

EXECUTIVE SUMMARY

Petroleum is currently the largest single source of energy in the United States; it is used for, among other things, running vehicles, generating electricity and heating homes and businesses. When prices are stable and relatively low, as they were for much of the 1990s, they tend to be taken for granted and receive little attention. However, when prices are volatile, particularly when they spike as heating oil prices did last winter, they become the center of attention.

As a result of the concerns about volatile and rising fuel prices in Maine (see Appendix D for graph showing Maine retail fuel prices from 1/96 through 8/00), the 119th Legislature during its Second Regular Session established two study groups to examine the matter: this Study Committee and the Task Force to Reduce the Burden of Home Heating Costs on Low-Income Households.

This committee, created by Joint Order (see Appendix A for copy of the order), was directed to gather information on the changes in fuel prices and to develop recommendations for minimizing the effects of price changes or minimizing future price increases. The committee held public hearings in Bangor, Sanford and Lewiston and gathered information from federal and state agencies, the petroleum industry, the NYMEX, consumer advocates, and the trucking industry (summaries of the committee's four, information-gathering meetings are located in Appendix H). The committee also held a joint meeting in Augusta with the Task Force to Reduce the Burden of Home Heating Costs on Low-Income Households and subsequently reviewed the Task Force's final report. Due to the complex nature of the study issues, the committee sought from the Legislative Council an extension of its reporting deadline; the Legislative Council, at its September 26, 2000 meeting, approved an extension to December 15, 2000.

While this committee makes recommendations that would most appropriately be addressed to several committees of the Legislature, the Joint Order creating this study directs that this report be addressed only to the Joint Standing Committee on Transportation. The committee assumes the Joint Standing Committee on Transportation will take any steps it deems appropriate to involve other legislative committees in the review of these recommendations. Obviously any of the recommended legislation attached to this report that is ultimately introduced will find its way in the normal course of the referencing of bills to the appropriate committees.

Since the Joint Standing Committee on Transportation will not have an opportunity to act on any of the recommendations until January 2001, at the earliest, the Study Committee finds itself in an inauspicious position to propose options for addressing the fuel price issues as they relate to the current heating season. Consequently most of the committee's recommendations take a longer view of the issues surrounding fuel prices; the committee's recommendations focus primarily on future supply and process issues.

In summary, the committee finds:

- That heating oil inventories in Maine and New England provide an important cushion against supply disruptions and potential price spikes. When heating season inventories are low compared with historic averages, as they presently are, it poses a risk of contributing to price spikes during demand peaks.
- That severe volatility in gasoline and diesel fuel prices can adversely impact consumers and businesses, in particular trucking businesses. Gas and diesel taxes increase the ultimate price paid by consumers, but do not contribute to price volatility. Suspension of the federal taxes could be of some assistance; however, unless revenues from such taxes are made up from other sources, any reduction in the taxes would result in an undesirable reduction in federal highway funds.
- That, as a general rule, energy planning and energy efficiency-related functions should be handled by one agency. A transfer of the energy–efficiency responsibilities from the Department of Economic and Community Development to the State Planning Office would improve coordination and efficiency of energy-related functions. There is a need to examine the adequacy of funding for energy planning and energy efficiency-related functions of state government.
- That the more educated consumers become about energy matters and the more they make use of the conservation and energy assistance options available to them, the less vulnerable they will be to price volatility. Consumer education about available options and how to take advantage of them should be an important part of the State’s effort to help consumers prepare for this and future heating seasons.
- That there is no evidence at this time that interruptible customers in Maine (large commercial and industrial customers who receive a rate incentive by agreeing to switch to a fuel other than natural gas during periods of peak demand and supply constraint) have negatively impacted or pose a serious risk of negatively impacting winter heating oil supplies or prices.
- That energy conservation reduces energy consumption and consumer bills. Reducing heat loss from low-income households through weatherization allows fuel assistance dollars to go further and reduces waste of energy as well as the funds spent on energy. Energy conservation and reduction in inefficient energy use should be a goal of the State.

In summary, the committee recommends:

- Adoption by the Legislature of the recommendations of the Task Force to Reduce the Burden of Home Heating Costs on Low-Income Households as they appear the Task Force’s November 1, 2000 Final Report. Briefly, these are:
 - That the Legislature annually authorize a working capital advance of \$10 million to the Low Income Home Energy Assistance Program to provide fuel assistance during the summer when prices are generally lower, thus increasing the assistant provided.
 - That the Maine State Housing Authority (MSHA) and Finance Authority of Maine (FAME) be directed to develop a proposal for establishing a program to provide low

interest loans or grants to individuals for the purchase of energy conservation improvements.

- That the Legislature authorize the issuance of an \$8 million General Fund bond, the proceeds of which would be used by the MSHA to fund the conservation loan and grant program.
 - That the MSHA and the State Planning Office (SPO) be directed to study the feasibility of establishing an Office of Energy Conservation within MSHA.
 - That the MSHA be directed to investigate during the month of April in each year for the years 2001 – 2003, the possibility of increasing the percentage of LIHEAP funds available for weatherization.
 - That the Public Utilities Commission be directed to continue to monitor the effects of gas interruptibles on the price and supply of heating oil in Maine.
 - That the SPO be directed to conduct a study to determine whether, and if so how, per capita residential energy consumption in the State could be reduced by at least 25% by the year 2011.
- That the Joint Standing Committee on Transportation report out legislation creating a task force to examine and, to the extent possible, to quantify the costs and benefits to the State of creating a State heating oil reserve and of purchasing options on heating oil futures.
 - That the Joint Standing Committee on Transportation propose a Joint Resolution memorializing Congress to remove or reduce federal diesel taxes during the winter season in the Northeast, provided that the loss of revenues to the Federal Highway Trust Fund is otherwise made up so that the distribution of funds from the Trust Fund to the State is not diminished.
 - That the Joint Standing Committee on Transportation report out legislation directing the State Planning Office and the Department of Economic and Community Development to develop a plan for the orderly transfer of the energy efficiency responsibilities of the DECD to the SPO and to recommend an appropriate funding level for the energy-related responsibilities of the SPO after the transfer.
 - That the Legislature support cost-effective and reasonable steps to educate the public about energy assistance programs and methods of reducing energy use and costs.
 - That the Legislature pass a Joint Resolution encouraging Congress to establish a mechanism whereby the State of Maine obtains a right to heating oil distributed from the Northeast Heating Oil Reserve based on the amount of heating oil conserved in the State through the application of public funds.

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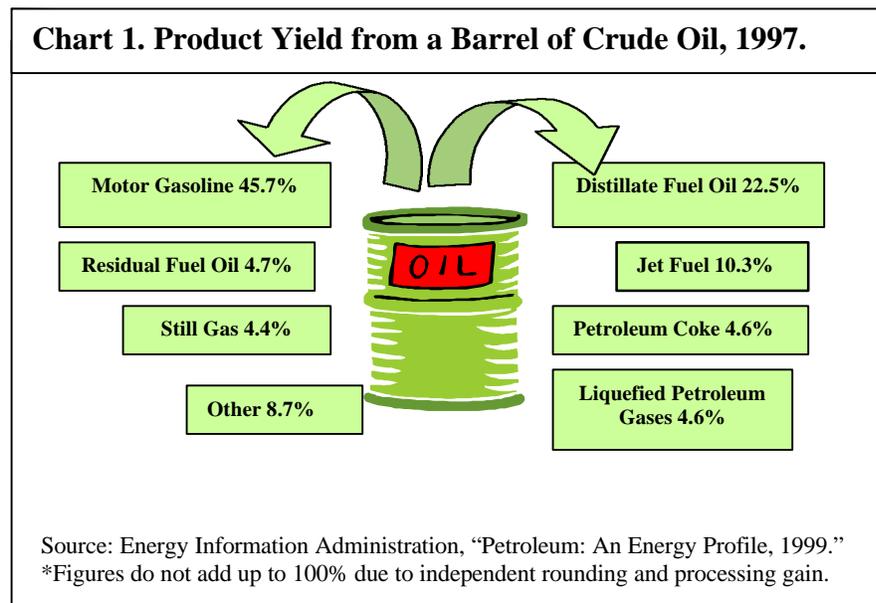
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I. Background: An Overview of the Petroleum Industry

