

A Refined Approach, by Carla L. Romita

The Mann Report, April 2006

Now that Congress has passed comprehensive energy policy legislation, much of the focus has shifted to energy politics at the State level. Just as property owners are facing high energy prices caused by strong global demand and stretched refining capacity, New York and other Northeast states are developing strategies for tightening sulfur standards in heating oil. Some lawmakers have proposed an immediate shift to dramatically lower sulfur standards on a State by State or even county by county basis. It has even been suggested that heavier grades of heating oil that do not meet greatly reduced sulfur standards almost overnight should be off limits to New York property owners. These flawed proposals have received little traction and are unlikely to succeed because they are premised upon a misunderstanding of international markets and industry distribution chains.

Our industry supports the introduction of cleaner burning heating fuels. Suppliers, refiners, and distributors already have migrated towards lower sulfur standards for most diesel products. By the end of this year, the vast majority of the on-road diesel produced and distributed within the United States will contain no greater than a 15 parts per million (ppm) sulfur content – a major focus for achieving cleaner air standards. Heating oil will follow. The industry is working towards a four fold decrease in the sulfur content of heating oil. However, the seasonal nature of demand in New York, as well as the influence of external market forces, requires a stepped approach – one that is coordinated at the regional level.

Over the past several years, domestic refiners have invested heavily to meet federal mandates for cleaner burning gasoline and diesel fuel. Given these recent capital projects, refiners will not further invest in producing lower sulfur heating oil simply because of a politically driven increase in localized demand that occurs for three months a year. Even if demand were sufficient to justify a shift in production strategy, domestic refiners would need extensive lead times to invest in new equipment and bring the product to market. Moreover, domestic refiners alone simply do not have the capacity to produce enough heating oil to meet the peak winter needs of New York and surrounding States.

Currently, New York relies upon foreign imports for about one half of its mid-winter needs. While many of the foreign countries from which New York receives its supply are producing cleaner burning fuels, some exporting countries, such as Russia and Venezuela, have no plans to move in that direction. Accordingly, forcing lower sulfur standards on New York consumers would cut available imports during periods of peak demand. Moreover, the diesel transportation market already has built up significant regional, domestic, and international demand. As European countries continue to push for lower sulfur standards in diesel, the global increase in demand for this product will magnify the supply shortfall by driving investment dollars towards the supply of low sulfur diesel at the expense of low sulfur heating oil.

Distribution issues also illustrate the need for an integrated, regional approach. To prevent cross-contamination, different grades of heating oil must be segregated into a separate system from refinery to barge to terminal to truck in order to prevent contamination with other products. Constructing a localized supply system to handle a boutique grade of heating oil is useless if each link in the upstream supply chain is not also segregated.

The industry has reached out to regional agencies to ensure that New York and the other Northeast states move in a coordinated and consistent fashion. This is wise. If properly phased-in on a regional level, cleaner burning heating fuels should pay significant dividends by extending the useful life of your heating equipment, allowing the use of higher efficiency equipment, and lowering your maintenance costs. However, if improperly implemented without due consideration for national refining capacity, import patterns, and distribution chains, a rush towards cleaner heating fuels will result in significant supply disruptions and higher, more volatile heating costs at the worst possible time for your business. The most dramatic effects would take place during the heating season, when local demand is greatest and much of the fuel oil that supplies the New York market is shipped from overseas.

New York's oil heat industry supports the move to low sulfur heating fuels. It will be beneficial to their businesses, reduce the maintenance costs of your equipment, and allow the use of more efficient heating equipment. However, the primary concern is that you do not run out of oil and that you are not subjected to uncontrolled and unnecessary price spikes in the middle of the winter. New York business and building owners should not be forced to move rapidly to a boutique product that will not be widely available for some time. A realistic, multi-year schedule that is designed so as to not burden the consumer is what is warranted.