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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548



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FOR RELEASE ON DELIVERY
Expected at 9:30 a.m.
Tuesday, February 12, 1980

STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON ENVIRONMENT, ENERGY, AND NATURAL RESOURCES
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS
THE ^{DOE'S} ~~DEPARTMENT OF ENERGY'S~~ ^{ON} RESPONSE TO THE
RISING PRICE OF HOME HEATING OIL

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Mr. Chairman and Members of the Subcommittee:

We welcome the opportunity to be here to discuss the findings in our recent report, "Washington, D.C., Area Home Heating Oil Supplies Adequate but at Escalating Prices" (EMD-80-42, January 22, 1980), which we prepared at the request of Senator John Warner. While the report focuses on the Washington, D.C., area heating oil market, the issues discussed in the report concerning rising heating oil prices and the Department of Energy's (DOE's) response to them are national in scope and are not limited to any particular geographic area. I will emphasize these issues in my testimony.

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ESCALATING HOME HEATING OIL PRICES

Nationally, the average residential selling price for heating oil increased 111 percent between July 1976, when heating oil prices were decontrolled, and last August. Most of this increase occurred since January 1979. I should note that according to DOE figures, the price, as of November 1979, had increased to 83.7 cents a gallon, a 55-percent increase since January 1979. We are concerned that DOE,

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however, has done little to determine the reasons for, and the equitableness of, the price increases.

By August 1979, the latest period for which data was available when our report was prepared, the national average retail price of heating oil had risen to 77.2 cents a gallon--40.6 cents above the July 1976 price of 36.6 cents.

The prices refiners charge are reflected in these escalating retail prices and account for most of the increases. Between July 1976 and July 1979, refiners' heating oil selling prices had increased about 31 cents a gallon. The rising cost of crude oil helps to explain some of this increase--about 18 cents is due to increased crude oil costs. The resulting gross margin, however, (the difference between their cost of crude oil and their selling price for a refined product) of almost 13 cents a gallon represents a 233-percent increase. From the gross margin, refiners must pay the costs of purchased petroleum products, refining, marketing, and other costs of doing business. Any amount remaining after deducting such costs would reflect increased profits.

Although we did not attempt to determine profits, we did note an unusual increase in gross margins during the first 7 months of 1979. While refiners increased their gross margins by an average of only 2 cents a gallon during the first 2-1/2 years following decontrol, they increased these margins by about 8.6 cents a gallon during the first 7 months of 1979. During these 7 months, the refiners' selling price for heating oil increased 21.6 cents, while their crude oil costs increased 13 cents a gallon.

REASONS FOR INCREASED PRICES

The refiners' price increases have been a source of much controversy, which has not yet been resolved. DOE's attempts to do so have been limited and inadequate. Refiners contend that the increases are justified and are necessary to assure adequate petroleum supplies. Others, however, believe that the increases are unreasonable and are an unfair burden on consumers.

Refiners argue that there are several reasons for the higher prices and margins in addition to higher crude oil costs. They say that as a result of reduced refinery operations in 1979, caused by the shortfall in crude oil supplies earlier in 1979, fixed costs must be divided among fewer gallons produced. They also say that some refiners have had to purchase heating oil on the spot market at very high prices in order to supplement their own production, and that higher prices and margins are necessary in order for refiners to make needed investments in expanding and upgrading refining facilities.

Others contend that the prices have increased much faster than costs. In November 1978, DOE's Office of Hearings and Appeals said that refiners' prices had increased at a greater rate than their associated costs and that this situation was likely to continue in the future. The Congressional Research Service reached a similar conclusion in their October 1979 analysis.

DOE'S INATTENTION TO RAPIDLY
ESCALATING HEATING OIL PRICES

The Congress, in its deliberations on the Federal Energy Administration's (FEA's) proposed amendments to remove price and allocation controls from No. 2 distillates, 1/ expressed concern that heating oil prices would rapidly increase after decontrol. The Acting FEA Administrator testified that between July 1976 and 1978, heating oil prices were expected to rise about 4 cents a gallon, even if controls were continued, and that FEA found no reason to expect any increase in the price over and above that expected under continued price and allocation controls.