A. Consumption.

According to the Energy Information Administration (EIA) of the Department of Energy, petroleum is currently the largest source of energy in the United States, representing roughly 40% of all energy consumed. Natural gas represents 25%, coal 23%, and nuclear, hydroelectric, geothermal and other sources represent the remaining 12%.¹ The EIA estimated that in 1999, petroleum demand in the U.S. averaged over 18.6 million barrels per day, and while the U.S. is one of the largest producers of petroleum, it consumes more than it produces.²



B. Crude Oil.

Through the petroleum refining process, crude oil produces heating fuel, transportation fuel, and various nonfuel products (including solvents, lubricating oils, and refinery gases). Nine out of ten barrels of petroleum are used to produce fuel products, with motor gasoline constituting 40 percent of the entire demand for petroleum products.³

i. A Brief History of Crude Oil Prices. Considerable stability existed in the crude oil market from the late 1940's to the early 1970's. From this point forward, crude prices have become less stable, reacting to changes in the U.S. and global economy, as well as to changes in governmental regulation.⁴ The strain on crude oil inventory and supply caused by the energy crisis of the 70's resulted in the development of energy conservation programs, as well as the government's

¹ Energy Information Administration, "Petroleum, An Energy Profile, 1999."

² Id.

³ Id.

⁴ Id.

involvement in the allocation of existing crude oil and product supplies to refiners. The government's inflation fighting wage and price control program placed restrictions on the price of domestic crude oil, while the price of crude on the global market was escalating. When these controls were lifted in the early 80's, domestic prices moved into line with foreign prices.⁵ In the early 80's, a decrease in consumer demand for crude oil, coupled with an increase in crude production by non-OPEC countries, resulted in an over-abundance of crude oil in the world marketplace. In the mid-80's, OPEC increased production, and prices continued to fall until demand on the world market slowly began to increase. With the Iraqi invasion of Kuwait in the early 90's, and the United Nation's embargo that followed on crude products from both countries, crude oil prices began to steadily increase. Four months after the invasion, crude oil production from other countries stabilized prices in the world market.⁶

ii. Crude Oil Reserves and OPEC. It is estimated that the United States has some 22.5 billion barrels of proved crude oil reserves,⁷ primarily in Texas, Alaska, and California.⁸ The EIA estimates that the United States holds roughly 3 percent of the world's remaining crude oil reserves.⁹ Members of the Organization of Petroleum Exporting Countries (OPEC) possess a large percentage of the world oil supply and consequently have great influence over world crude prices. Roughly 43% of crude production worldwide comes from OPEC member countries, and they hold roughly 67% of the world's crude reserves.¹⁰ OPEC began its organization in 1960 working with large oil companies that had vested interests in their countries' crude production. OPEC members presently establish among themselves production guidelines to reach desired price levels.

⁵ Id.

⁶ Id.

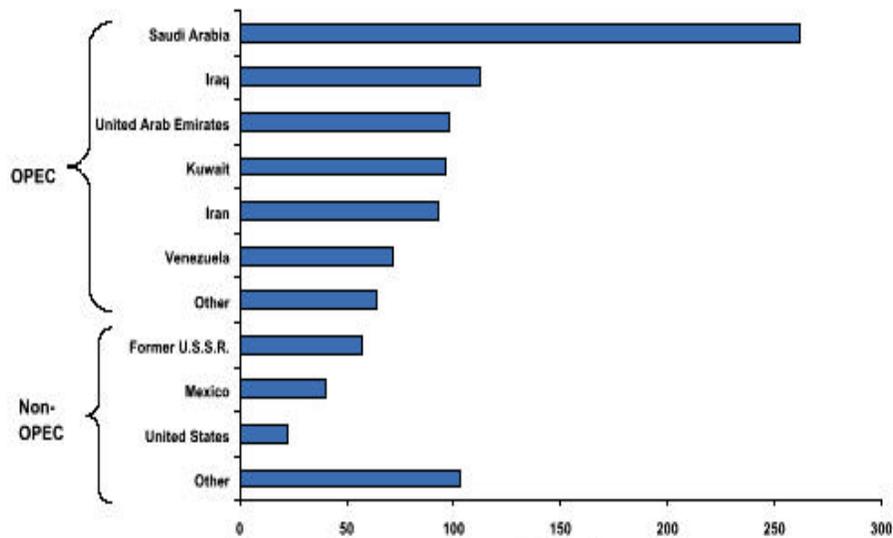
⁷ The EIA defines "proved crude oil reserves" as those which are recoverable under existing technological and economic conditions.

⁸ Energy Information Administration, "*Petroleum, An Energy Profile, 1999.*" The estimate is based on 1997 figures.

⁹ Id.

¹⁰ Id.

Chart 2. Estimated Reserves of Crude Oil by Nation, 1997.

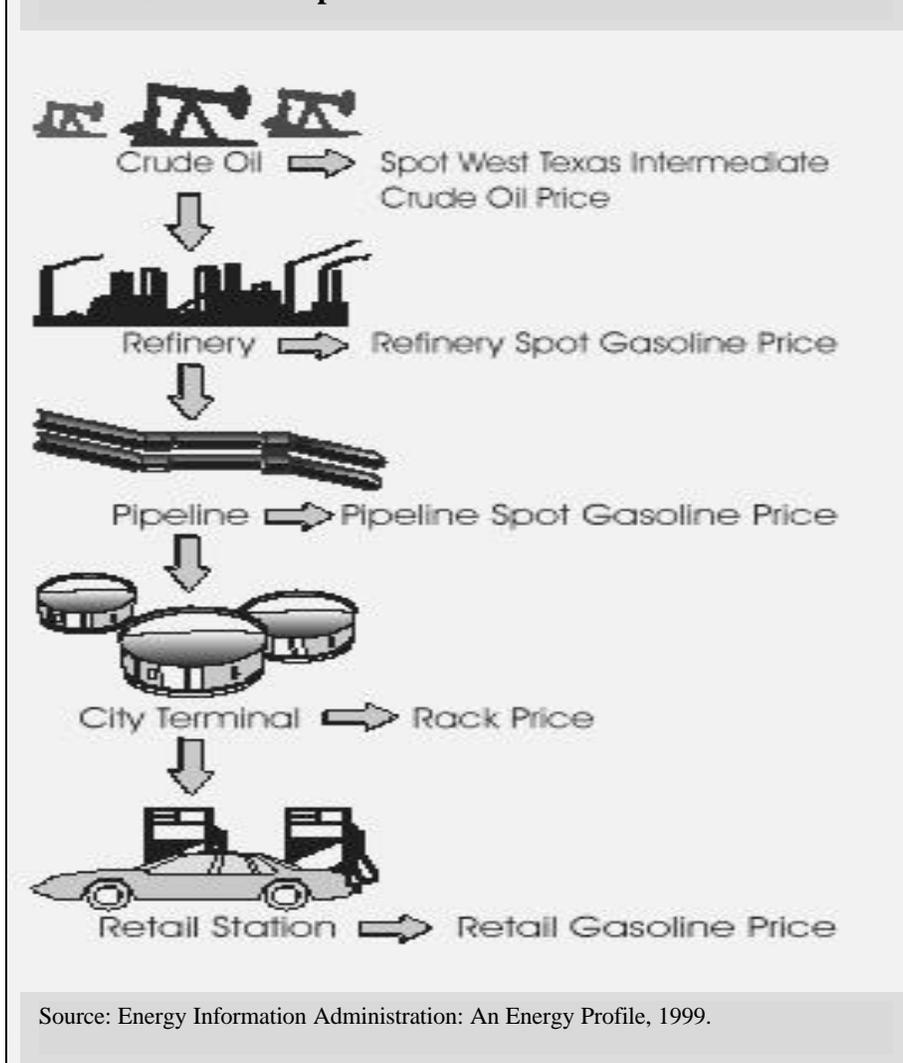


Source: Energy Information Administration, Petroleum: An Energy Profile, 1999.

