Just when we thought it couldn't get any worse

*by Philip J. Baratz, C.T.A.**

The month of August ended with one of the largest natural disasters to ever hit our nation. The physical devastation, and ongoing human tragedy brought on by Hurricane Katrina—and, unfortunately, by the terribly mishandled pre-storm preparation and post-storm response—just makes you shake your heads, and want to hug your children. That the hurricane wreaked havoc upon the industry that we all rely on for our livelihoods gave us maybe the smallest glimpse of the despair that residents (survivors?) of Louisiana, Mississippi, and Alabama must be feeling.

One of the many big "wake up calls" in the aftermath of Katrina is how fragile our nation's energy infrastructure is. Here we are, weeks later, and as much as 10% of our refining capacity—the ability to simply turn crude oil into usable, consumable products—is still off-line. Most predict that at least 5% of our ability to refine crude oil into heating oil will be unavailable for (at least) the next few months.

About five years ago, heating oil prices touched down below $.40 cents per gallon. During the last week of August, the RANGE (lo to hi) was $.40 cents per gallon—spot gasoline prices increased about $1.00 per gallon during that same time period. How lucky (if you can use that phrase) we were that the storm didn't hit 60 days later, as we were starting the heating season. Inventories, as of the first few weeks after the storm, were still running ahead of year-ago levels, but with demand starting to increase, it seems very evident that, lacking an extremely mild October and November, the refinery outputs of distillates will have a difficult time keeping pace. Our government stepped up to the plate, and released some crude oil from our Strategic Petroleum Reserve (SPR), and then the International Energy Agency (IEA) released some refined product. Both moves helped cooler heads prevail, and limited some of the markets' move higher. But, all of this happened in early September, as summer driving wound down, and before winter heating began.

So, where does this leave us, or those of us who market, hedge and deliver heating oil to customers that are pretty unprepared for the latest price spike? The newspapers are filled with stories of heating oil dealers reneging on their price offers, or others who are ceasing certain offers to customers. The focus for many of these stories is on the dealer who refuses to "risk" offering a fixed price to his or her customers, even though customers are clamoring for the fixed price. Pardon my ignorance, but if one party is willing to sell to another at a fixed price, and the second party is willing to pay the fixed price to the first party, where, pray tell, is the risk? Could it be that oil dealers, themselves, are fearful that it is the customer who might renege? Think about it—Mr. "X" locks in his heating oil at $2.75 per gallon with Company "Y". Then (if the stars are aligned) prices drop sharply after the first of the year, and retail prices fall to $1.50 per gallon. How sympathetic is the public (and the press, and the State's Attorney Generals) going to be to the plight of the oil company trying to get Mr. "X" to pony up the $2.75 per gallon that he committed to? So, many are now faced with a situation where they would take the risk of selling oil at $3.50 per gallon, rather than fixing the price at $2.75 (all of these numbers are made up, as each region's retail prices and margins seem to be moving about on a daily basis—much like the price of retail gasoline).

As is often the case, many heating oil dealers—and some "industry leaders"—are crying foul, and looking everywhere but in the mirror. We all long for the days when oil was $.50 per gallon at the rack, and customers were incredibly loyal (Were they really loyal, or was it not worth their time to shop around to try to save just a few cents per gallon?). Those days seem to be well gone. More and more companies are offering capped prices to their customers, while others remain fearful of the additional expense of the "cap protection", and prefer to keep their heads in the sand. "It can't go any higher" has been the popular rallying cry for the last $1.00 per gallon! It is hard to think that saving the 15-cent premium was really worth it, after prices moved by a dollar.

We are an industry full of experts. Everyone has an opinion. I, too, have an opinion, but it is not one that I am willing to risk my livelihood on (as a side note, it is quite fitting that the NACS—gasoline marketers—show has been relocated to Las Vegas this year. Vegas might be the only place with more people accustomed to risk than in the energy business). The two main problems with having opinions are (1) sometimes you are wrong, and (2) even if your "logic" is correct, sometimes that doesn't matter to the market. Should prices be where they are? Should they have done what they did? Perhaps, no. But, does that really matter? Too many in the industry get too caught up in what (they think) should or shouldn't happen, that they turn a blind eye to what IS happening, and the impact it is having on their customers, their staff and their business.

Planning just got a heck of a lot tougher. Educating customers is even more important than it has been in the past. From experience, we know the uphill battle in trying to explain things to some who are either set in their ways, don't understand, or are simply not interested. What are we (all) after? I would have to think that consistent customers are better for everyone than shoppers are. Although it might sound counterintuitive, now is the time to educate, AND now is the time to maximize your margins. A penny used to matter. Then, it became a nickel. Now 10, 15 or 20 cents price difference is often perceived as less important than certainty of supply. Look at gasoline prices from one corner to the next. Customer prices for next season, fixed, capped, etc. are all over the map. The determinant has much less with the oil company offer than it does with the timing of the offer, or of the acceptance.

By focusing so much on price, it becomes nothing more than a gamble, in which the oil company is praying that they guess right on prices. Suppose, just for one moment, that prices varied up and down with the market, but never exceeded a certain level. Customers would pay a "market price", but know that if something caused a major increase in costs, they would be protected. The oil dealers, on the other hand, would be able to go and run their businesses, with the certainty of stable (and possible widening) margins. Now, just imagine that all of this came with a fee that ranged from 7 to 17 cents per gallon (on average, depending upon the "deductible"), and that the "fee" was covered by the customer. That is how a cap should work—prices should vary, but have a ceiling. It shouldn't be a promise that prices will NEVER go higher than where they are now. If you think about all of the stress that has been going on over the past few months—some would say the past few years—and decided to stay away from guessing what the market was going to do, and to stay away from giving oil away for free in the hopes that "free oil" would lead to customer loyalty, how would that feel? How would your staff like it, and how would your customers like it?

This season looks like it has, and will take many to their breaking points. As unfortunate as that is, it should be enough to make you re-think some of the ways that you operate your business. Times have never been like this. That is true, but it looks like times will never return to "the good old days". If you refuse to change with the times, the times might not be too friendly. If you need to step back, and review the way that you have been, are, and should be looking at things, give us a buzz. ❑

oh p.58.p65 2 10/11/2005, 1:34 PM