He committed FEA to a program of monitoring distillate prices from September 1, 1976, through March 31, 1977, to insure that heating oil price increases would be necessary and reasonable. FEA did monitor prices and found that by January 1978, however, the price had risen to 48.5 cents a gallon, an increase of 11.9 cents--almost triple FEA's expected increase. FEA decided, however, that the increases were not so high as to justify reimposing price controls.

In August the Office of Hearings and Appeals held hearings on heating oil prices and estimated that from July 1976 through April 1978, refiners' wholesale prices for heating oil were \$193 million in excess of what could have been charged under continued regulations. The difference amounted to 0.4 cent for every gallon

1/Heating oil accounts for about 65 percent of No. 2 distillate, with diesel fuel making up the remaining 35 percent.

of heating oil sold during this period. Although the Energy Regulatory Administration (ERA) agreed with the Office of Hearings and Appeals estimate, it argued that heating oil prices had not increased sufficiently to warrant the reimposition of price or allocation controls.

In its report on the hearings, the Office of Hearings and Appeals also said that there were significant doubts that workable competition existed in the refinery sector of the industry and recommended that ERA complete a series of studies by September 1, 1979, on the subject. At the hearing, the Department of Justice participant recommended that competition questions be addressed by his Department. However, the Office of Hearings and Appeals was not convinced that this recommendation could provide short-term relief from noncompetitive conditions that might exist in the heating oil industry.

The Office of Hearings and Appeals further recommended that if heating oil price increases at the refinery level continued to exceed increased costs and if the ERA studies indicated the absence of workable competition, ERA should conduct formal rulemaking proceedings to determine the nature and extent of the price control program that should be reimposed.

ERA, however, has not implemented the recommended series of studies. ERA officials told us that they do not believe the issue of competition among refiners of heating oil is their agency's responsibility, but rather a matter solely for the Federal Trade Commission or Department of Justice to deal with. We disagree. As

support for the decontrol of middle distillates in July 1976, FEA concluded that competition and market forces in the industry were adequate to prevent consumers from being charged inequitable prices for middle distillates. We believe that DOE should address these same aspects at times such as these, when heating oil prices are rapidly escalating.

DOE has not reviewed the issue of the equitableness of heating oil prices since the end of the 1977-78 heating season. We met with senior level officials in ERA and the Office of Policy and Evaluation to inquire into actions DOE had taken or should take to investigate escalating heating oil prices. We found little had been done and that DOE was not on top of the situation. This in itself was not good news, but the officials' opposing views regarding who was responsible for dealing with the price increases were even more disconcerting to us. Each office pointed to others as having the principal responsibility.

ERA officials told us it is not their responsibility, since their agency is only responsible for implementing regulatory policy. On the other hand, officials in the Office of Policy and Evaluation told us that it is ERA's responsibility to alert DOE management when there is need for a Federal response to price increases.

We attempted to clarify this issue of responsibility. On December 4, 1979, we wrote a letter to DOE presenting the issues we had developed in our review. We requested that DOE give us their official position on these issues by December 12, 1979, either in

writing or by meeting with us. We had hoped that by now, DOE would have responded. However, we have not yet received any response from them on either our letter or our report.

We recognize heating oil is not under allocation or price controls and, therefore, should not be subjected to the same amount of attention as a controlled product such as gasoline. Even so, we believe that DOE has a responsibility to the Congress and the public to analyze situations such as the recent escalation of heating oil prices and, if necessary, take appropriate action. Both the Department of Energy Organization Act and the Federal Energy Administration Act of 1974, for which DOE now has responsibility, aim to insure fair and reasonable consumer prices for energy supplies. We believe that DOE has failed to take even the first steps necessary to insure that this objective is met, since it has not paid enough attention to the rapidly escalating heating oil prices.

Accordingly, we recommended in our report that the Secretary of Energy determine whether current heating oil prices are equitable and justified by increased costs and, if not, whether Federal action is needed. We also recommended that DOE prepare the study assessing the competitiveness of the refinery sector of the heating oil industry as recommended by the Office of Hearings and Appeals.

In summary, our review revealed that:

--The increased price of heating oil has sparked much debate and has significantly exceeded FEA's predictions at the time of decontrol in July 1976.

--Even though these increases were highlighted by the Office of Hearings and Appeals, ERA has not acted on their recommendations.

--DOE does not appear to be on top of the heating oil situation and is not in a position to say whether current heating oil prices are equitable.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to your questions.