iii. Crude Prices vs. Retail Prices. There are various costs associated with crude oil products as they are moved throughout the distribution process. When a product of crude oil is sold from a refinery or terminal loading rack, the rack price is paid, which includes the price the refinery paid for the crude (Spot West Texas Intermediate Crude Oil Price) as well as relatively low additional costs associated with storage, distribution, and production that were paid by the refiner.¹¹ Gasoline retailers pay the dealer tank wagon (DTW) price to refiners and distributors, which includes transportation and promotional costs above the rack price. The retail price, the price the consumer pays for gasoline, includes the DTW price paid by the retailer, additional operational costs, dealer margins, and taxes.

¹¹ Id.

Chart 3. Simplified Gasoline Market Structure.



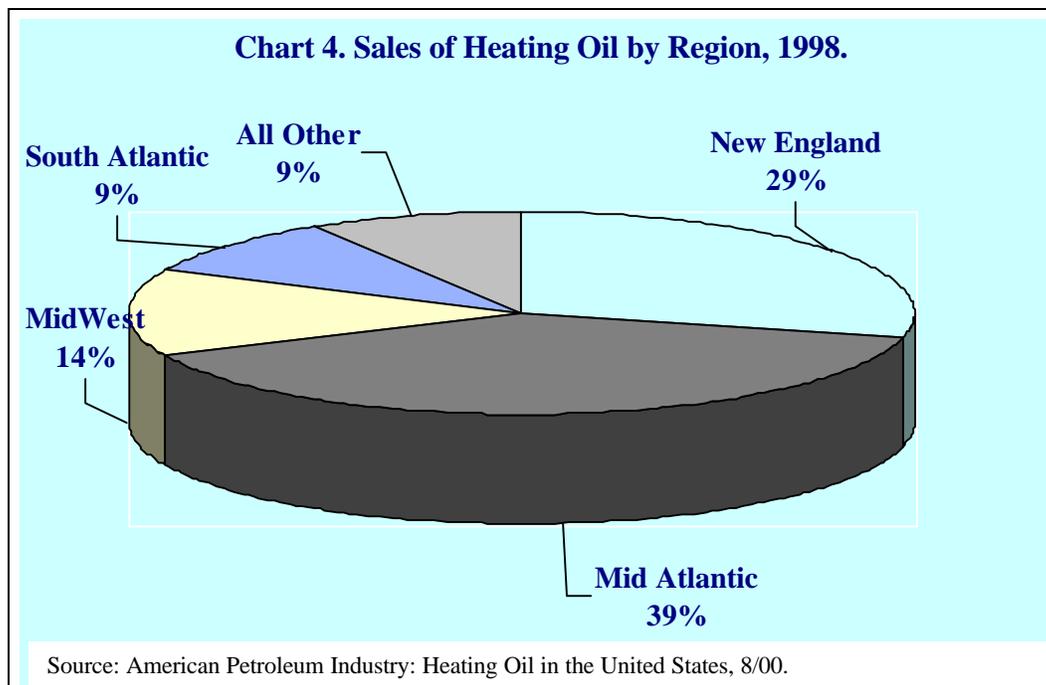
C. Heating Fuels.

i. Heating oil. Heating oil (number 1, 2 and 4 distillate fuel oil) can be used for residential and commercial heating purposes, and it is the predominant source of heating fuel used by residences and businesses alike in the Northeast. In 1997, 8 percent of all energy used for residential heating purposes in the U.S. came from heating oil and of that, 73 percent was utilized by the Northeast.¹² Heating oil use is most highly concentrated in the areas of the Northeast, the Mid-Atlantic, and the Great Lakes (see Chart 4: Sales of Heating Oil by Region). The average yearly consumption of heating oil for a single-family home is roughly 730 gallons, with an average cost in 1999 of \$657.¹³ On the East Coast, the heating

¹² Energy Information Administration, "The Northeast Heating Fuel Market: Assessment and Options," 2000.

¹³ American Petroleum Institute, "Heating Oil in the United States" August, 2000.

oil supply is derived on average from the following: heating oil stocks provide roughly 10 percent of the total supply; local refinery¹⁴ production provides 35 percent; transfers of heating oil from other regions provides 40 percent; and net imports provide 15 percent.¹⁵ All heating oil consumed in New England must be delivered by tankers, barges, or ground transportation, since there are no refineries or pipelines in New England. There is a refinery located in St. John, New Brunswick that, based on anecdotal evidence received by the committee, appears to supply a significant amount of heating oil to the State.



In the winter of 1999-2000, heating oil prices in the Northeast experienced a dramatic increase for a period of about four weeks (see section G-iii and Appendix E, Graph: Maine Retail Fuel Prices for 1/1996 through 8/2000). A relatively rapid change to colder than normal temperatures in the month of January, combined with low stock levels¹⁶ and supply delivery difficulties due to the bad weather, caused heating oil prices to spike from \$1.21 to \$1.99 per gallon¹⁷ (see Appendix D, Chart: Heating Oil Market Timeline, Factors Affecting Price Fluctuations). At the same time, many natural gas customers were also switching to heating oil (due to interruptible contracts or for cost reasons), which further increased the demand for heating oil. Projections by the EIA for this winter indicate that by the end of November, nationwide stocks levels will reach

¹⁴ According to the EIA, as of January 1, 1999 there were 14 operating refineries in PADD 1 (the East Coast of the U.S.). Of these, 11 are located in the Delaware and New York City corridor and account for 95 percent of PADD 1 refinery capacity of 1.5 million barrels per day.

¹⁵ American Petroleum Institute, "Heating Oil in the United States" August, 2000.

¹⁶ The EIA in "The Northeast Heating Fuel Market," refers to stock level patterns for the years of 1989-99.

¹⁷ API, "Heating Oil in the United States," 8/00.

127 million barrels, roughly 13 million less than the normal stock level for that time of year.¹⁸ As of September 1, 2000, the EIA reports that distillate fuel stock levels nationally are close to 20 percent behind last year's levels, and about 15 percent lower than average stock levels for this time of year.¹⁹ East Coast stock levels are also behind, roughly 39 percent lower than average stock levels for this time last year.²⁰ Without forecasting a colder than normal winter, the EIA has estimated that the Northeast will experience higher heating oil prices than last winter. (See Table 1. Consumer Winter Heating Oil Costs)

Table 1. Consumer Winter Heating Oil Costs,* Average Northeast Household Heating with Oil				
	97-98	98-99	99-00	00-01
	Actual	Actual	Actual	Fcst (Base)
Gal	636	647	643	683
\$/gal	\$.93	\$.80	\$1.19	\$1.32
Cost (\$)	\$591	\$518	\$765	\$901

*Source: EIA *Winter Fuels Market Assessment 2000*, September 13, 2000.

ii. Kerosene and Propane. Number 1 and Number 2 kerosene fuel oils are petroleum distillates that may be used for residential heating (with space heaters, cook stoves, water heaters), and kerosene-type jet fuel is used for commercial and jet aircraft engines. Propane is produced as a by-product of both the oil refining process (when gasoline and heating oil are refined) and of the natural gas production process.²¹ U.S. imports of propane provide roughly 10 percent of the total supply; imports are important in maintaining adequate supplies since, as a by-product fuel, production levels depend entirely on production levels of fuel oil and natural gas. The prices of propane are affected by crude oil prices and by the prices of competing fuels.²² Similar to heating oil, its prices are also affected by low inventories and changes in weather patterns. Currently distillate fuel oil production is high as is natural gas production; thus propane production is also high. According to the EIA, propane stock levels in the U.S are the lowest they have been since 1996 and are 13 percent lower than year-ago levels.²³ East coast propane stocks, however, remain within the normal range for this time of year.²⁴

¹⁸ EIA, "Winter Fuels Market Assessment 2000, Presented to the Northeast-Midwest Congressional Coalition," September 13, 2000.

