American Forest & Paper Association

Comments Submitted for the Record
U.S. Senate Committee on Finance

Prohibition on Alternative
Fuel Credit and Alternative
Fuel Mixture Credit for Black Liquor

July 10, 2009

The American Forest & Paper Association (AF&PA) appreciates the opportunity to provide the Senate Committee on Finance with input on the legislative staff draft proposal clarifying the types of fuels qualifying for the alternative fuel mixture tax credit.

The alternative fuel mixture tax credit is scheduled to expire December 31, 2009. However, the Senate Finance Committee staff draft proposal eliminates fuel derived from the processing of paper or pulp, including lignin, wood residues, or spent pulping liquor, from alternative fuel mixture tax credit eligibility at an earlier date, to be determined by enactment.

- AF&PA opposes the effort to eliminate our industry's renewable energy from eligibility for the credit prior to December 31, 2009. Revoking the forest products industry's eligibility for the alternative fuel mixture tax credit before it expires, in spite of the industry's compliance with IRS regulations and interpretations, could have serious consequences for our companies and our nearly one million employees at a time of unprecedented economic challenges. Such an effort also fails to recognize that the forest products industry is a leader in the efficient production of renewable, carbon-neutral energy.

- We urge policymakers to fully recognize how potential changes to current law could affect the industry, its employees, and this country's renewable energy supply.

- The U.S. forest products industry increasingly finds itself competing for wood fiber on an unlevel playing field due to government mandates and incentives for new uses of wood fiber. The industry believes that markets, and not government programs, should determine the use of wood for renewable energy, but when government mandates and incentives exist, they must treat existing renewable energy generation equally with new renewable energy suppliers. To do otherwise creates market distorting effects that potentially risk the competitiveness of the nation's largest producer of renewable energy.

- The alternative fuel mixture credit is designed to encourage the use of alternative fuels to generate energy for use in a business and rightly applies equally to new and existing facilities.

- The staff discussion draft violates the principle of technology neutrality by picking winners and losers among industries that use liquid biomass fuel in similar processes to generate energy for business use.

Industry Background

AF&PA is the national trade association of the forest products industry, representing pulp, paper, packaging and wood products manufacturers, and forest landowners. Our companies make products essential for everyday life from renewable and recyclable resources that sustain the environment. The forest products industry accounts for approximately 6 percent of the total U.S. manufacturing GDP, putting it on par with the automotive and plastics industries. Industry companies produce $200 billion in products annually and employ approximately 1 million people earning $54 billion in annual payroll. The industry is among the top 10 manufacturing sector employers in 48 states.

The housing crisis, liquidity crunch, ensuing credit collapse and recession have had a profound impact on the forest products industry. Since 2006, nearly 350,000 forest products employees have lost their jobs—over a quarter of the industry's total workforce. In 2008, 18 paper mills were permanently closed, shutting down 27 paper machines, and 14 machines were permanently shuttered at other facilities. So far in 2009, more than 70 mills have taken market-related downtime and 4 mills have permanently closed.

Biomass Energy Production and Usage

The forest products industry exemplifies the renewable energy production and use that Congress and President Obama are seeking to foster nationwide.

Paper and wood products manufacturers are the country's largest renewable energy generators and users. The forest products industry generates more renewable energy than all the wind, solar, and geothermal energy combined. The industry generates 28.5 million megawatt hours of electricity annually from renewable biomass—enough to power 2.7 million homes. Our facilities meet, on average, 66 percent of their energy needs from renewable biomass energy that they produce on site, eliminating the need to purchase energy produced from fossil fuels.

Wood biomass is used by the forest products industry as a raw material to manufacture paper and wood products, and to generate the energy to power manufacturing facilities. The industry's biomass comes from by-products of the papermaking process, residuals from the manufacture of wood products, and other biomass materials.

Black liquor is a thick, dark liquid that is a by-product of the process that transforms wood into pulp, which is then made into products. Black liquor is principally comprised of lignin, which is the substance in trees that binds wood fibers together and makes

them rigid, and which must be removed from wood fibers to create pulp. Lignin, and therefore black liquor, contains more energy per pound than other major wood components. Black liquor is used as fuel at pulp and paper manufacturing facilities to generate electricity as well as the heat needed to produce the pulp and make various products. In addition to black liquor, the forest products industry also uses non-liquid biomass in boilers, kilns and other processes to provide heat, steam and electricity.

Environmental Benefits

Using black liquor to fuel mills is highly efficient and reduces reliance on fossil fuels. This energy is renewable. Unlike coal, oil or natural gas, trees and the wood they provide grow back. Our increasing use of renewable energy has allowed the industry to reduce its use of carbon-intensive fossil fuels and purchased energy per ton of product by 19 percent since 2000.

