Steps to Ensure the Viability of the Residential Fuel Oil Distribution System

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Introduction

For the 14 million homes and apartments heated by oil in the United States, the continued availability of heat is threatened by a number of problems affecting the fuel oil distribution network. The profitability of many oil dealers is threatened by problems with suppliers, declining market share, and the complex regulatory environment -- all factors over which dealers have little or no control. Minority and smaller dealerships are particularly vulnerable to these problems.

The Office of Advocacy of the Small Business Administration (SBA) has commissioned Resource Planning Associates, Inc. (RPA), to identify the major external problems threatening the viability of the residential fuel oil distribution system, particularly of dealers, and to suggest actions that SBA, the dealers' associations, and individual dealers can take to solve these problems. In this study, we characterize the role of the independent fuel oil dealers, identify the major categories of problems affecting them, and suggest a number of solutions.
There are approximately 8,000 heating oil dealers in the United States, most of them independent. Dealers purchase heating oil from refineries, wholesalers, and terminal operators, who may also deliver to the end users. However, homeowners purchase nearly 86 percent of their heating oil from independent local distributors (dealers) and terminal operators and only about 14 percent directly from refiner-owned distributors.

Dealers generally have flexible credit policies and offer their customers a number of valuable services. For example, more than half of all heating oil dealers provide their customers with inspections, maintenance, installation, and replacement services in addition to oil deliveries. Some dealers also advise customers on the issues of energy conservation and fuel switching.

Dealers are located in urban, suburban, and rural areas and typically deliver the fuel to 500 to 3,000 residential customers. (A company with over 3,000 customers is considered quite large.) Most dealer sales range between 1 and 2.5 million gallons per year, depending on the region in which they operate. The higher volumes are sold in New England; the lower in the Southeast. Dealers
located in the suburbs usually sell larger volumes of the product to limited numbers of customers, whereas those in urban areas tend to sell smaller volumes to a wider range of consumers. The average service area covers a 50-mile radius.

Although about 22 percent of residential consumers continue to rely on heating oil as their source of home heat, fuel oil dealers' market viability is threatened by changes in the economic environment. Inflationary cost pressures have led suppliers to discontinue certain supply and credit practices that were beneficial to dealers (such as 30-day payment plans and a 1-percent discount for cash purchases). Indeed, many suppliers have established sales policies that are disadvantageous to dealers -- including unwillingness to enter into new supply contracts.

In addition, heating oil dealers' cash flow position deteriorated as the price of oil rose and the time period between sales and payment increased. For example, dealer purchase cost of fuel oil more than doubled over the 1973-1977 period and operating costs increased by 27 percent. Net profit margins have been drastically reduced since
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1974 (a reduction of 15 percent between 1974 and 1977). Net margins decreased by 33 percent in 1976-1977 alone. These downward economic trends have intensified under more recent inflationary pressures.

Several studies indicate that profitability will continue to decline. Also, increased costs and inadequate return on equity make it more difficult for fuel oil dealers to finance inventories and equipment. Dealers now need to provide additional personal collateral or seek additional debt financing.

Heating oil dealers must also compete for residential customers with natural gas and electricity companies. Government regulations, however, allow utilities to charge customers more favorable prices; utilities also have greater resources for aggressive market programs (e.g., special seasonal discounts, cheaper installation, intensive promotional campaigns).

Fuel oil dealers' problems have been exacerbated since heating oil regulations were lifted on July 1, 1976. The price of No. 2 heating oil increased by an average of 22.6 percent over the 1976-1978 period, with more
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than half the increase occurring in the 1976-1977 heating season. A number of factors contributed to this increase. First, despite increased production and conservation efforts, the demand for fuel oil far exceeded supply during the severe 1976-1977 winter. Second, natural gas shortages were greater than expected. The slack between supply and demand was met by imports. Average imports were 30 percent above 1975 levels. During the 1977-1978 heating season, prices continued to increase but at a slower rate. However, supplies were adequate, partly because the winter weather was less severe than in the previous year. In addition, there were no serious natural gas shortages.

As oil prices skyrocketed, many residential customers converted to natural gas. Others turned to alternative sources of energy, such as woodburning stoves, particularly in the Northeast, while many more cut fuel oil consumption through various conservation measures. Although conversions and conservation have eroded oil dealers' share of the home heat market, future fuel conversions are likely to be limited by gas supply uncertainties, technological constraints, government policies, and price considerations.
RPA's approach to this study included three major tasks. First, we identified external problems crucial to the market viability of fuel oil dealers and selected specific problems for analysis. To identify problems, we interviewed a number of dealers, attended official hearings and meetings,* and reviewed reports on the fuel oil distribution business and the home heating market. We selected specific problems for analysis on the basis of our discussions with the Office of Advocacy and the regional fuel oil dealer task forces.

We then developed hypotheses on possible causative factors behind each problem. To test our hypotheses and to obtain dealers' views on the types of action required to address their problems, we interviewed a number of dealers in each size category as well as suppliers, bankers, and representatives of dealer associations.

Third, we analyzed the interview information to identify the causes and effects of each problem and to determine appropriate corrective actions. We identified three

* Including, for example, Public Hearing on Retail Fuel Oil Dealers Price and Supply Problems, SBA Regional Task Force meetings, and Fuel Oil Marketing Advisory Committee meetings.
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major problem areas:

- Tighter, more stringent supplier credit and allocation practices
- Decreasing market share vis-a-vis natural gas and electricity
- Anticompetitive government regulation.

In developing possible solutions to these problems, we recognize that not all dealers will survive the current business environment. In addition, we do not believe that new government regulation will solve fuel oil dealers' problems. However, some new regulation may be necessary for emergency situations, such as a severe shortage, to ensure that no links in the supplier-dealer-consumer chain are broken. Dealers also recognize that declining market share is a partial reflection of the national energy policy of conservation.

Fuel oil dealers are essential to the residential energy distribution network and must remain viable. Many customers will continue to use oil, and many others, especially inner-city residents and the rural poor, cannot afford to convert to other fuels. In addition, many present oil consumers cannot be reached by existing gas pipelines.
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Although our study is limited to external problems, we recognize that internal problems are by no means inconsequential to the viability of the fuel oil distribution system. On the contrary, improvements in management and accounting practices must be seriously considered by the dealers, a review that is best done on a company-by-company basis. A number of organizations offer assistance in dealing with internal problems. For example, Price-Waterhouse, Inc. has designed a number of innovative educational programs that could help dealers improve financial skills.

In the following chapters of this report, we identify each major external problem and suggest solutions. The critical role of the fuel oil dealer in providing homeowners with oil delivery service is described in Chapter 1. The specific problems, their causes, and their impacts on fuel oil dealers are discussed in Chapter 2. Finally, in Chapter 3, we outline a set of actions that SBA, the Office of Advocacy, dealer organizations, and dealers themselves can take to ensure the continued viability of the fuel oil delivery system.
Oil will continue to supply a major portion of the U.S. residential heating demand, despite rising prices, diminishing reserves, and uncertainties about supply. Although many homeowners have recently switched from oil heat to natural gas, oil will continue to hold a relatively constant share of the residential heating mix because of rising, continuing deregulation of natural gas prices, gas supply uncertainties, and lack of access to gas distribution pipelines. As we describe in this chapter, fuel oil dealers are vital and necessary to ensure that oil reaches residential consumers.

As background, we first describe the patterns of residential fuel consumption in the United States and document the continuing reliance on oil as a source of home heat. Second, we outline the essential role of fuel oil dealers, both within the home-heating oil distribution network and within the communities and markets they serve.
Today, 22 percent of all housing units in the United States are heated by oil. Three regions with comparatively severe winters -- New England, Mid-Atlantic, and Mid-North Central -- account for 82 percent of all oil sold for residential heating in the country. In New England, 62 percent of residential energy consumption is accounted for by oil; in the Mid-Atlantic states, 42 percent; and in the Mid-North Central states, 22 percent.¹

An increasing number of homeowners have switched from heating oil to other fuels, mainly natural gas, in recent years, primarily because they perceive gas to be cheaper than oil. The change for the three major oil-consuming regions is shown in Exhibit 1.a. However, the substitution of gas for oil is unlikely to continue at this rate for several reasons:

- Residential access to natural gas pipelines is limited. Homeowners in sparsely populated rural areas and outer suburban areas cannot switch to gas heat...
Exhibit 1a
Oil as Percentage of Residential Energy Consumption by Region, 1972-1977

- New England: 66.2% in 1972, 62.5% in 1977
- Mid-Atlantic: 45.0% in 1972, 41.6% in 1977
- Mid-North Central: 22.2% in 1972, 21.6% in 1977

because many of these areas lack natural gas pipelines. Rural areas are more dependent on oil than on gas for space heating (see Exhibit 1.b). In areas served by gas, homeowners are becoming increasingly unable to hook up to nearby pipelines because these lines already carry gas at capacity. To increase the volume of these lines would require their virtual replacement. It is not certain whether gas utilities will be willing to invest in new, higher capacity pipelines.