¹⁹Id.

²⁰Id. Based on anecdotal evidence, it appears stock levels in Maine may also be low. As this report goes to press, the Study Committee awaits a report from the SPO on heating oil inventories in Maine. By statute the report is due at the beginning of January 2001; in September the committee requested the report be issued earlier (see summary of September 19th meeting in Appendix H).

²¹ EIA, "Propane Prices: What Consumers Should Know."

²² EIA, "Propane Market Status Report: Presentation to the Coalition of Northeastern Governors," July 26, 2000.

²³ Id.

²⁴ Id.

D. The Role of Natural Gas in the Northeast.

Oil has been the primary choice in the Northeast for energy, in part because it has been economical for consumers, and in part because natural gas has not been easily accessible. However, with the increase in the construction of natural gas pipelines over the past 20 years, consumers have increasingly been able to switch from oil to natural gas.²⁵ Between 1982 and 1998, 1.6 million consumers switched from oil to natural gas.²⁶ In 1997, over 7,300 homes in New England made the transition from heating oil to - natural gas, while 27 percent of all newly constructed homes in the Northeast in 1998 selected oil heat.²⁷ According to the Maine Public Utilities Commission, there are now an estimated 22,000 natural gas customers in Maine. The residential consumption levels for oil have dropped in the Northeast by 20 percent since 1980, due partly to warmer winters and greater efficiency; the number of heating oil consumers however has stayed relatively stable. Natural gas pipelines are constructed to handle fluctuations in consumer demand during the year, and natural gas contracts with large users often provide for service interruptions when the pipeline is operating under specific conditions and temperatures. Natural gas prices reflect three main factors: the actual cost of the fuel; the costs associated with transporting, storing and distributing the fuel, and the type of service contract (firm or interruptible) obtained by the consumer. Retail rates for natural gas are subject to Public Utility Commission regulation and so are not volatile in the manner that heating oil prices are. According to the American Petroleum Institute (API), natural gas prices nationwide have typically been lower than heating oil prices, though in the Northeast natural gas tends to be more expensive than elsewhere in the nation.²⁸ Costs comparisons for individual customers depend, of course, upon various factors, including not only the costs of the fuels, which are subject to change, but also the costs of conversion and the relative efficiencies of the heating systems used.

i. Natural Gas in Maine. Maine has recently experienced a substantial increase in natural gas supply as a result of the two interstate natural gas pipelines that were completed last year. Distribution of gas to retail consumers in the state was, until recently, provided by one company, Northern Utilities, Inc. With the advent of the new pipelines, two new distribution companies have appeared: Maine Natural Gas LLC and Bangor Gas Company LLC. New natural gas distribution infrastructure has been constructed and retail service initiated in numerous areas. Among the municipalities that have recently acquired or are scheduled to acquire natural gas service are these: Windham, Brunswick, Freeport, Pownal, Gorham, Bucksport, Rumford, Bangor, Brewer, Veazie, Orono, Sanford, and Old Town. Several other areas are under consideration for future development, including Augusta, Waterville, Skowhegan, and Bath. A number of large industries and government facilities have converted to or increased their use of natural gas. These include Maine Medical Center, Pike Industries, Philips Elment,

²⁵ EIA, "The Northeast Heating Fuel Market."

²⁶ Id.

²⁷ API, "Heating Oil in the United States," August, 2000.

²⁸ Id.

International Paper, Auburn VPS, Vishay Industries, International Brands Corporation, Fort James Corporation, the Brunswick Naval Air Station, the Portsmouth Naval Shipyard, and the University of Maine's Gorham and Orono campuses. The pipelines have also made possible five gas-fired electric generation facilities sited in various regions of the state. The collective capacity of these facilities will provide some 1650 MW of power to the New England region.²⁹

E. Transportation Fuels.

i. Motor Gasoline. Motor gasoline represents almost 46 percent of the entire nationwide demand for petroleum fuels and products.³⁰ (See Chart 1: Product Yield from a Barrel of Crude Oil). Motor gasoline is used for powering automobiles, light trucks, boats, farm vehicles and other equipment. Gasoline is produced primarily in three grades: regular, midgrade, and premium. Gasoline prices vary by region due to state taxes, the number of competing gasoline retailers,³¹ and whether or not the region is near a refinery. This year, gasoline prices have been higher than previous years, due to the dramatic increase in world crude oil prices (see Chart 5: Prices of Crude Oil and Retail Regular Motor Gasoline 1970-1997).³² A combination of low crude and gasoline inventories have also contributed to the high prices seen this year. With the increase in production by OPEC this fall, the EIA projects that crude oil prices will begin to decline by the end of this year.³³ However, the low stock levels may provide for unpredictable gasoline prices this winter.

²⁹ Information on natural gas in Maine provided by the Public Utilities Commission.

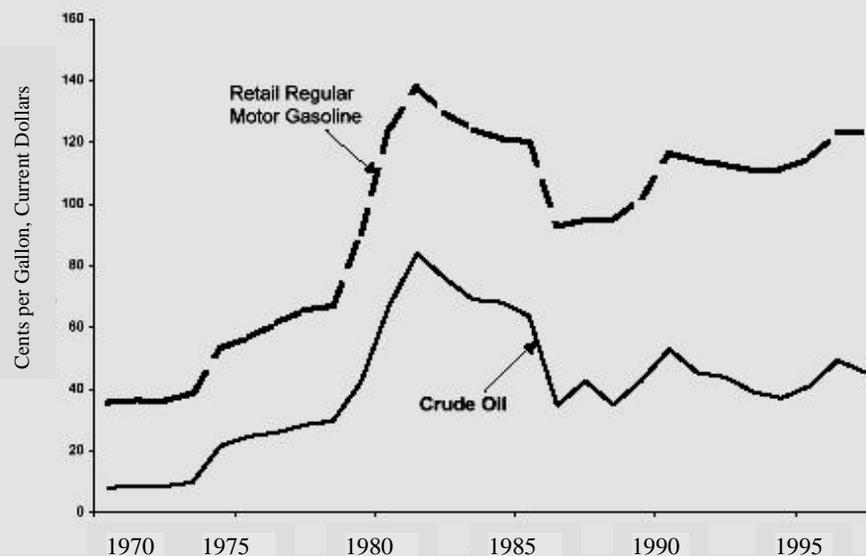
³⁰ EIA, "Petroleum, An Energy Profile, 1999."

³¹ The Attorney General, pursuant to 10 MRSA §1671, collects and analyses data relating to wholesale petroleum transactions to determine market concentration and competition in the State; an annual report on the matter is issued each January to the Legislature.

³² EIA, "Update: A Year of Volatility: Oil Markets and Gasoline," June 2000.

³³ Id.