The energy produced from biomass sources including black liquor is carbon neutral. Forests and forest products absorb and store carbon dioxide equal to 10 percent of annual U.S. carbon emissions. The use of black liquor as a fuel results in no net increase of carbon dioxide in the atmosphere because the carbon in black liquor was originally extracted from the atmosphere and its release during fuel-use mimics the same natural cycle that occurs in the forest when trees decompose and release their carbon. Our continued commitment to reforestation ensures that the cycle for carbon neutrality is complete.

This energy is sustainable. We ensure that the wood fiber we use is grown in a sustainable manner. In fact, thanks to our long-term commitment to sustainable forestry practices, there are more forested acres today than there were 50 years ago. Our continued commitment to renewable energy and sustainable forest management demonstrates that a balance between the two is both possible and necessary.

This energy is efficient. Co-generation technology is recognized widely as the most efficient method for producing electricity, and co-generation power plants are often 50 to 70 percent more efficient than single-generation facilities. The forest products industry is a leader in the use of co-generation. We have more bio-based co-generation capability than all other industries combined and most paper and wood products mills produce the majority of their electricity using co-generation technology.

Renewable Energy Tax Incentives Impact

Federal, state and local governments have enacted measures to encourage the development of alternative fuel sources. The most common goals of these provisions are to increase energy security, to reduce greenhouse gas emissions, and to ameliorate the pollution associated with the burning of fossil fuels.

Government efforts to encourage renewable energy have led to unintended consequences, particularly for the forest products industry. Mandates and incentives to encourage renewable energy production may favor new energy production over existing, thereby creating winners and losers. For example, the staff discussion draft

targets the forest product industry because of its existing energy production. Such a policy would be unfair to the forest products industry which has a long history of producing renewable energy using highly efficient processes. It would be unfortunate if government policies disadvantage the largest existing base of renewable energy.

The U.S. forest products industry operates in a globally competitive marketplace and cannot easily pass on costs to customers and stay in business. As government policies increase the demand for biomass-based power, forest products companies must compete for wood biomass against utilities that have the ability to pass on fuel costs directly to their customers, and other new entrants into the bio-energy market.

Additional competitiveness pressures on forest products manufacturing facilities could threaten the survival of the largest industrial generator of renewable electricity in America and result in less, rather than more, renewable power for our nation. As with wind, solar and geothermal power, wood biomass serves as a carbon neutral energy source; unlike wind, solar and geothermal, wood biomass has multiple uses, serving as the raw material for value-added manufactured goods such as paper, packaging and wood products.

Alternative Fuel Mixture Credit

In 2005, Congress created two credits for the sale and use of alternative fuels: one specifically for transportation fuels and one for other uses. Notably, IRC section 6426(e) authorizes a tax credit of 50 cents per gallon of alternative fuel contained in a qualifying alternative fuel mixture that is sold or used by a taxpayer, as a fuel, in its trade or business. A qualifying alternative fuel mixture is a blend of an alternative fuel and a taxable fuel, containing a minimum of 0.1 percent taxable fuel. Included within the definition of alternative fuel is liquid fuels derived from biomass. Black liquor is a liquid fuel derived from biomass.

The alternative fuel mixture credit is designed to encourage the use of alternative fuels to generate energy for use in a business. Forest products companies have utilized the alternative fuel mixture tax credit for the use of black liquor as a fuel. To utilize the tax credit, companies must register with the IRS as an alternative fuel producer. The law requires alternative fuels to be mixed with gasoline, diesel or kerosene. Any fossil fuel amounts that are used are minimal compared to the significant amounts of carbon-neutral renewable biomass energy that pulp and paper manufacturers generate. In many mill configurations, companies are able to displace fossil fuel in other parts of their process which results in no net increase in fossil fuel use at a facility.

One way to measure the value of incentives related to renewable energy is to calculate the benefit per BTU of energy produced. AF&PA estimates that the alternative fuel mixture credit available to black liquor is in the range of the tax incentives provided to other renewable fuels as identified by the Joint Committee on Taxation in its publication JCX-25-09R: Tax Expenditures For Energy Production And Conservation. The alternative fuel mixture tax credit as applied to black liquor production and usage has a mid-range value of approximately $8.77 per million BTUs of heat energy. That

compares with $6.15 for wind and geothermal, $8.45 for biodiesel, and $13.29 for cellulosic bio-fuel. The incentive for corn ethanol is $5.92 per million BTU. As you can see from the data, the value of the alternative fuel mixture credit per million BTUs of heat energy is not disproportionate to incentives available to other sources of renewable energy generation.