- Interruptions in natural gas supply (e.g., when a distribution pipeline ruptures) to residential users have severe and immediate effects. Few consumers have back-up heating systems fueled by oil or electricity. In contrast, basement oil storage tanks and oil dealers' storage facilities protect homeowners using oil from upstream interruptions.

- The Natural Gas Policy Act (NGPA) of 1978 decontrolled gas prices gradually through 1985. As a result, the price of natural gas could soon reach or exceed the price of oil.

- Proved reserves of domestic natural gas have declined steadily at a rate of over 3 percent annually
### Exhibit 1.b

**Types of Residential Heating, Urban and Rural, by Census Region, 1978**

<table>
<thead>
<tr>
<th></th>
<th>Housing Units (%)</th>
<th>Northeast</th>
<th>North Central</th>
<th>South</th>
<th>West</th>
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<tr>
<td></td>
<td></td>
<td>Total</td>
<td>Urban</td>
<td>Rural</td>
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<tr>
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<td>9</td>
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</tr>
<tr>
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<td>1</td>
<td></td>
<td>6</td>
<td>15</td>
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</table>

over the last 5 years (see Exhibit 1.c). The ability of domestic gas supplies to meet increased demands resulting from conversion is, therefore, uncertain.

- Shrinking domestic natural gas reserves require increased imports of foreign natural gas, either by pipeline from Mexico or Canada or by tanker in the form of liquefied natural gas (LNG). Prices of gas imports are higher than for domestic gas. Mexico and Canada base their pipeline-exported gas price on world crude oil prices. Current LNG prices are even higher on a per-Btu basis.

- Converting from heating oil to natural gas is expensive, ranging from a low of $600 to a high of $2,000. For lower income homeowners, the cost is prohibitive unless subsidized by government loans or tax credits. For some homeowners, the economic value of conversion may be questionable. The rising price of natural gas to residential consumers may prevent an adequate payback of the initial conversion investment.

Exhibit 1.c
Estimated Proved Natural Gas Reserves in the United States, 1970-1978

Questions about the desirability of homeowner conversion to natural gas are underscored by recent government refusals to advocate residential fuel switching. In a recent television appearance, Deputy Energy Secretary, John Sawhill, said he could not recommend "converting from one fuel to another." Sawhill stated that the price of natural gas will rise quickly under NGPA and that the cost differential between heating with natural gas and with oil will "narrow very significantly."

Other alternative sources of home heat have received increasing attention in recent years. The accelerated development and utilization of alternative energy sources and technologies is necessary to reduce the nation's dependence on fossil fuel supplies and imports. But alternative technologies using renewable energy sources, such as solar energy, wind power, and electric heat pumps, are not ready to serve the large home-heating market currently fueled by oil. Even under the most optimistic scenarios, nationwide conversion to alternative energy sources will be a long, gradual process.
THE FUEL OIL DISTRIBUTION NETWORK

THE ROLE OF THE FUEL OIL DEALER

A large segment of homeowners will continue to rely on fuel oil for heating, as indicated by the combination of rising gas prices, uncertain domestic gas supplies, and lack of immediate or near-term substitutes for heating oil. In this section, we characterize the role of the independent fuel oil dealer in the fuel oil distribution network and describe the essential services dealers provide to their customers.

An estimated 8,000 heating oil dealers distribute fuel to residences in the United States. They deliver 80 percent of all heating oil sold in this country. The average dealer employs about 8 people, uses 5 trucks, services over 1,000 residential fuel oil accounts, and pumps 2.25 million gallons of oil annually. Dealerships can be small, medium, or large. A small dealership typically sells under 2 million gallons of fuel oil


annually. A medium-sized dealer sells between 2 and 7 million gallons annually and a large dealership has annual sales exceeding 7 million gallons.

Most fuel oil dealerships are small, independent businesses. They rely on the major oil refiners to supply them with heating oil, but they are unaffiliated with refiners. In fact, refiner involvement in the retail distribution of heating oil has dropped significantly in recent years. In 1979, refiners retailed only 8 percent of all No. 2 fuel oil, a sharp drop from 1972 when they accounted for 27 percent of all retail oil sold. This drop in refiner retailing has increased the importance of the small, independent dealers (see Exhibit 1.d). In New England, for example, 86 percent of retail fuel oil gallonage is independently supplied.

Most of the oil-heated residential market is served by small fuel oil dealers. Twelve percent of the companies in the United States serve more than 3,000 customers, while 88 percent serve under 3,000 customers.6 Within this group of small dealers is a segment of minority-owned

Exhibit 1.d
Market Shares of Refiners and Independent Fuel Oil Dealers, 1974-1979

retail heating oil dealerships. Although minority dealers comprise a small percentage of the overall retail heating oil market, they play a relatively important role in the distribution system. For example, minority dealers in New England make up less than 2 percent of all retail oil dealers, yet they service an estimated 40 to 60 percent of all inner-city accounts. More important, they deliver oil to low-income neighborhoods that most other dealers, small and large, do not want to service.

Fuel oil dealers are unique in the way they interact with their customers. Although electric and gas utilities have near monopolies in the areas they serve, fuel oil dealers directly compete with other dealers in their service areas. This competitive element requires that the dealer provide responsive service and the fairest price possible. Several other factors distinguish the retail fuel oil network from its competitors, the gas and electric utilities:

- Fuel oil dealers provide flexible service. Gas utilities can serve customers only in communities hooked up to gas pipelines, whereas fuel oil dealers


(RPA)
THE FUEL OIL DISTRIBUTION NETWORK

can provide service to anyone with an oil-burning system. Many remote rural areas and outer suburban areas are dependent on oil as a source of heating fuel. Gas utilities cannot extend gas lines to all these areas in the foreseeable future.

Fuel oil dealers provide a wide range of services in addition to delivering fuel. According to a 1979 survey, 65 percent of all fuel oil dealers nationwide also sell, install, and/or service all types of heating equipment. The percentage of dealers offering such service is even higher in the areas most heavily dependent on fuel oil. Complete equipment service is offered by 93 percent of the dealers in New England, by 80 percent of the Mid-Atlantic states dealers, and by 43 percent of the dealers in the midwestern states.  

An essential service provided by most fuel oil dealers is the extension of credit. In many cases, fuel oil dealers provide credit to low-income, high-risk customers who may not be able to secure credit from other sources. Dealers finance the consumer's oil inventory, often over a period

of months. For low-income consumers, dealers' financing extends over the 6- to 8-week period between oil delivery and consumer receipt of federal aid.

As members of the communities they serve, dealers are aware of the particular needs of the residents in the area. Heating oil dealers are able to offer consumers personalized, responsive service that would be infeasible for a utility. For example, they provide partial deliveries to low-income consumers who cannot afford to keep their oil storage tanks completely filled. This, of course, causes the dealers to run a higher cost, low-margin operation.

Despite the fact that fuel oil dealers provide distribution of an essential commodity to many homes, they currently find it increasingly difficult to remain in business. The rising price of oil, general inflation, and the concurrent rise in the cost of borrowing money have all threatened their financial viability. As the average dealer has been subjected to severe economic pressure resulting from the staggering rise in the cost of doing business, he has, at the same time, suffered growing resentment from consumers who are indignant about
the rising cost of heating their homes. The dealer who serves the consumer directly and absorbs a portion of the increased operating cost to maintain his customers receives a diminished margin on his sales. Many dealers have been forced out of business by such economic factors. In New England, a region in which oil is by far the predominant fuel for home heating, 916 dealers have gone out of business since the Arab oil embargo in 1974, a decrease of 32 percent. It is estimated that another 300 dealers will fail by the end of 1982.9

Although it is impossible to solve the problems and ensure the survival of every individual fuel oil dealer in the United States, it is clearly essential that the viability of the delivery system itself be maintained. Given the nature of this delivery system and the fuel oil dealer's role, it is apparent that the failure of this system as result of individual fuel oil dealership failures will have serious economic and social impacts.

In the following chapters, we analyze problems dealers currently face that threaten the delivery system and propose steps that could be taken to ensure the continued efficient distribution of heating oil to the homeowner.
A number of economic problems facing fuel oil dealers may force many of them out of business and ultimately threaten the viability of the fuel oil delivery system. These problems, in large part the result of external business factors, are beyond the control of the individual dealer. The dealer, who is generally a small, independent businessman, has limited resources to cope with three major external problems:

1. Increasingly stringent supplier allocation and credit practices
2. Declining share of the residential heating market

Although internal management problems within fuel oil dealerships may also threaten the delivery system, these problems are not within the scope of this study. Rather, our discussion will focus on external economic
factors and related problems that threaten the continued efficient distribution of heating oil to homeowners.

In this chapter, we identify specific problems within each major problem category, detail the causes of each problem, and describe its impacts on fuel oil dealers and their customers. Our discussion of these impacts is based on information and comments obtained during our extensive interviews with dealers, suppliers, and industry experts.