Chart 5. Prices of Crude Oil and Retail Motor Gasoline, 1970-1997



Source: EIA: "Petroleum, An Energy Profile, 1999."

ii. Diesel Fuel. Number 1, 2 and 4 distillate diesel fuel oil is used for diesel engines and firing industrial and electric utility boilers. Diesel fuel represents three-quarters of all refinery sales of distillate fuel oils.³⁴ Prices for diesel fuels tend to reflect the prices for heating fuels, and therefore tend to decline after the heating season.³⁵ This year diesel fuel prices were higher than last for many of the same reasons that drove the prices of gasoline higher.

F. Taxes on Motor Fuels.

i. Brief History. Federal and State governments rely on motor fuels taxes to provide significant revenues. While motor fuels taxes in other many countries are significantly higher, taxes remain a significant portion of the price that consumers pay for motor fuel in the United States. The first federal excise tax on gasoline (1-cent-per-gallon) was instituted in 1932 to aid in the reduction of the deficit, and minor increases were made to the tax in the following two decades.³⁶ In 1951, the diesel fuel tax was created by the Revenue Act of 1951, authorizing that both gasoline and diesel fuel be taxed at 2 cents per gallon.³⁷ In 1956, the Federal Highway Fund was created, and motor fuels taxes began to be used to fund Federal highway construction. Motor fuels taxes were heavily relied upon after the recession of 1981-82, and in 1982 the Surface Transportation Assistance Act

³⁴ EIA, "Petroleum, An Energy Profile, 1999."

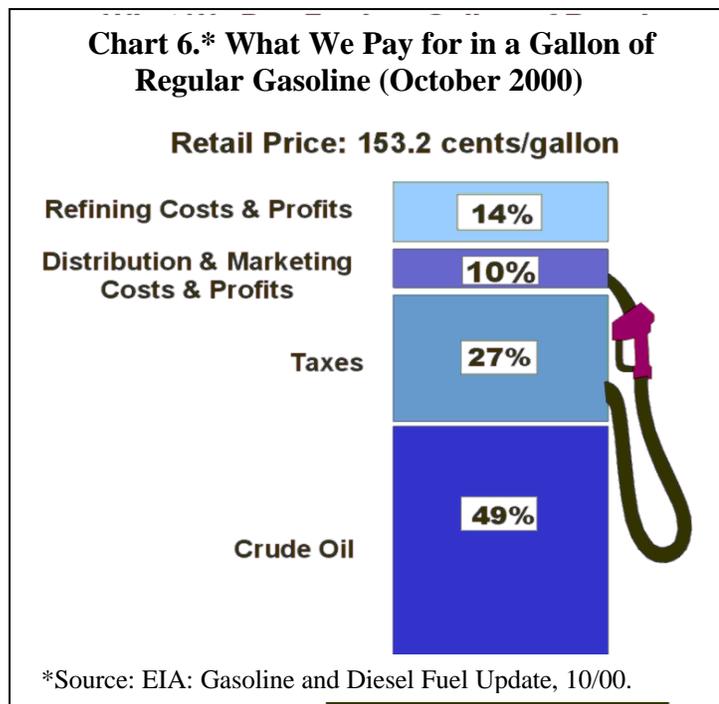
³⁵ EIA, "Update: A Year of Volatility: Oil Markets and Gasoline," June 20, 2000.

³⁶ EIA: "Motor Fuels Tax Trends and Assumptions, 1998".

³⁷ Id.

increased the tax rate on both gasoline and diesel fuel from 4 to 9 cents per gallon.³⁸ The Tax Reform Act of 1984 increased the diesel fuel tax to 15 cents per gallon; a competing proposal to increase taxes on trucks based on vehicle weights was defeated. Both gasoline and diesel taxes were increased in 1986 by 0.1 cent per gallon to fund the cleanup of underground storage tanks. The Omnibus Budget Reconciliation Act of 1990 increased both the gasoline and diesel fuel taxes by 5 cents per gallon, with half of the revenues going to the Highway Trust Fund and the rest toward general revenues. The Omnibus Budget Reconciliation Act of 1993 further increased the tax on gasoline and diesel fuels by 4.3 cents per gallon, predominantly funding the Federal Highway Trust Fund.

ii. Current State and Federal Taxes. The state excise taxes on gasoline and diesel fuel vary, ranging from 7.5 and 36 cents per gallon for gasoline and 7.5 and 29 cents per gallon for diesel.³⁹ Since 1970, state taxes on gasoline (adjusted for inflation) have represented between 7 and 21 percent of the end-use price (see Chart 6: What We Pay for in a Gallon of Gasoline, 10/00). The national average for state gasoline taxes is now 22.6 cents per gallon. State diesel taxes have ranged between 10 and 17 percent since 1983, and 16 and 17 percent since 1991. The average state tax nationwide on diesel is 23.1. Currently Maine’s gasoline tax is 22 cents per gallon, and the diesel tax is 23 cents per gallon. The Federal gasoline tax is currently 18.4 cents per gallon; the federal diesel fuel tax is 24 cents per gallon.



³⁸ Id.

³⁹ Id.

iii. The Federal Highway Fund. According to the U.S. Department of Transportation, Federal Highway Administration, in FY 1997 (the latest year for which complete figures are currently available) Maine paid \$108,547,000 in Federal taxes designated for the Federal Highway Trust Fund and received in Federal-Aid apportionments and allocations from the Highway Fund \$138,617,000. The Federal Highway Trust Fund administers funding to the states based on formulas with weighted factors that take into account the state's contribution levels and transportation needs. For Maine, the cumulative ratio of apportionments and allocations to payments since 1956 is about 1.14 (for every \$1 Maine has paid in, it has received, on average, \$1.14). Federal Highway Funds are apportioned for the following programs: Interstate Maintenance, National Highway System, Surface Transportation Program, Bridge Replacement and Rehabilitation, Congestion Mitigation and Air Quality, Appalachian Development Highway System, Recreational Trails, and Metropolitan Planning.

G. Summary of Historical Price Spikes in the Northeast Distillate Fuel Market.

There have been three major distillate price spikes in recent history. According to the EIA, all three price spikes involved similar factors: unusually cold weather causing a large increase in demand; loss of power in refineries causing supply disruptions; and difficulties with transporting products due to inclement weather. The levels of distillate stocks have also played a role in each of the price spikes though in varying degrees. Historically, distillate stock levels have grown during the summer and fall, particularly in the Northeast, in order to accommodate the increase in demand during the colder winter months. Higher stock levels also function as a safeguard in the event of a supply disruption, which is shown in the following brief summary of the three most recent cases.

i. Winter of 1989-90. The winter season of 1989-90 began with distillate stock levels nationwide at 14 million barrels below average, and East Coast stocks were also low, averaging 7 million barrels below average.⁴⁰ Although refineries were increasing their production levels in November, below normal temperatures in the Northeast and other parts of the country began to spread to the Gulf Coast resulting in many refineries closing down and limiting production. In early December, distillate price spreads⁴¹ had risen to 15 cents per gallon, and by the end of the month, it had peaked to over 41 cents per gallon.⁴² By the end of December, the price spike was over.⁴³ Refiners on the East Coast hit production levels of 480,000 barrels per day before early February when their production began to slow.⁴⁴

⁴⁰ EIA, "Northeast Heating Fuel Market: Appendix C: Historical Distillate Price Spikes: December 1989-January 1990, January-February 1994, and January-February 2000."

