti-manipulation rules.

The Commodities Futures Trading Commission (CFTC) must also get tougher on speculative trading and provide rigorous enforcement of existing rules and future authorities granted by Congress. In short, the commodities market is broken, and it needs fixing because the speculative buying and selling is hurting consumers and small businesses alike.

2.) Adequate Federal LIHEAP Funding:

The federal budget now allows for the full funding of LIHEAP and WAP for FY2009. An additional $1 billion in emergency relief funding was authorized by Congress to supplement 2008's budget. While this is very positive news, we will continue to push for additional funding and a change in the leveraging aspects of the LIHEAP statute that make participation in the program difficult for small business heating oil retailers. MOC and NEFI are members of national coalitions and will continue to advocate for strong federal and state energy assistance programs.

3.) The National Research Alliance – NORA:

In 2000, Congress approved Public Law 106-469 the National Oilheat Research Alliance (NORA) – a collaborative program established by the Oilheating industry to strengthen the industry by improving education and training for employees in the industry, providing customers with important energy information, and developing new products for customers. NORA provides the opportunity and ability to work cooperatively for a better and stronger industry. NORA has developed world class education programs, new efficient appliances, and strong consumer education campaigns highlighting the benefits of Oilheat and the need to improve efficiency. Funding for the program comes from a mandatory fee of $.002 per gallon on every gallon of heating oil sold in 22 key participating heating oil states.

Over the last eight years, NORA has done a great deal to help our customers respond to today's high energy prices, including the development of new equipment to ensure peak efficiency and energy savings. For example, NORA grants have been used to create a condensing furnace with a 96% efficiency rating – 13 points higher than the efficiency described by EPA in the Energy Star program. This furnace was the first of its kind on the market to earn a ground breaking Annual Fuel Use Efficiency (AFUE) rating.

Additionally, NORA has developed a downloadable software application – the Fuel Savings Analysis Calculator (FSA) – that retail Oilheat dealers can use to show customers the enormous savings that can occur by upgrading to a new Oilheating system for both heat and hot water.

Finally, NORA has worked vigorously to develop Bioheat as a supplemental domestic renewable resource. Overall, the efforts of the Oilheat industry and NORA are helping to solve issues that will improve efficiency, lower prices and reduce consumption in every household.

4.) Massachusetts Biofuel Mandate:

With the help of MOC, Massachusetts may soon become one of the first big Oilheat states to mandate the use of biofuel - a blend of heating oil and crop-based feed stocks such a soy beans, vegetable and plant oils. Back in November of 2007, Governor Deval Patrick filed legislation calling for a biofuel and biodiesel mandate that would require a 2% blend of biofuel in heating oil by July 2010, with incremental percentage blends of 3, 4 and 5% annually increasing through 2013. In February, MOC's Board of Directors voted unanimously to support the biofuel mandate, and that support has helped the legislation gain momentum.

Since that time, MOC has been intimately involved in the legislative drafting process and we are currently working closely with key state legislators and aides to craft legislation that mandates the use of safe, effective, and high quality biofuel products for Oilheat retailers and consumers.

5.) System Betterment Charge for Oilheat Equipment Replacement:

Last year, in recognition that there are thousands of needy households with older, inefficient home heating oil systems, MOC's Board of Directors voted unanimously to draft a state legislative proposal that would levy a small assessment – one half cent – on every gallon of home heating oil sold in Massachusetts to create an Oilheat equipment upgrade program that mirrors the System Betterment Charge (SBC) used by regulated utilities. The funds would be used only for Oilheat-to-Oilheat system upgrades and 30% of the funds would be set aside specifically for low income families. The legislative proposal is still being considered by lawmakers and MOC will continue to lobby for its passage this year, and if needed, next year.

Senator Kerry, Senator Snow and members of the Committee, I want to thank you once again for the opportunity to testify on the important challenges facing the heating oil industry and heating oil users. I truly hope that my remarks will help in your efforts to find relief for all those impacted by the high cost of energy.

And Senator Kerry, on behalf of the fuel oil industry nationwide, I want to thank you for your diligent work over the years to provide assistance to small businesses through SBA programs, and for your support for the NORA program as one of our lead sponsors when the bill was first introduced, and your continued support for the program as we work with Congress this year on strengthening the NORA statute.

Michael Ferrante
President, Massachusetts Oilheat Council
118 Cedar Street
Wellesley Hills, MA 02481
Tel: 781.237.0730
Fax: 781.237.2442
mferrante@massoilheat.org
www.massoilheat.org