A. SUPPLIER ALLOCATION AND CREDIT PRACTICES

Since the early 1970s, there have been dramatic changes in the relationships between small independent fuel oil distributors and the companies that supply them (i.e., primary suppliers such as refiners and secondary suppliers such as independent terminal operators). Before the 1974 oil embargo, suppliers competed with one another to attract heating oil distributors and expand their market. In recent years, that competition for distributors has been largely eliminated. In fact, suppliers now limit the amount of product they distribute and the number of dealers they will supply. As a result, the roles played
by dealers and suppliers in today's heating oil market have been virtually reversed in the last 10 years. As one medium-sized dealer stated, "My suppliers used to take me out to lunch; now I take them out."

The changing supplier/dealer relationship in recent years is the result of two major supplier actions: first, supplier fuel oil allocation practices have become increasingly unfavorable, and second, the suppliers' credit practices to dealers have become more stringent. These changes have resulted in serious economic and operating problems for many fuel oil dealers, as we delineate below.

UNFAVORABLE SUPPLY PRACTICES

Three problems are related to suppliers' allocation practices:

- Unpredictable allocation
- Nontransferability of allocation rights
- Disproportionate impacts on small and minority dealers.
Unpredictable Allocation Practices

Tight supplies of No. 2 heating oil and "unpredictable foreign supply" have resulted in oil suppliers' allocating fuel oil supplies to their customers in an arbitrary manner. Because middle distillates have been decontrolled since 1976, individual suppliers can decide their own policies for allocating oil to dealers and there is a great variation in allocation practices among suppliers.

For example, some dealers' allocations are based on their previous year's monthly or annual fuel oil purchases, seasonal variations in fuel oil consumption, or any other method deemed appropriate by the supplier. In 1979, suppliers limited allocations for 63 percent of the dealers to the level of oil purchased in the 1978/1979 winter season. In fact, many dealers were allocated less fuel oil than what they had purchased the previous year. For example, one medium-sized dealer in New England indicated that his supplier, a major oil company, had reduced his allocation by 15 percent. He was given

no explanation for the reduction and was forced to make up the remainder by seeking greater allocations from other suppliers.

Arbitrary allocation practices have several major adverse impacts on dealers. First, dealers are never certain whether their suppliers will provide them with enough or too much fuel to meet their customers' needs. Obviously, dealers who purchase all their heating oil from one supplier can be more severely affected by reduced or uncertain allocations. In 1979, 45 percent of fuel oil dealers purchased all of their product from one supplier.

At the same time that dealers increasingly cannot rely on consistent long-term fuel oil allocations from their suppliers, dealers are also penalized if they fail to completely utilize the supply allocated to them. In many cases, if a dealer fails to "draw" his allotment during a specified period, his allotment for the next corresponding period is reduced accordingly. In 1979, after a relatively mild heating season, 67 percent of dealers said that their suppliers required that they use their allotted product or lose it.2

Another New England dealer cited his experience with the aggressive manner in which suppliers penalize dealers and reduce allocation. In the middle of the 1978/1979 heating season, this dealer reduced his drawdown of fuel oil at the request of his supplier. Apparently, the supplier had a problem of fuel oil receipts and transportation during a cold spell. To make up the shortfall, the dealer contacted a number of other sources to secure fuel oil. Later in the same season, however, the dealer was informed by his regular supplier that his allocation for the 1979/1980 season would be decreased because of reduced usage earlier in the heating season.

Heating oil suppliers strive to maintain strict control over the products they distribute for several reasons. In some cases, they face genuine fuel oil shortages and are forced to limit the amount of oil they sell to dealers. Suppliers contacted were quick to justify their allocation practices and were reluctant or unable to suggest any solutions or alternatives.

For example, last year Texaco offered dealers 87 percent of their previous allocations. A Texaco official told RPA that Texaco traditionally bought 87 percent of its oil on contract and purchased the remaining 13 percent on
the spot or open market. Because of rising spot prices and the margin between spot and contract prices last year, Texaco no longer purchased oil on the open market. Instead, it cut its allocation to dealers by 13 percent.

Most suppliers cite unpredictable foreign supplies as the reason for the need to allocate heating oil. The chief executive officer of a major refinery said that the inventory buildup problems in the winter of 1979/1980 were "directly attributed to the political problems in Iran."³

However, we have identified a number of other reasons for tight control of fuel by suppliers:

- Primary suppliers/refiners try to optimize their regional supply distribution networks and product mix and maximize the production of other more profitable refined products. Several suppliers have consequently withdrawn from entire market areas. For example, a major oil company has terminated all of its heating oil operations in New England so it can instead sell

distillate in a market with a higher profit potential (such as feedstock for petrochemical manufacture).  

Other major oil companies have withdrawn from markets in the Midwest and New England to better streamline their distribution systems. For example, a Vermont heating oil jobber said that both Shell and Gulf have stopped distributing their heating oil in that state. He theorized that the companies felt that their distillate products could be sold more profitably elsewhere, either in other states or for use as jet fuel or feedstocks.  

Although sale of heating oil is profitable, we believe that markets for jet fuel and chemical feedstock are more attractive to these suppliers, not only because of the higher profit potential but also because they are less price-sensitive and less likely to be associated with resistance to price increases.  

- Suppliers try to channel their products to preferred customers. We found that suppliers prefer to do business with established fuel oil dealers who have  

5. Ibid.
good credit ratings. Because few suppliers now have surplus supplies, they feel no pressure to cultivate relationships with new dealers.

- Allocation can also be used as a competitive hedge by refiners in areas where they have retail outlets. A dealer from Worcester, Massachusetts, said that another dealer in his area, "who has bought most of his product from Texaco for years, has been limited to a quota of 70 percent. Yet, the Texaco company subsidiary in the area solicits new accounts." 6

- Refiners also try to hold their product until the price rises. During the summer of 1979, refiner allocation practices precipitated a slow buildup of heating oil stocks. Refiners held heating oil stocks with the stated intent of trying to meet the DOE goal of 240 million barrels in primary storage by October. Certainly, suppliers reaped a greater profit by keeping oil in primary storage instead of distribution or consumer tanks.

According to one midwest jobber, "They knew if they held onto the product through the summer, they'd

FUEL OIL DEALERS

get that much more money for it." U.S. Representative William Hughes (D, N.J.) said that the 115 million barrels of heating oil added to primary stocks in the summer of 1979 increased in value about $200 million "as it sat in storage.... Only the big oil companies benefit, while distributors and consumers pay higher costs." 7

Allocation practices have a significant effect on many dealers. First, dealers may be forced to carry oil surpluses during a warm winter (such as was the case in the 1979/1980 heating season) or operate with deficit supplies during an unusually cold winter. The cost of carrying stocks during the summer can be expensive, yet some major refiners require that dealers purchase 1 gallon of oil during the summer to "earn" either 1 or 2 gallons in the winter months.

Carrying excess fuel oil stocks is expensive at current product cost and the cost of money. Not only is financing inventories difficult, but also the higher operating costs inevitably result in higher retail costs

to consumers. In turn, higher prices damage the relationship between the homeowner and the dealer, which results in homeowner conversions to relatively cheaper natural gas. The dealer, in absorbing the cost of carrying such allocation-related surplus, suffers a decrease in his profit margin in an effort to maintain market share.

Deficits in fuel oil supply, sometimes caused by supplier practices, adversely affect the dealers as well. A reduction in a dealer’s sales because of insufficient fuel oil supply results in higher per-gallon operating costs and lower profitability. When these costs are passed on to the already burdened and angry consumer, fuel switching and/or reduced margins can result, as outlined earlier. Dealer supply deficits have also resulted in consumer perceptions of fuel oil as an unreliable fuel. In a recent fuel oil dealer survey, 19 percent of the dealers surveyed indicated that the major reason consumers switch from oil to gas heat is their perception that natural gas is a more abundant and reliable fuel than No. 2 fuel oil.8

Fuel oil deficits resulting from supplier allocation practices can also restrict dealers from expanding their business activities. To operate in the current business environment, dealers must constantly seek ways to increase their customer base as a hedge against market erosion caused by conversion to natural gas and homeowner conservation. Obviously, inadequate supplies of fuel oil prevent dealers from finding and selling to new customers.

Finally, supplier allocation practices create a barrier for new competitors who seek entry in the marketplace. Considerable uncertainty over secure fuel oil supplies stemming from supplier allocation practices inhibits new entrants into retail markets. In the long run, this barrier could reduce the high level of competition in the marketplace.

Nontransferability of Allocation Rights

The transfer of allocation rights at the time of change in ownership of a fuel oil dealership is becoming an increasingly troublesome issue to dealers. Essentially, fuel oil suppliers are seeking to maintain control of the
distillate distributed by reserving the right to withdraw allocation to a particular dealership if it changes hands. We believe that the same reasons that motivate suppliers' allocation practices also apply to the practice of nontransferability.

Many fuel oil suppliers are controlling their product by requiring dealers to agree to a "key-person clause" in the supply contract. The clause identifies a specific individual in the firm, usually the owner, as the only person to whom the supplier is obligated to provide fuel oil. If the "key person" leaves or gives up ownership of the business, the clause provides for termination of the contract.