⁴¹ "Distillate price spread" is "the weekly average New York Harbor #2 heating oil price minus the West Texas Intermediate crude oil price." *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

ii. Winter of 1993-94. East Coast distillate stock levels remained at 7 million barrels above average until early January of 1994, when a cold snap in the Northeast drove temperatures down well below normal.⁴⁵ These extremely cold temperatures caused distillate East Coast stocks to fall by 31 million barrels.⁴⁶ While there was no interruption in supply, distillate price spreads increased from 15 cents per gallon in January to 28 cents per gallon in early February.⁴⁷ An increase in distillate imports as well as in refinery production on the East Coast brought a boost to distillate stocks during the month of February, yet they were still below average levels.⁴⁸

iii. Winter of 1999-2000. From mid-December to early January, East Coast stock levels fell from average levels to 10 million barrels below average.⁴⁹ Demand for distillate increased dramatically in the end of January as severe weather took hold for several weeks and heating needs in the Northeast and Mid Atlantic rose by 40 percent. Supplies were interrupted as weather conditions prevented distillate deliveries. Distillate spreads at the end of January were rising by 14 cents per gallon weekly. The New York Harbor spot price for heating oil jumped from \$.76 to \$1.77 per gallon between January 14 and February 4, 2000.⁵⁰ By February 4th, East Coast stocks were 20 million barrels below average, and refineries on the East Coast were increasing production by 60,000 barrels per day in efforts to boost stock levels.⁵¹ Although distillate stock levels typically decline during the first quarter of the year, East Coast stock levels increased somewhat in the first quarter, bringing stocks to more normal levels.

iv. Projection for winter 2000-2001: EIA and State Planning Office Information. As mentioned earlier, projections by the EIA for this winter indicate that by the end of November, nationwide stocks levels will reach 127 million barrels, roughly 13 million less than the normal stock level for that time of year.⁵² As of September 1, 2000, the EIA reports that distillate fuel stock levels nationally are close to 20 percent behind last year's levels, and about 15 percent lower than average stock levels for this time of year.⁵³ East Coast stock levels are also behind, at roughly 39 percent lower than average stock levels for this time last year.⁵⁴ Without forecasting a colder than normal winter, the EIA has estimated that the Northeast will experience higher heating oil prices than last winter.

⁴⁵ Id.

⁴⁶ Id.

⁴⁷ Id.

⁴⁸ Id.

⁴⁹ Id.

⁵⁰ EIA, "The Northeast Heating Fuel Market: Assessment and Options."

⁵¹ EIA, "Northeast Heating Fuel Market: Appendix C: Historical Distillate Price Spikes: December 1989-January 1990, January-February 1994, and January-February 2000."

⁵² EIA, "Winter Fuels Market Assessment 2000, Presented to the Northeast-Midwest Congressional Coalition," September 13, 2000.

⁵³ Id.

⁵⁴ Id.

H. Brief Summary of the Strategic Petroleum Reserve and the Northeast Heating Oil Reserve.

i. Strategic Petroleum Reserve. The Strategic Petroleum Reserve (SPR) was established by the Energy Policy and Conservation Act of 1975 which provided for a maximum petroleum reserve of 1 billion barrels. The SPR was used for the first time during Operation Desert Storm in 1991. Currently, close to 570 million barrels are in the SPR, stored in various locations along the Gulf of Mexico coastline. In response to perceived inadequacies in world crude supplies, in particular from OPEC, on September 22, 2000 the President authorized the exchange of crude oil to companies who will be required to return the oil in the fall of 2001.⁵⁵ As of October 13, 2000 the SPR has financial guarantees for 23 of the 30 million barrels to be released, and 500,000 barrels have been transferred from the Strategic Reserve Bryan Mound site in Texas to Morgan Stanley Dean Witter. Companies are expected to fulfill the exchange no later than the end of November.⁵⁶

There was some concern that refineries running at capacity would not be able to handle more crude and therefore that the release would not be of any help in increasing heating oil supplies. However, according to the most recent figures available from the Energy Information Agency (October), refineries appear to have sufficient capacity to process the crude. EIA's October 2000 fourth-quarter projection assumes refineries running an additional 10 million barrels from the SPR and still operating at less than full capacity (the estimated fourth quarter utilization rate is 95.4%).⁵⁷ It is worth noting that the EIA only tracks U.S. refineries; the refinery located in St. John, New Brunswick which supplies heating oil to the Northeast is not included in the EIA's calculations of refinery capacity.

ii. Northeast Heating Oil Reserve. The Energy Policy and Conservation Act of 2000 (Public Law 106-469) provides for the creation of a Northeast Home Heating Oil Reserve and the circumstances for releases from the Reserve. The Reserve may contain no more than 2 million barrels of petroleum distillate that may be released in one of two ways: sold through a competitive process, or through an exchange agreement. The Northeast Home Heating Oil Reserve is now full. The President may authorize a release from the Reserve should there be a "severe energy supply interruption" determined by the following: "a dislocation in the heating oil market has resulted from such interruption; or a circumstance...exists that constitutes a regional supply shortage of significant scope and duration and that action taken under this section would assist directly and significantly in reducing the adverse impact of such shortage."⁵⁸ Dislocation

⁵⁵ The statutory provisions authorizing an SPR drawdown are set forth in 42 USC §6214.

⁵⁶ Information on current status of releases from the SPR taken from the DOE web site, www.fe.doe.gov/spr.

⁵⁷ See DOE/EIA written answers to questions propounded by the committee attached as Appendix L.

⁵⁸ Public Law 106-469, 11/9/00.

in the heating oil market is defined as “ the price differential between crude oil...and No. 2 heating oil...increases by more than 60% over its five year rolling average for the months of mid-October through March, and continues for 7 consecutive days; and the price differential continues to increase during the most recent week for which price information is available.”⁵⁹ While none of the Reserve oil is designated for use in any particular state (the market will determine where the oil flows), it is expected that because of its location in the Northeast and the fact that it will be released only when there is a supply need in the Northeast, releases will ameliorate, at least to some extent, a price spike in the Northeast.

II. Findings and Recommendations

1. Findings.

The committee makes the following findings.

A. Heating oil inventories. Heating oil inventories in Maine and New England provide an important cushion against supply disruptions and potential price spikes. When heating season inventories are low compared with historic averages, as they presently are, it poses a risk of contributing to price spikes during demand peaks.

As noted in the background section of this report, heating oil stocks are low. The petroleum industry has suggested that “weather, not inventories, was the principal reason for last year’s home heating supply problems in the Northeast”⁶⁰ and have suggested more generally that stocks are not a significant factor in today’s supply market. The industry has noted that it has moved to a just-in-time-inventory approach to meeting market needs (largely the result of increased transparency in the market, e.g., computerization which allows wholesalers to track oil supplies and manage stocks “better”). The committee, however, finds that while just-in-time inventories help the industry avoid the price risks associated with storage (buying high and selling low), in the event of high demand (such as during a cold snap), the further away the oil supply, the greater the likelihood of supply disruption (e.g. storms at sea keeping tankers in New York Harbor) resulting in significant price spikes. Historically (see background section of this report), low stocks have contributed to price spikes.

The committee notes that there have been several actions taken this year that may help alleviate the effects of the low inventories this winter.

⁵⁹ From DOE web site, www.fed.doe.gov/spr/heatingoil/_salebasis.htm

⁶⁰ Statement of John Felmy, Director, Policy Analysis and Statistics, American Petroleum Institute, before Commonwealth of Massachusetts Joint Committee on Energy, September 12, 2000, p.3. Copy provided to the Study Committee by the Maine Petroleum Association.

- The Maine Oil Dealers Association has estimated that some 60% of customers have entered fixed-price contracts with dealers; these are presumably backed by dealer contracts with suppliers or options on contracts. These arrangements should assure supply and price predictability for these customers; price volatility, however, remains an issue for the remaining 40% of customers, who are presumably less sophisticated or less well off and so the more vulnerable customers.
- The Department of Energy has established a Northeast Heating Oil Reserve of 2 million barrels (see background section of this report).
- The President has arranged for release of 30 million barrels of crude from Strategic Petroleum Reserve (see background section of this report).