The nontransferability of allocation rights, whether resulting from use of the key-person clause or from outright refusal to contract with the new owner of a dealership, can preclude transfer of dealer ownership to legal heirs or new market entrants. Obviously, the value of a dealership is substantially reduced if the current owner cannot guarantee the new owner that sufficient fuel to conduct business will be available from current suppliers.
For example, we interviewed a Mid-Atlantic fuel oil dealer who indicated that the key-person clause thwarted his efforts to find a new supplier, because every new contract he was offered by suppliers included the clause. He was unwilling to sign such contracts because he believed they would substantially diminish the sale value of his dealership. As dealers' flexibility in procuring fuel oil diminishes, the likely result is fewer new dealerships. Over time, continued use of this clause could create another barrier to entry into the fuel oil business, which could potentially reduce the level of competition in an otherwise very competitive business.

Disproportionate Impacts on Small and Minority Dealers

The problem of obtaining adequate fuel oil supplies is particularly acute for small, less-established dealerships, especially those operated by minorities. These dealers must buy, often on a COD basis, from secondary suppliers, who are wholesalers and not refiners. Thus, dealers not only are forced to pay higher fuel oil prices (by an average of 1 to 4¢/gallon), but they must rely on supplies that are less reliable than those of the primary
supplier (or refiner). According to the Connecticut Minority Fuel Dealers Association, not a single minority fuel dealer in New England has a contractual supply relationship with a refiner.\(^9\) In contrast, 71 percent of fuel oil dealers in general had written agreements with a primary supplier in 1979.\(^10\)

The reasons for minority dealerships' lack of supply contracts can be traced to the early 1970s when fuel oil supply exceeded demand. Minority dealers at that time established relationships with secondary suppliers, who bought the product at spot market prices and resold it at prices competitive with those of major refiners.

The situation has since changed dramatically; crude oil supplies have tightened and the price of petroleum products has risen. Secondary suppliers must now buy fuel oil from major refiners at high prices and/or on the spot market, where supply is periodically tight and prices are unpredictable. For instance, in June 1979, the average retail price of heating oil was 69.1\(^\circ\), yet the New York

\(^9\) Connecticut Minority Fuel Oil Dealers Association.
\(^10\) Fuel Oil & Oil Heat, October, 1979.
spot market price was 78.3¢. Invariably, the dealers' price to the consumer is even higher because of the high purchase cost and additional markup to cover operating and overhead expenses.

Minority dealers and most other small dealers are unable to obtain contracts with primary suppliers for several reasons:

- Primary suppliers are unable or unwilling to increase the amount of heating oil they distribute by adding new customers (dealers), when they are already allocating to existing customers.

- Many of the small and minority dealers pose a high credit risk to primary suppliers. Risk has become of increasing concern to suppliers in a time of high product cost and high cost of money. One East Coast supplier told us during interviews that a dealer has to prove he "runs a tight ship" in today's oil industry to obtain credit from suppliers. In general, primary suppliers are leery of unfamiliar, unestablished dealers.

Small dealers often lack the volume to be profitable customers of major refiners. High volume is the best leverage for dealers with suppliers. Again, suppliers pointed out that dealers who distribute smaller quantities of fuel may often seem "more trouble than they're worth" in terms of supplier service effort and other business procedures.

Because they lack long-term contracts with primary suppliers, minority and small dealers who handle a large percentage of all inner-city residential accounts, are forced to rely totally on secondary suppliers.\textsuperscript{12}

This has serious consequences for both the dealers and their customers. When supply is disrupted unexpectedly by international events, the uncertain supply of these dealers can delay delivery of essential heating oil to their low-income customers.

The problem of uncertain supply is compounded by the fact that, in most cases, these dealers have no storage capability to adequately buffer them against supply

\textsuperscript{12} Minority dealers in New England, while comprising only 2\% of the total dealer population, handle 40-60\% of all inner-city accounts.
disruptions or price increases. Not a single minority dealer in all of New England or the Mid-Atlantic states has storage space to shield him from inconsistencies in supply. Such storage was not needed when fuel oil supplies were abundant and the price of fuel oil was rising at a very moderate rate.

Furthermore, dealers who buy from secondary suppliers at higher prices inevitably must charge their customers more than dealers supplied by primary suppliers. Many of the minority dealers' customers are low-income inner-city residents whose energy needs are subsidized by special government programs. As a result, much of this higher-priced fuel is finally paid for by the government.

In addition, the relatively high level of accounts receivable generated by a low-income customer base results in higher financing costs for these dealers. Minority dealers are, partially as a result of their higher product prices, unable to expand into and compete in middle- or upper-income consumer markets.

Because of currently high product costs, reduced allocation levels, and some level of absorption of increased operating costs, many small and minority dealers are threatened with failure. If they do fail, their low-income, inner-city accounts may not be readily served by larger dealers, who generally serve more reliable and profitable accounts. Many dealers avoid neighborhoods where customers pose a high credit risk and frequent street crime threatens delivery personnel.

One dealer interviewed admitted that he allowed his business in a particularly dangerous area to disappear by attrition. He pointed out that many of the companies that do serve these areas must add an extra man to each delivery truck because of the possibility of robbery, thus increasing operating costs and ultimately fuel costs. Several other minority dealers also reported that they have been robbed while conducting business on a COD basis in low-income areas.

CREDIT PRACTICES

Obtaining credit is essential to every heating oil dealer. Because of increasingly high product costs and increasingly
high costs of money, credit has become a serious problem for many dealers. A national survey of dealers taken in the fall of 1979 showed that 45 percent of those interviewed felt that tighter credit terms were their biggest problems.¹⁴

Fuel oil dealers' credit problems result from two adverse supplier actions: the elimination of traditional credit terms that favor dealers and suppliers' reluctance to extend credit to dealers. These problems and their implications for fuel oil dealers are outlined in the following section.

Elimination of Traditional Credit Terms Favorable to the Dealer

The financial interaction between dealers and their suppliers has changed significantly in recent years. Many heating oil dealers are particularly concerned by the elimination of several credit-related programs that were standard operating procedures between dealers and

suppliers when oil supplies were more abundant. Specifically, suppliers have cancelled, altered, or reduced programs such as "summerfill," a 1-percent discount for cash payment within 10 days, and credit lines of 30 days or more in many cases. Each of these practices and the reasons for its alteration or elimination are briefly reviewed below.

The Summerfill Program

Summerfill is the practice by which suppliers/refiners fill dealers' heating oil tanks in early summer and allow the dealer to hold the inventory without paying for it until the fall, usually October. This interest-free inventory financing was extremely beneficial for dealers. In effect, summerfill programs filled all storage (both consumer and dealer) in the heating oil distribution network during off-season summer months, which allowed dealers and consumers to prepare for the winter heating season. Such storage also served as a buffer against supply disruptions and price increases.

Suppliers decided to provide summerfill on a year-to-year basis, depending on their perception of economic and market conditions. As a result, the uncertainty about the availability of summerfill storage causes great
anxiety for heating oil dealers. Several dealers stated that summerfill assures both dealers and their customers that heating oil supplies will be adequate in the upcoming winter season. Again, consumers' perception of the adequacy of oil supplies with their dealers is a major factor in their decision to convert to natural gas.

In some cases, suppliers who have eliminated summerfill still expect dealers to purchase large quantities of oil during the summer without financial assistance. The experience of a New England dealer illustrates the difficulty of financing summer inventory. His suppliers eliminated summerfill, yet expected their customers to acquire from 27 to 30 percent of their annual allocation between May 1 and October 27. A heating oil jobber for 43 years, he reported, "It is impossible for me to abide by terms such as this without financial assistance."15

Many dealers have discontinued summerfill for several reasons. Most importantly, the cost and value of home heating oil has risen dramatically in recent years. It has become prohibitively expensive for suppliers to essentially finance dealer inventories over a summer.

At the same time, reduced consumption by drivers has reduced suppliers' need for storage space for summer gasoline inventories.

**Cash-Payment Discount**

Suppliers' discounts for cash payment was another credit practice particularly attractive to dealers. Under the plan, if a dealer paid cash for oil purchased within 10 days, he received a 1-percent discount on the total owed. Dealers accustomed to the discount saved substantial amounts of money; some based their profit margin on its use.

For example, a New York retailer said that loss of the discount would cost him between $50,000 and $75,000; the situation threatened to "wipe him out." Another New York heating oil jobber said that, without the discount, he would lose 50 percent of his profit.16

Suppliers have eliminated the 10-day discount for several reasons. The high cost of heating oil and rising cost of money have certainly taken away much of the incentive for the discount. Perhaps more important, it is a service or incentive that suppliers no longer need.

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to offer; dealers must now buy oil on supplier terms and have little flexibility or leverage. An oil distributor in New Jersey stated that one major supplier (Gulf) eliminated the 1-percent discount because it felt it could require dealers to "pay within 10 days anyway." The supplier claimed that eliminating the discount was "a plain business decision" resulting from skyrocketing oil prices and growing accounts receivable.17

Reduced Payment Periods

Payment periods accorded heating oil dealers are critical to their financing. Traditionally, suppliers have given dealers at least 30 days to pay for heating oil. As one dealer pointed out, although his terms were technically 30 days net, he was usually allowed up to 60 days before any pressure was applied or credit action taken by his suppliers: "Today, terms are anywhere from net 10 days to 1-percent 10 days, shut-off after 30 days."18

Reduced payment periods have a detrimental effect on the cash flow of retail dealers. Because most dealers

cannot collect from homeowners within 30 days or less, payment of their inventory costs within a short time results in their effectively financing the cost of homeowner oil supply. To pay for the oil they deliver to consumers, dealers must either borrow at today's high interest rates and essentially finance their customers' oil or demand quicker payments from consumers.

Consumers have begun taking longer to pay fuel oil dealers and accounts receivable have risen. During the winter of 1976/1977, when oil prices rose dramatically, New England dealers' accounts receivable reached a total of $500 million, more than $220 million (44 percent) of which was overdue. This lack of liquidity drove many dealers out of business.19

It may be impossible for dealers to secure quicker payments in some areas. Legislation under consideration in Connecticut, for example, would require that heating oil dealers offer payment terms of "not less than thirty days, provided that the purchaser has no outstanding balance at the time of sale."20

Furthermore, many fuel oil dealers must borrow up to 50 percent more to finance the higher-priced product than they did last year for the same volume, at interest rates that recently exceeded an all-time high of 20 percent. They must also provide additional personal collateral. The escalation in dealer borrowing and finance cost results in either profit absorption by dealers or higher product costs. Over the summer of 1979, suppliers charged dealers from 10 to 12¢ more per gallon. To keep their markup over 20 percent, dealers would have had to boost prices by 14 to 15¢ per gallon. Many did not, however, because they feared their customers would convert to natural gas.21

The National Petroleum News noted that tight credit forces dealers to "tighten credit terms with customers (homeowners) by stressing the need for payment within 30 days. If customers resist, interest rates, discontinuances, and referral of overdue accounts to collection agencies will become automatic procedures."22 Dealer collection practices are already much stricter. The average time period jobbers allow before they consider an account

22. Ibid.
delinquent has declined dramatically nationwide, from 67
days in 1975 to 48 days in 1979. Furthermore, 72 percent
of dealers said that they now have more COD accounts.23

The net result of reduced payment periods is the
imposition of higher prices and stricter collection prac-
tices on consumers, who inevitably become increasingly
alienated from dealers. Many consumers are resorting to
nonpayment or tardy payments. The resulting growth in
dealers' accounts receivable exacerbates their cash-flow
problems.

Although many dealers pass higher costs directly to
their customers, some "eat margins to maintain market."
The nationwide average for dealers' gross margins declined
from 35 percent of sales in 1973 to 27 percent in 1979.24
That is, dealers must absorb their rising costs to reduce
the impact on their consumers and avoid losing customers
to natural gas. Obviously, this practice severely
affects the profitability and overall health of the
heating oil dealership.

Reduced payment periods can also create supply
problems for dealers. Suppliers have effectively reduced

dealer payment periods without technically changing payment terms by refusing to increase credit lines to match rising product costs. In effect, the dealer's credit line shrinks with every rise in the price of oil, and the time period during which he can draw oil on credit is equivalently reduced. A dealer in southern New England described how, while the price rose 20 percent over a period of "a few months," his supplier refused to raise his credit line accordingly. The net result, he said, was a 20-percent reduction in his ability to buy supplies.  

Several dealers interviewed pointed to particularly restrictive tactics used by suppliers in their extension of credit. They complained that not only had payment periods been reduced from 30 days to 10 days, but suppliers no longer allowed time for payment by mail, leaving them with less than 10 days to pay.

Suppliers have tightened their credit terms for a variety of reasons. Perhaps most important is the strong sellers' market that has developed in the last few years; suppliers no longer need to offer dealers attractive credit terms.

and other incentives. In addition to eliminating favorable dealer credit, suppliers have withdrawn other customer-oriented services as well.

Many dealers see reduction in supplier sales forces as a sign of lack of competition among oil companies. One dealer said that at one time supplier sales representatives formerly visited at least once a week. He said he is now "lucky" to hear from a salesman once a month. A dealer interviewed in New Hampshire described how many of his problems stem from the elimination of competition among suppliers. Not only have they tightened his credit terms, they no longer finance seasonal painting of his trucks or offer cooperative advertising opportunities.

Suppliers contacted were ambivalent regarding the elimination of incentives they once offered heating oil dealers. One salesman for a major oil supply company said that earlier supplier selling practices such as truck painting, subsidized advertising, "business weekends," and "wining and dining" sessions were "ridiculous." He claimed that many dealers "abused" the privileges bestowed upon them when suppliers sought to attract their business.
FUEL OIL DEALERS

Suppliers often cite two other major causes of injustice of newly stringent credit terms: the spiralling cost of oil and the rising cost of money in today's economy. Suppliers constantly contend that, because of these factors, they can no longer afford to finance dealer inventories at previous levels.

Another factor cited by heating oil suppliers for their reduction in payment periods is the change in terms now offered them by their foreign suppliers. A general tightening of credit began in the spring of 1979, when OPEC began demanding payment for crude within 30 days instead of 60. A spokesman interviewed at a major oil company (Texaco) claimed that refiners must now pay for oil as it is loaded onto tankers in the Mideast.

Supplier Reluctance to Extend Credit

Although suppliers have been tightening credit for dealers with whom they have established relationships, they have concurrently established stricter criteria on which they base decisions to extend credit at all. Many dealers cannot prove their creditworthiness to
suppliers and thereby obtain product. According to several dealers, suppliers demand either cash on delivery or certified checks at the pick-up point. Dealers required to operate under these conditions, most of them small, marginal ones to begin with, are in a precarious if not impossible business situation. First, they must spend valuable time getting cash or a certified check. More important, their cash flow position is untenable unless they impose equally harsh terms on their own customers.

Small and minority dealers who have never had access to attractive credit terms are particularly affected by this situation. Aside from the financial problems of running their heating oil distributorships on a COD basis, they are vulnerable to robbery in the inner-city high-crime areas in which most of them operate. Several minority dealers pointed to robbery as a recurring problem directly resulting from their need to operate their businesses on a cash basis.

Banks are also reluctant to extend credit to smaller dealers (under $2 million gross revenue). A banker in
western Massachusetts said: "The smaller dealers everywhere are going to get hurt. They're overextended and bad credit risks. They should sell out."26

Suppliers explain that their increased selectivity in offering credit to dealers is the result of the same factors that have caused them to tighten credit terms with everyone. One supplier told us that market conditions require that suppliers be careful as to whom they extend to. To be creditworthy, a dealer must prove that he runs a "tight ship." Proof may consist of sophisticated and complete company financial statements. One Mid-Atlantic dealer said: "We are subject to closer scrutiny of financial statements, more attention to discount terms, more requests for better financial reports such as inventory and accounts receivable. This is true of our supplier and our bank. With today's high prices, they are watching how we handle our finances more closely than ever."27

27. Fuel Oil & Oil Heat, October 1979.
FUEL OIL DEALERS

A New England dealer described the case of a dealer "who had been buying from Texaco for five years and paying his bills according to terms [and who] was told after examination of his annual P&L that he was no longer a customer in good standing."28

B. DECLINING MARKET SHARE

In recent years, the rising price and unstable supply of imported oil has resulted in increasing pressure on the retail heating oil business as homeowners convert to natural gas and actively reduce energy consumption. Each of these major causes of declining market share is discussed in the following sections.

CONVERSION TO NATURAL GAS

U.S. homeowners are increasingly switching from oil to natural gas as a source of home heat. In 1978, 53,562 oil-heated homes switched to natural gas, and the American

Fuel Oil Dealers

Gas Association (AGA) predicted 225,000 conversions for 1980. For some heating oil dealers, homeowner conversion has eaten away their market share at alarming rates.

A medium-sized dealer interviewed in Illinois said that one-third of his customers switched to natural gas in a year; a Chicago dealer lost 23 percent of his customers in a year as well. Fuel oil dealers in New England also were adversely affected by homeowner conversion. Forty percent of all oil-to-gas conversions in 1979 were in the Northeast. A New England dealer interviewed said that his business was off 30 percent during the 1979/1980 heating season, largely as a result of natural gas conversions.

In a national survey of heating oil dealers taken in December of 1979, half the dealers indicated that they had lost residential customers to gas heat in the past year. Forty percent of those interviewed said that gas conversion is a serious threat to their business. On the average, each dealer lost 8 accounts to gas.

FUEL OIL DEALERS

The dealers cited several reasons for homeowner fuel switching: the currently lower price of gas, the perception of abundant supplies, effective gas industry advertising, and inconsistent government policy.