B. Volatility in diesel fuel prices. Severe volatility in gasoline and diesel fuel prices can adversely impact consumers and businesses, in particular trucking businesses. Gas and diesel taxes do not contribute to price volatility but do increase the ultimate price paid. Higher gas and diesel prices encourage conservation and fuel efficiencies, which reduce overall consumption of the fuels; however, there are limits to the conservation measures that can be taken by trucking companies. Reductions in diesel taxes could provide relief to trucking companies in Maine that are finding it financially difficult to adjust to quickly rising pump prices. On the other hand, unless revenues from such taxes are made up from other sources, any reduction in the taxes will result in a reduction in highway funds.

Trucking companies typically contract to provide services over a certain period at a certain price based on an estimate of fuel prices. If fuel prices spike up, this can significantly impact the bottom line for the trucking company. The committee received anecdotal evidence suggesting sharp increases in diesel prices have contributed to a number of trucking companies across the country filing for bankruptcy. The committee also heard that diesel prices vary from state to state and that truckers seek out lower prices when filling up truck tanks. To the extent Maine's prices are higher than prices in other states, truckers, it was suggested to the committee, may ultimately buy less fuel in Maine.

While the federal diesel tax is uniform across the country, state fuel taxes vary from state to state. Maine's fuel taxes are about at the national average (see background section of this report). There are states with lower taxes and states with higher taxes. However, reduction in state fuel taxes, though it might conceivably encourage some truckers to buy more gas in Maine, would reduce diesel tax revenues (which are dedicated to the Highway Fund) and would not directly address the issue of price volatility, which appears to be the major issue confronting the trucking industry. Also, since state diesel taxes are apportioned among states based a complex formula that factors in miles driven in each state, it is not clear how much benefit actually would be provided to interstate truckers if the tax in Maine were reduced.

C. Energy planning and efficiency. Energy planning and energy efficiency-related functions should, as a general rule, be under one agency. A transfer of the energy–efficiency responsibilities from the Department of Economic and Community Development to the State Planning Office would improve coordination and efficiency of energy-related functions. There is a need to examine the adequacy of funding for energy planning and energy efficiency-related functions of state government. State energy planning capacity can provide a source of accurate historical and contemporary energy information as well as a means of identifying and analyzing important trends and patterns and forecasting energy supplies, demands and prices. This information can assist policy makers in developing energy policies, allowing earlier awareness of emerging or changing trends and better understanding of the potential effects of energy policy choices.

From 1974 – 89 Maine’s Office of Energy Resources was responsible for state energy planning; duties included producing detailed energy resource plans (including long range forecasts), setting building and appliance efficiency standards and developing and coordinating state energy policy. In 1989 the Office was abolished; certain of its duties were eliminated with it and others have been eliminated in more recent years; certain responsibilities associated with energy efficiency were transferred to and remain with the Department of Economic and Community Development. Responsibility for energy policy coordination and the development of energy resource plans was transferred to and remains with the State Planning Office. Due to limited resources (almost all funding for energy planning activities comes from limited federal grants), these agencies indicate they are unable to undertake many these responsibilities.

Last year, in response to the extraordinary heating oil price spike, the Joint Standing Committee on Utilities and Energy reported out and the Legislature enacted LD 2668 (PL 1999, Ch. 758) which directs the SPO to report annually to the Utilities and Energy Committee on petroleum product inventories in the State and to report any significant heating oil supply inventory shortfalls which the Office anticipates based on information available to it.⁶¹ The SPO was required to collect this information under the prior existing law, but had done nothing with it. The Office has absorbed the cost of implementing the new law.

Under the electric restructuring law (35-A MRSA §3211) the State Planning Office has also been given the responsibility for developing an energy conservation program to be implemented by transmission and distribution utilities using independent service providers. An assessment on the utilities covers SPO’s costs of carrying out this responsibility.

D. Consumer awareness. The more educated consumers become about energy matters and the more they make use of the conservation and energy assistance options available to them, the less vulnerable they will be to price volatility. While there are

⁶¹ See 5 MRSA §3307-C, sub-§5.

indications that heating oil consumers are growing more aware and taking increased advantage of contract options with oil dealers to reduce price risks, not all customers have the ability to take advantage of these options. It is also not clear that consumers are taking full advantage of the options available to them to improve home energy efficiency and thus reduce heating costs. Consumer education about available options and how to take advantage of them should be an important part of the State's effort to help consumers prepare for this and future heating seasons.

The Governor has developed a so-called Bundle ME Up program to increase customer awareness and utilization of available energy assistance and conservation options. The program may be found on the web at <http://www.bundlemeup.org/>. The effort includes several avenues of public outreach (the internet site, a brochure, a toll-free information line, an email address, media ads, bill inserts and direct mailings).

As noted above, many heating oil customers have taken steps to protect themselves from price spikes this winter by signing fixed-price contracts. The Maine Oil Dealer's Association has estimated that last year 25% signed such contracts; this year about 60% have apparently done so.

E. Natural gas interruptibles. There appears to be no evidence at this time that interruptible customers in Maine (large commercial and industrial customers who receive a rate incentive by agreeing to switch to a fuel other than natural gas during periods of peak demand and supply constraint) have negatively impacted or pose a serious risk of negatively impacting winter heating oil supplies or prices. However, with a number of new gas-fired electric plants coming on line that may make use of interruptible contracts, the issue deserves continued monitoring.

Interruptible contracts in New York appear to have contributed to the oil price spike in New York last winter, raising concerns about whether the interruptible contracts in Maine pose a similar risk to Maine's oil market. According to the Maine Public Utilities Commission, Maine's situation is not analogous to that of New York.

Interruptible consumers in New York have historically rarely been interrupted; last winter they were. The load that then suddenly switched from natural gas to oil constituted a very significant demand spike in the oil market. It is possible that the NY interruptibles had an impact on oil markets throughout the Northeast. The New York utility commission has issued an order requiring interruptibles in that state to have on hand or available by firm contract a 7-10 day oil supply. This was done to ensure protection of the natural gas market (some of the interruptibles did not in fact interrupt when required to under their contracts last winter, causing difficulties in the gas supply); this action by New York should also help address the ancillary effect on the oil market of unanticipated fuel switching by the interruptibles in that state.

Currently in Maine, interruptibles, when interrupted, constitute an insignificant portion (about 1%) of the oil market. Interruptions are scheduled every winter so demand on the oil market is predictable, and the interruptions are essentially for the entire heating season; by the time of a cold snap and a demand spike, they are already off line and oil supply has been arranged.

F. Demand-side management and low-income assistance. Energy conservation reduces energy consumption and consumer bills. Reducing heat loss from low-income households through weatherization allows fuel assistance dollars to go further and reduces waste of energy as well as the funds spent on energy. Energy conservation and reduction in inefficient energy use should be a goal of the State.

Energy conservation efforts often require an up-front capital expense (such as the purchase and installation of insulation) that can pose financial difficulties for persons of limited means. However, reduction in energy loss results in long-term cost savings from reduced fuel purchases; the capital costs of conservation often have a relatively short pay back period from the energy cost savings.

Last year the Utilities and Energy Committee proposed and the Legislature enacted a law creating an energy savings pilot program for State Government.⁶² The new law establishes an energy savings goal for the State and requires the Department of Administrative and Financial Services to develop a pilot program to achieve significant energy savings at 10 state facilities. In addition to saving the State money and setting a worthwhile example for other energy consumers in the State, the achievement of significant energy savings by state government, a large consumer of energy, has the potential for reducing energy demand within the State, thus freeing those energy resources for other uses. Under the pilot program, performance-based contracts will be used. Such contracts allow for the assurance of energy savings equal to or in excess of contract payments.