The primary incentive for conversion is the current price differential between oil and gas, a result of the phased decontrol of natural gas prices under NGPA. This act prevents gas prices from rising immediately to their true value, on a par with fuel oil prices. Thirty-one percent of dealers surveyed in the winter of 1979 underscored the importance of price to consumers when choosing fuel.31

However, the actual price that consumers pay depends on their geographical location. Jensen Associates, an international consulting firm, found that natural gas either had little price advantage or had a net disadvantage in New York and Boston. The firm gave the following figures

31. Fuel Oil News, December 1979. However, a more recent analysis by the Consumer Energy Council of America entitled "An Analysis of the Economics of Fuel Switching v. Conservation for the Residential Heating Oil Consumer," (October 5, 1980) concludes, "Converting heating systems from oil to natural gas is one of the least effective ways for consumers to reduce their energy bills."
for comparable amounts of natural gas and heating oil:

<table>
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<tr>
<th></th>
<th>Natural Gas @ Current Rate</th>
<th>Heating Oil @ 80¢/gallon</th>
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<tbody>
<tr>
<td>Boston</td>
<td>$734.26</td>
<td>$797.60</td>
</tr>
<tr>
<td>New York</td>
<td>$947.69</td>
<td>$820.80</td>
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Consumers assume that domestic natural gas supplies are abundant but heating oil must largely be imported. Over 19 percent of the fuel oil dealers surveyed in 1979 felt that consumers' perception of plentiful domestic reserves of natural gas was their primary motive for conversion.32

Advertising campaigns developed by AGA and gas utilities have had a significant influence on consumers. AGA has a massive promotional budget of $35 million for its 1980 campaign. In comparison, the National Oil Jobbers Council recently began advertising oil heat with a 1-year budget of only $259,000.33

FUEL OIL DEALERS

Inconsistent and unclear statements have misled and confused many consumers about government policy on fuel switching and decontrol under NGPA. At one time, the Carter administration openly endorsed conversion to natural gas. As recently as January 1979, DOE announced a 3-year surplus of gas and urged homeowners to convert from oil. The story was widely circulated by the media, and natural gas companies intensified their campaigns. Many consumers now feel that the U.S. government supports their conversion to natural gas. Most are unaware that DOE apparently reversed course in March 1980, when Deputy Secretary Sawhill cautioned consumers about fuel switching and stated that DOE could not recommend it.

Fuel oil dealers, unaccustomed to competing aggressively with alternative fuels, are just beginning to take positive steps to maintain their market share. A medium-sized dealer in Massachusetts, for example, now offers extensive energy-conservation services to his customers. He has thus been able to prevent significant erosion of his market. By pushing conservation, his company has

convinced homeowners of its interest in saving fuel and money. This demonstrated effort to help customers save fuel has resulted in their continued loyalty and decreases the likelihood of their conversion to other fuels, particularly natural gas.

However, not all dealers can plan aggressive marketing campaigns. Many lack the training, sophistication, and manpower to promote service, efficiency, and conservation. These dealers are the most severely affected by competing fuels. Because they are unable to offer service and energy savings to their customers, they lose more of them to conversion or to other dealers.

HOMEOWNER CONSERVATION

As a result of rising fuel costs and the availability of more sophisticated, effective equipment, homeowners are intensifying conservation efforts and significantly reducing the amount of oil they burn during the heating season. Per-home sales of fuel oil have declined for most dealers, in some cases dramatically. Nationwide, heating oil customers have cut consumption by about 13 percent in recent years. According to a New England
dealer, his average customer used 1,700 gallons of heating oil annually prior to 1973; by 1976, average consumption had declined to 1,100 gallons, and in 1979, the figure was 1,000.\textsuperscript{36}  

Homeowners, particularly those heating with oil, are becoming increasingly energy-conscious and energy conservation oriented. (In 1970, heating oil accounted for 2 to 3 percent of the homeowner's monthly household budget; this figure rose to over 10 percent by 1979, illustrating the growing need for conservation on the part of oil consumers.\textsuperscript{37}) A larger percentage of oil-heated homes have insulation and storm windows than those heated by other fuels. In the winter of 1978-1979, 51 percent of oil-heated homes had storm windows (on all windows), while only 39 percent of natural gas-heated homes had similar coverage. That same winter, 93 percent of oil-heated homes had some type of attic or wall insulation, compared to 82 percent of natural gas-heated homes.\textsuperscript{38} Consumers

\textsuperscript{36} SBA Hearing, March 14, 1979.  
\textsuperscript{37} Ibid.  
FUEL OIL DEALERS

are also turning down their thermostats and using ancillary energy sources such as wood. Furthermore, the federal government is encouraging these conservation practices via tax credits.

Such conservation has significant impacts on fuel oil dealers. Reduced sales volume is perhaps the most damaging. Because dealers sell less fuel per customer, they must increase their customer base or experience higher overhead and operating costs per gallon sold. Passing these increases to homeowners can increase customer alienation and result in natural gas conversion; on the other hand, if dealers absorb the higher costs, their profits are reduced.

Smaller, less sophisticated dealers suffer particularly from the homeowners' conservation efforts. These dealers, who are unable to offer such conservation assistance as equipment service and maintenance, lose customers to larger dealers who can provide these services or to gas utilities that sell cheaper fuel. The high cost of fuel has resulted in a low level of homeowner loyalty to the fuel oil dealer. A 1979 study of homeowners showed that 85 percent felt their dealer did nothing to help
them save fuel and was only trying to sell them as much fuel oil as possible. According to the study, many homeowners would gladly switch to another dealer or utility if such a move would save them money.39

Although homeowner fuel-saving creates substantial problems for dealers unable to offer conservation services, it is an opportunity for those who can. These dealers can offset their decreased oil sales by marketing new oil-burning equipment to consumers. A dealer in Massachusetts lost less than 1 percent of his 5,000 accounts to natural gas by aggressively marketing energy conservation.40 Much of the equipment now used in American homes is old and less efficient than current equipment, making the marketing of new equipment an attractive option. Seventy-five percent of all oil burners in use today are more than 10 years old; the majority have been in service for over 25 years.41

DOE's Residential Conservation Service (RCS) Program has caused considerable concern among heating oil dealers. Although each state that decides to participate must design its own program for administering RCS regulations, all states must ensure that gas and electric utility companies will help homeowners and renters reduce their fuel bills. The inclusion of fuel oil dealers in the program, however, is left to the discretion of each state. Many dealers fear that they will be at a competitive disadvantage if they are not included, because consumers may feel that only the gas and electric companies are interested in helping them reduce energy costs.

Under the RCS program, each state can request its utilities to inspect and audit customer residences to analyze "the costs and potential savings of applicable energy conservation and renewable resource measures." If fuel oil dealers are included, they would examine consumers' oil-heating equipment and make conservation recommendations. If they are not included, this inspection would fall to the gas and electric utility companies. Although
the program does not provide for or allow the recommendation of fuel-switching as a conservation measure, the fuel oil dealers fear that auditing of oil-heating equipment by the utility companies would give them the opportunity to promote consumer conversion to gas or electricity.
SBA, dealer organizations, and dealers themselves can take a number of actions to address the problems that threaten the viability of the fuel oil delivery system. We believe that government regulations or interference in the conduct of individual business should be avoided except to ensure supplier-purchaser equity during emergency shortages. Our recommendations focus on actions that will help to relieve some problems in the external environment facing fuel oil dealers. Although these actions cannot guarantee the economic survival of every dealer, they will help to ensure that the fuel oil delivery system does not fail.

In this chapter, we recommend actions to help resolve the problems identified and described in Chapter 2. To ensure that these solutions are realistic, given today's business environment, we also address constraints in developing any feasible remedies.
RECOMMENDATIONS

In the following sections we briefly restate the nature of the problems, outline the constraints in their resolution, and recommend actions to SBA, its Office of Advocacy, dealers' associations, and individual dealers.

A. DETERIORATING SUPPLIER/DEALER RELATIONSHIPS

The relationship between suppliers and dealers has deteriorated significantly over the past 10 years as a result of changes in the economics of the fuel oil industry. Consequently, fuel oil dealers now face tighter supplier allocation and credit practices. These practices in turn have created a series of problems that seriously affect the fuel oil delivery system and the success of small-business dealerships.

The three major allocation problems are:

- Unpredictable fuel oil allocation practices
- No supply contracts for minority or small dealers
- Nontransferability of allocation rights. The revision of past credit practices presents dealers with
RECOMMENDATIONS

a separate set of problems, most of which affect their cash flow.

Potential solutions to the allocation problems and any constraints that we identified in analyzing these solutions are discussed below. Solutions to the credit problems are addressed later in this chapter.

UNPREDICTABLE ALLOCATION OF FUEL OIL

We recommend three approaches to offset the effects of unpredictable supplier allocation practices:

1. Design appropriate standby legislation

2. Organize an information exchange system

3. Increase dealers' marketing activities.

Monitor Appropriate Standby Regulations

The Office of Advocacy within SBA should monitor and comment on standby allocation regulations to ensure
RECOMMENDATIONS

equitable distribution of fuel oil to dealers and ultimately to consumers during emergency shortages, both national and regional.

The Office of Advocacy should review the Economic Regulatory Administration's (ERA) proposed revisions to the standby allocation regulations. The Office could at any time request ERA to implement the standby regulations to discourage suppliers from creating artificial shortages in the marketplace.

The Office of Advocacy could also advocate legislation establishing emergency fuel oil reserves in vulnerable regions such as the Northeast, the Mid-Atlantic states, and the Midwest. The reserves, to be established in close cooperation with local fuel oil dealers, would ensure equitable fuel distribution during times of crude oil supply disruptions as well as during situations of product shortage created by suppliers' practices.

Organize an Information Exchange System

Dealers' associations could organize an information exchange system which provides data on fuel oil
surpluses and shortfalls at both the regional and the national levels. Such a system can help independent fuel oil dealers with surplus product to sell it to dealers with shortages or storage capacity. Dealers would use the associations' system to identify potential buyers or sellers, but the final transactions would be accomplished directly between dealers. This exchange system could complement the spot market. By monitoring the information exchange system, the Office of Advocacy could identify potential problems and work with DOE to ensure continued deliveries to consumers.

Increase Dealer Marketing Activities

Dealers should be prepared to initiate aggressive marketing programs during periods of excess supply. Dealer associations could assist dealers in their marketing efforts by disseminating facts about oil and gas availability and use to homeowners through the media. In the long term, such consumer information programs would help decrease market share erosion.
RECOMMENDATIONS

Constraints in Addressing Arbitrary Allocation

We identified three constraints to developing responses to the allocation problem. First, suppliers will resist any change in current allocation practices. Unless the government intervenes in suppliers' business operations, it would be unrealistic to expect significant voluntary changes or controls on their allocation practices.

Second, uniform allocation policies cannot be established for any extended time because regional oil surpluses and deficits will continue to occur as a result of weather uncertainties, homeowner conversion patterns, and the evolving nature of the fuel oil business.

Third, any unfair trade practices on the part of suppliers are difficult to establish without resorting to a time-consuming hearing and litigation process. Moreover, such action would not help to resolve allocation problems in the short term, when it is needed.
RECOMMENDATIONS

NO SUPPLY CONTRACTS FOR MINORITY AND SMALL DEALERS

We recommend five approaches to the special supply problems of minority and small dealers:

1. Assist with dealer credit ratings
2. Urge supplier cooperation
3. Foster additional dealer storage
4. Revise loan criteria
5. Encourage earmarking of state fuel set-asides.

Assist with Dealer Credit Ratings

SBA should use its existing resources to help small and minority dealers take steps to improve their credit ratings. It should provide complete or partial financial assistance for participation in formal training programs, such as those conducted by Price-Waterhouse, where dealers can learn skills to help them improve their financial and management practices. As their operations become more sophisticated, their credit ratings will improve, thus encouraging suppliers to sign more contracts.
RECOMMENDATIONS

Urge Supplier Cooperation

At the same time, the Office of Advocacy should encourage primary suppliers to contract with minority and small dealers, especially those who demonstrate acceptable credit ratings and credit training. It should inform suppliers of the measures it is taking to improve smaller dealers' credit and of the dealers' efforts as well.

Foster Additional Dealer Storage

SBA's district and regional offices could help small and minority dealers find and rent available storage space (either whole tanks or portions of tanks) as a buffer against uncertain supply and increasing costs of fuel oil. The agency could provide credit for the associated working capital requirements and help dealers arrange joint or cooperative ventures to create additional storage facilities. It could also consider advocating tax credits for owners of existing storage facilities who increase their capacity and rent it to minority or small fuel oil dealers. This would serve as an incentive for the further creation of storage space.
RECOMMENDATIONS

Revise Loan Criteria

SBA should also revise its loan criteria for fuel oil dealers to allow existing loans to be used for storage space rental, purchase of existing facilities, or new construction.

Encourage Earmarking of State Fuel Set-Asides

Finally, through its district and regional offices, SBA could also consider encouraging each state energy office to earmark a portion of the state's fuel oil set-aside for delivery to low-income consumers by the minority and small dealers. This measure would not only ensure such dealers a portion of the market but would also provide a more secure supply of fuel oil for low-income groups in the event of supply disruptions.

Constraints in Addressing Lack of Supply Contract

In developing recommendations to address the problem of supply contracts for minority and small dealers, we identified three major constraints. First, we recognize
that primary suppliers are reluctant to take on new customers, especially when supplies are limited. Moreover, in an uncontrolled market, suppliers cannot be forced to sell fuel to any customer, including smaller, less-established dealers or with customers who have poor credit.

Second, the construction of a special storage facility for minority and smaller dealers raises many complex issues. How will the oil be transported to the storage facility? How many facilities are required and where could they be built? Would it amount to discrimination against other dealers? In addition, this construction raises economic and management questions. For example, how will it be financed? How will access be controlled? Who will coordinate and manage the new facilities? The need to resolve these questions makes the creation of a special storage facility appear infeasible, at least in the short term.

Third, the resolution of the small and minority dealer problem must be carefully planned to avoid tampering with the natural competitive forces in the marketplace.
NONTRANSFERABILITY
OF SUPPLY CONTRACTS

Suppliers' contracts with key-person clauses may prevent fuel oil dealers from transferring their businesses to their heirs or selling them to potential buyers who have no other access to oil. Although this problem is not widespread, it has potential implications for the fuel oil industry in general and particular impact on dealers who hold such contracts. Suppliers who write nontransferability into contracts put dealers at an extreme disadvantage by obstructing their flexibility in business operations. This practice may well be an unfair trade practice.

Increase Understanding of Nontransferability Contracts

To better understand the causes of the problems raised by nontransferability contracts, and find appropriate remedies, the Office of Advocacy, DOE, and other concerned government agencies should stay aware of marketing practices of suppliers to identify those that may negatively impact fuel oil dealers. The SBA task force should help acquire relevant data on the key-person clause and inform the fuel oil business community of its detrimental effect.
RECOMMENDATIONS

on dealers. SBA should make appropriate trade organizations aware of its findings and publicize its intent to find a prompt solution to this problem. This would warn suppliers and might discourage them from using the key-person clause in their contracts.

Constraints in Addressing Nontransferability Contracts

We found two major constraints to the resolution of this problem. First, it is very difficult to establish in detail the true reasons for a supplier's use of the key-person clause without a hearing, which is time-consuming and would not alleviate the problem in the short term. Second, according to Congressional inquiries, there are no legal methods of removing the clause.

DISCONTINUATION OF PAST CREDIT PRACTICES AND IMPOSITION OF STRICT CREDIT LINE/TERMS

As we discussed in Chapter 2, suppliers have discontinued certain credit practices (i.e., summerfill program, discount for prompt payment) that were beneficial to fuel oil dealers. Moreover, suppliers are now imposing
RECOMMENDATIONS

Stricter credit terms (10-day payment period, cash on delivery) that strain many dealers' cash flows. Dealers' credit lines have also tightened because of higher product prices, resulting in less product on credit for a given dollar amount.

We recommend three ways in which SBA and the Office of Advocacy can assist dealers with their financial difficulties:

1. Expand existing loan programs
2. Continue monitoring dealer needs
3. Expand information and management assistance efforts.

We recommend also that dealers undertake a consumer information program as a separate approach to these financial difficulties.

Expand Existing Loan Programs

SBA should continue to expand and improve its existing loan programs for fuel oil dealers. SBA has adopted a
number of measures to help relieve the financial difficulties of fuel oil dealers in the small business sector. Over the past year, it has designed a series of assistance programs to address both the short-term cash-flow problem and the longer term capital requirements of small dealers. The major programs are:

- **The Economic Dislocation Loan Program.** This program provides low-interest loans up to $100,000 to fuel oil dealers. SBA should consider raising the ceiling of this loan for working capital needs.

- **The Emergency Energy Shortage Economic Injury Loan Program (EESEI).** This program offers low-interest loans up to $350,000 to small businesses that have been seriously affected by fuel oil shortages. Through the task force programs described below, SBA should continue to inform dealers how to avail themselves of this assistance.

- **The Seasonal Line of Credit Program.** This program addresses the problem of working capital deficiencies arising from seasonal variations in business. To qualify, fuel oil dealers must have been in business for at least 1 year and be unable to acquire needed capital elsewhere. SBA will guarantee up to $500,000
or 90 percent of the total loan, whichever is less, for a year. The use of this loan by small and minority dealers should be encouraged through information dissemination.

If additional funds are necessary for the above programs, SBA should propose such expenditures to the President and Congress.

Continue Monitoring Dealer Needs

In addition to the loan programs, SBA has adopted other measures to help small dealers cope with the changing business environment. As oil prices rise and fuel oil dealers' gross revenues increase, more small businesses are likely to become ineligible for financial aid from SBA. So that more dealers may qualify, it has raised the ceiling on gross revenue from $2 million to $6 million; it also recently created an "inflation-proof" dealership size standard of 100 employees. SBA should continue its monitoring of dealer needs and its efforts to ensure the economic health of the fuel oil business.
RECOMMENDATIONS

Expand Information and Management Assistance Efforts

The Office of Advocacy has organized regional fuel oil task forces that provide information and management assistance with SBA loan programs. Task forces are now focusing on actions to protect the viability of the fuel oil business sectors. This office should expand its effort (and related resources) to inform field personnel in appropriate areas of the needs and problems in the fuel oil community.