2. Recommendations.

Many of the recommendations that follow would most appropriately be addressed to several committees of the Legislature. However, the Joint Order creating this study directs that this report be addressed only to the Joint Standing Committee on Transportation. The committee assumes the Joint Standing Committee on Transportation will take any steps it deems appropriate to involve other legislative committees in the review of these recommendations. Obviously any of the recommended legislation attached to this report that is ultimately introduced will find its way in the normal course of the referencing of bills to appropriate committees.

Since the Joint Standing Committee on Transportation will not have an opportunity to act on any of the recommendations until January 2001, at the earliest, the Study Committee finds itself in an inauspicious position to propose options for

⁶² See LD 2446, as amended by Committee Amendment A, enacted as PL 1999, Ch. 735, and codified at 5 MRSA §1770.

addressing the fuel price issues as they relate to the current heating season. Consequently most of the committee's recommendations take a longer view of the issues surrounding fuel prices; the following recommendations focus primarily on future supply and process issues.

As a result of and in accordance with the findings described in the section 1 above, the committee makes the following recommendations.

A. Support for recommendations of the Task Force To Reduce The Burden Of Home Heating Costs On Low-Income Households. The final report (November 1, 2000) of the Task Force To Reduce The Burden Of Home Heating Costs On Low-Income Households offers eight recommendations dealing with issues associated with heating oil. The Study Committee, which met jointly with the Task Force on October 12th and reviewed generally with the Task Force the options that ultimately appeared as recommendations in the Task Force's report, has also independently considered the matters addressed by those recommendations and supports the recommendations. Rather than repeat what is laid out in that report, which the reader may consult directly, the following briefly summarizes the Task Force's recommendations (with the exception of Recommendation #2 in that report which relates to an issue that, as it turns out, is moot);⁶³ the Study Committee hereby endorses and incorporates into this report the Task Force's recommendations as they appear the Task Force's November 1, 2000 Final Report.

i. Working Capital Advance to LIHEAP. The Study Committee recommends the Legislature annually authorize a working capital advance, to be available by July of each year, of \$10 million from the General Fund, Unappropriated Surplus, to the Low Income Home Energy Assistance Program. These funds should be available to provide fuel assistance during the summer when prices are generally lower, thus increasing the assistance provided. This program should be coordinated with the federal government to ensure repayment of the advance from federal LIHEAP funds.

ii. Loans and grants for energy conservation; bond. The Study Committee recommends that the Maine State Housing Authority (MSHA) and Finance Authority of Maine (FAME) be directed to develop a proposal for establishing a program to provide loan interest loans or grants to individuals for the purchase of energy conservation improvements. The FAME and the MSHA should be directed to provide a report with their proposal to the Joint Standing Committee on Utilities and Energy and the Joint Standing Committee on Appropriations and Financial Affairs.

The Study Committee also recommends that the Legislature enact legislation authorizing the issuance of an \$8 million General Fund bond, the proceeds of

⁶³ Recommendation #2 relates to a proposal that was being considered by Congress to require a 25% state match for weatherization funding. Congress did not adopt the proposal, thus the issue addressed by recommendation #2 is moot.

which would be used by the MSHA to fund the conservation loan and grant program.

iii. Establishment of an Office of Energy Conservation. The Study Committee recommends the MSHA and the State Planning Office (SPO) be directed to study the feasibility of establishing an Office of Energy Conservation within MSHA. The MSHA and SPO should be directed to present their report to the Joint Standing Committee on Utilities and Energy and the Joint Standing Committee on Appropriations and Financial Affairs.

iv. Investigation of increase in weatherization portion of LIHEAP. The Study Committee recommends the MSHA be directed to investigate during the month of April in each year for the years 2001 – 2003, the possibility of increasing the percentage of LIHEAP funds available for weatherization. The federal cap on the percentage is 25%; increases up to the cap should be examined.

v. Monitoring interruptibles. The Study Committee recommends that the Public Utilities Commission be directed to continue to monitor the effects of gas interruptibles on the price and supply of heating oil in Maine.

vi. State-wide reductions in energy consumption. The Study Committee recommends that the SPO be directed to conduct a study to determine whether, and if so how, per capita residential energy consumption in the State could be reduced by at least 25% by the year 2011. The SPO should be directed to consider the effects of increasing efficiency requirements for heating systems, appliances and building standards. The study should also consider the value of tax incentives for energy efficiency improvements. The SPO should be directed to present its report to the Joint Standing Committee on Utilities and Energy, the Joint Standing Committee on Taxation, and the Joint Standing Committee on Appropriations and Financial Affairs.

B. Examine creation of state heating oil reserve and/or the use of hedging mechanisms. The Study Committee recommends that the Joint Standing Committee on Transportation report out legislation creating a task force to examine and, to the extent possible, to quantify the costs and benefits to the State of creating a State heating oil reserve and of the purchase of options on heating oil futures. The goal of the task force should be to determine whether either of these options could be used successfully to reduce or stabilize consumer costs.

The examination of a heating oil reserve should include an assessment of the effect of just-in-time inventories on winter heating fuel stocks and price volatility, as well as an assessment of available tank storage capacity, and the necessary size of a reserve in order to address identified industry reserve deficiencies. The examination should also assess how a reserve would affect the heating oil market, including industry reserves, the costs and risks to the State, and an identification of possible funding sources.

The examination of the purchase of options on heating oil futures should include whether the purchase of call options on heating oil futures by the State, or by others under the direction of the State, could provide a cost-effective hedge against price spikes and, in a more targeted fashion, whether the purchase of such call options could be used to provide a hedge against price increases in the context of the administration of LIHEAP.

With the assistance of the SPO as staff, the task force should be directed to prepare a report and submit it to the Joint Standing Committee on Utilities and Energy and the Joint Standing Committee on Appropriations and Financial Affairs no later than March 9, 2001. These committees should be authorized to report out legislation in response to the report.

C. Seek seasonal suspension of federal diesel tax. The Study Committee recommends that the Joint Standing Committee on Transportation propose a Joint Resolution memorializing Congress to remove or reduce federal diesel taxes during the winter season in the Northeast, provided that the loss of revenues to the Federal Highway Trust Fund is otherwise made up so that the distribution of funds from the Trust Fund to the State is not diminished. The Study Committee recommends no change in the State diesel tax.

D. Consolidate responsibilities for energy planning and enforcement of energy efficiency standards; review adequacy of funding. The Study Committee recommends that the Joint Standing Committee on Transportation report out legislation directing the Department of Economic and Community Development and the State Planning Office develop a plan for the orderly transfer of the energy efficiency responsibilities of the DECD to the SPO so that these energy matters are consolidated within the SPO. In the plan, the Department of Economic and Community Development and the State Planning Office should review existing funding for energy-related responsibilities of the DECD and the SPO and make recommendations regarding the appropriate funding level for energy-related responsibilities of the SPO after the transfer of the DECD's energy efficiency responsibilities. (Attached as Appendix J may be found information supplied to the Study Committee by the DECD and the SPO estimating the additional costs required for meeting current statutory responsibilities.)

E. Support consumer education. The Study Committee recommends that the Legislature monitor the effectiveness of the Governor's Bundle ME Up campaign and support cost-effective and reasonable steps to educate the public about energy assistance programs and methods of reducing energy use and costs.

F. Seek right to oil in Northeast Heating Oil Reserve. The Study Committee recommends that the Legislature adopt a Joint Resolution encouraging Congress to establish a mechanism whereby the State of Maine obtains a right to heating oil distributed from the Northeast Heating Oil Reserve based on the amount of heating oil conserved in the State through the application of public funds for conservation and weatherization.