SBA should utilize its existing management assistance programs as much as possible, and encourage fuel oil dealers to seek assistance with operations and finance. Such aid should be specifically geared to small and minority dealers, who are at a particular disadvantage.

Public Law 95-315, signed on July 4, 1978, directed SBA to implement an emergency loan assistance program that would provide small businesses with loans and loan guarantees as a means to establish or expand energy-related businesses. The Energy Loan Program provides money for conservation and solar-related activities and new energy technologies. SBA should organize seminars
RECOMMENDATIONS

To inform dealers of eligibility criteria. The seminars should cover designing, installing, and servicing equipment that would qualify dealers for assistance under the program. They could also be used to present information on related government energy programs.

Undertake Consumer Information Program

Dealers themselves can take action to resolve their cash-flow difficulties. They must inform their consumers of the various payment plans (e.g., budget plans, credit cards) that are available. Some of the dealers we interviewed stated that they had in fact avoided nonpayment or tardy payment by distributing such information to their customers.

Constraints in Addressing Revised Credit Practices

As we explored potential solutions to the important problem of credit and loans for small dealers, a number of major constraints became apparent. First, it is difficult, if not impossible, to eliminate the minimum 30-day payment period required by certain states without
causing a massive consumer outcry and motivating consumers to switch to natural gas. On the other hand, suppliers cannot be compelled to alter strategies that they find appropriate in a changing business environment. Nor can commercial banks be expected to provide loans to dealers at unprofitably low interest rates.

In addition, SBA cannot single out fuel oil dealers for preferred economic aid, although it can subsidize training programs to help small and minority dealers improve their credit ratings.

Theft of COD payments is also difficult to control. Increased security can only reduce theft, not eliminate it, and the added costs are often too great for minority and small dealers to bear.

Finally, SBA cannot create new programs to assist dealers if the financial investment requirements exceed its current budget. President Carter's desire to balance the 1980 national budget makes it highly unlikely that SBA will be given additional funds.
The declining market share of fuel oil dealers can be attributed to homeowners' conversion to natural gas and to their efforts to conserve energy. In the following section, we address these two factors and suggest a number of actions that SBA and dealers can take to mitigate their impacts. We also discuss the constraints we encountered in developing practical solutions to the problem of declining market share.

CONVERSION TO NATURAL GAS

We recommend four ways in which the Office of Advocacy, dealer organizations, and individual dealers can counter the negative effects of homeowners' conversions to natural gas:

1. Clarify government policy
2. Articulate position on incremental pricing
3. Expand promotion of fuel comparisons
4. Encourage expanded dealer services.
RECOMMENDATIONS

Clarify Government Policy

Many homeowners believe that consumption of fuel oil is contrary to U.S. energy goals. To ensure that the public understands the government's position on energy conservation and conversion, SBA's Office of Advocacy should ask DOE to clarify and publicize its revised stand on the use in the short and long term of fuel oil versus natural gas.

Articulate Position on Incremental Pricing

Under NGPA, Title II, interstate natural gas transmission companies are allowed to pass certain portions of their acquisition costs through utilities, for natural gas, to certain industrial users in the form of a surcharge. These incremental pricing provisions for industrial users in effect reduce the cost of natural gas to residential consumers and could possibly continue to be an incentive to homeowners to convert to natural gas. Thus, from the fuel oil dealers' perspective, deferring incremental pricing provisions may seem a useful measure to keep market share. However, the full implications of incremental pricing provisions are not completely apparent. If industrial users of gas switch back to oil, as some
of them are now doing, the price of gas to residential consumers will rise. Thus, the paradox is that incremental pricing provisions may also benefit fuel oil dealers.

Currently, Congress is debating whether to rescind the incremental pricing rule. In light of the ongoing debate on this subject, and since the incremental pricing issue affects many constituents, of which fuel oil dealers are just one, we recommend that the Office of Advocacy only articulate its position on incremental pricing. That is, this Office should define its position on the subject via an in-depth analysis of incremental pricing and its implications on a state and regional basis, and then articulate this position to the Federal Energy Regulation Commission.

Expand Promotion of Fuel Comparisons

Dealers and dealer associations should expand their current promotion of fuel oil and natural gas future price and supply availability comparisons. They should publish objective case studies on the economic characteristics of the two fuels and work with appropriate dealer organizations to increase the effectiveness of their campaigns.
RECOMMENDATIONS

Dealers should inform consumers of current and future availability and price of the fuels, and offer heating equipment comparisons. A media campaign using newspapers, dealer advertisements, and personal/direct contact targeted at consumers as well as at building contractors, architects, and others could influence fuel choice.

Encourage Expanded Dealer Services

The dealer organizations should also initiate an internal promotional campaign directed at the dealers, informing them of the need to provide fuel conservation services in a changing business environment. A campaign, such as the one developed by the New England Fuel Institute, is essential to inform the dealers that such service would help them control and reduce the rate of conversions to natural gas. Above all, this action will enable dealers to better establish themselves with consumers.

Constraints in Addressing Fuel Conversions

In designing measures to alleviate the impacts of natural gas conversions on fuel oil dealers, we identified two
RECOMMENDATIONS

constraints. First, the rate of phased regulation of natural gas prices under NGPA cannot be speeded up without extensive lobbying and Congressional action. Furthermore, there is no guarantee that such efforts would bring immediate relief. Second, discussion of gas supply and the per Btu efficiency of oil as compared to gas will not resolve the basic problem -- constantly increasing product prices -- faced by the fuel oil dealers.

HOMEOWNER CONSERVATION

As a result of homeowner energy conservation efforts, many fuel oil dealers face the consequences of a declining market share. However, energy conservation opens new market opportunities for fuel oil dealers who are willing to diversify into conservation-related businesses.

We recommend two actions to counter the negative effects of homeowner conservation:

1. Assist with dealer diversification
2. Form service cooperatives.
RECOMMENDATIONS

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Assist with Dealer
Diversification

SBA's Office of Advocacy should continue to encourage
fuel oil dealer associations to stimulate active participa-
tion in the provision of energy conservation services
to homeowners. An internal campaign, as recommended in
relation to the natural gas conversion problem, may be
used. In addition, the associations should develop
equipment-efficiency training programs. These actions
could help change dealers' attitudes toward diversifica-
tion and would enable them to understand the issues and
acquire the necessary technical expertise.

SBA regional offices should urge dealers and their associ-
ations to consider selling energy-saving equipment to
consumers. Dealers could then efficiently diversify into
an emerging market and recover the cost of energy audits
by building them into equipment costs. Using a central
clearinghouse or outreach program, SBA could disseminate
case histories or data on successful diversification to
dealers. For this purpose, SBA should establish a
communications link with DOE.
RECOMMENDATIONS

SBA should use the Energy Loan Program and other existing programs to help dealers finance diversification. In particular, direct, low-interest SBA loans should be extended for conservation equipment and innovative energy technologies. SBA should encourage dealers to take advantage of the Energy Loan Program.

Form Service Cooperatives

In addition to obtaining SBA assistance, dealers should cooperate to develop their own diversification skills. For example, small dealers who are unable to provide their customers with conservation services should consider forming a service cooperative that would allow them to pool their manpower and technical expertise. This venture could be organized by dealer associations but operated independently once established, with dealers sharing costs and profits.

Constraints in Addressing Homeowner Conservation

In developing recommendations to address the problems resulting from increased homeowner conservation, we acknowledge that this basic trend should not be stopped.
This factor constrains efforts to help dealers mitigate its effects.

The slow response of many fuel oil dealers to changing business conditions imposes another important constraint. Their attitudes cannot be easily changed. Even those who have the foresight often lack knowledge of diversification options, technical expertise, and/or financing. In addition, the market opportunity for dealers is limited by the Energy Tax Act of 1978, which allows tax credit for burners only and not for replacement of entire heating systems.

C. ANTIMCOMPETITIVE GOVERNMENT PROGRAMS

As discussed in Chapter 2, there is growing concern that fuel oil dealers may be excluded from the Residential Conservation Service Program (RCS). Some dealers feel that they would be at a competitive disadvantage were they not to participate in providing conservation services to consumers.
Several factors may preclude dealers from participating in RCS. Dealers may be unable to conduct energy audits because they lack the necessary personnel, specific technical expertise, or the necessary financial capability. Many dealer associations and smaller dealers may find the administrative requirements of the program too complex.

We recommend two ways in which SBA can address these problems:

1. Promote dealer participation
2. Foster dealer expertise.

**Promote Dealer Participation**

SBA's Office of Advocacy, through its regional or district offices, should encourage the state energy offices to allow interested dealers to conduct audits of oil-burning equipment and to be paid for doing so.
RECOMMENDATIONS

Foster Dealer Expertise

SBA should also encourage interested dealers to learn the skills necessary to perform audits. It should offer seminars and training programs, similar to those on homeowner conservation, covering energy diversification services. It should inform dealers of available funding and expand its financial assistance to auditing education so that interested dealers could participate in RCS. Dealer associations and the outreach programs described earlier could also provide opportunities for dealers to acquire auditing skills.