We agree with the general principle of technology neutrality and believe that energy tax incentives should be structured in a manner that treats competing technologies and processes equitably. Preferential treatment should not be given to new actors over existing ones or to one technology over another. Of course, it is not unusual for Congress to develop incentives or credits for technologies that have unexpected beneficiaries. Yet to single out a particular industry or process because it was unforeseen would be unfair. We agree with the statement made by John M. Urbanchuk in his testimony for the Senate Finance Committee's April 23, 2009 hearing "Technology Neutrality in Energy Tax: Issues and Options." Of the paper industry's use of the credit for black liquor he stated, "Revoking the paper industry's eligibility for this incentive would violate the technology neutrality concept."

International Trade Implications

Numerous countries, including the European Union and Canada have policies to encourage renewable energy production. In fact, the U.S. is the largest supplier of wood pellets to Europe to help meet their renewable energy mandates. In the first 4 months of this year, European purchases of wood pellets from the U.S. have jumped by more than 500 percent to 164,426 metric tons compared to the same year ago period.

AF&PA's careful review indicates that the alternative fuel mixture tax credit does not violate U.S. international trade obligations of the World Trade Organization (WTO). The tax credit is not a prohibited subsidy since it is not contingent on exportation nor on the use of domestic over imported products. Since the tax credit is not allocated to a firm or industry, the credit cannot be considered "specific" under the WTO Subsidies Agreement. Other industries that use fish oil, animal fat and vegetable oil as fuel also benefit from the tax credit. This is in contrast to the Canadian black liquor credit program, which would be defined as a subsidy under Article 1 of the WTO Subsidies Agreement since a tax credit or grant conferred by the Canadian government would be considered to be a "financial contribution" which confers a "benefit" to a specific sector, namely Canadian pulp and paper mills.

In addition, there is no evidence that the tax credit has had market-distorting effects on trade. In fact, Bureau of the Census data for the first quarter of 2009 indicate that U.S. wood pulp exports were down 19.5 percent and paper and paperboard exports are down almost 24 percent compared with year-ago levels.

Impact on Recycled Paper Mills

Many AF&PA members are in the recycling business. In fact, 38 percent of the fiber we use to make paper and packaging is recycled. Claims have been made that the alternative fuel tax credit has negatively affected mills that make recycled products as those mill processes do not include black liquor. The data does not support these claims. Recovered paper consumption was off 17.1% versus year-ago consumption levels through the first five months of 2009, which was virtually identical to the 16.9% decline in total paper and paperboard production during the same period. Hence, the data confirm that recovered paper consumption by U.S. paper mills declined in proportion to the industry's total output of paper and paperboard.

Recovered fiber markets are heavily influenced by global supply and demand. Fortunately, the global market appears to be improving now and recovered fiber export demand is beginning to firm. This is good news for the economics of maintaining infrastructure and for market demand for recovered fiber.

Concerns About Repeal

Forest products companies are model renewable energy users and practice the kind of renewable energy generation that Congress is seeking to replicate nationwide. The economic downturn has caused a dramatic decline in demand for consumer goods, which in turn has caused an historic drop in demand for pulp products, including paper and packaging. If Congress were to suddenly compound these economic challenges by revoking the tax credit, it could lead to additional plant closures, job losses, and economic disruption that would have not otherwise occurred. For some companies, current capital investments that support existing and future jobs depend on the cash flow generated by the credit during 2009. The resulting loss of the forest product industry's renewable energy generation and use would be a blow to the nation's ongoing efforts to support and expand clean-burning, environmentally friendly energy production.

The staff discussion draft picks winners and losers among industries that use liquid biomass as a fuel to generate energy for business use. Other industries that use fish oil, animal fat, and vegetable oil as fuel for furnaces would continue to benefit from the credit under the staff discussion draft. This unfairly discriminates against the forest products industry.

The alternative fuel mixture credit relies on a broadly used definition of biomass. The exclusion of the forest industry's biomass from the definition, as proposed by the staff discussion draft, could have adverse implications in the future. Targeting our energy as a "loophole" when it clearly qualifies under the law, fails to recognize the important advancements in renewable energy our industry has achieved.

Furthermore, the proposed exclusion of "any fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp" is overly broad and creates additional unintended consequences. This overly broad exclusion will essentially eliminate the forest products industry from incentives for any future

development of next generation renewable energy from biomass. Numerous efforts are underway in both the private and public sectors to develop synthetic gas from pulp mill wood residuals and black liquor which can be converted to alternative fuels, and liquid fuels from extraction of hemicelluloses from wood chips prior to pulping. Additionally, sludge from water treatment plants in pulp and paper mills can serve as feedstock for biological conversion to liquid fuels or for gasification to syngas and fuels.

For more than twenty years, the forest products industry has been working with the Department of Energy, numerous universities and commercial technology developers to research and demonstrate new renewable energy technologies. Several of these initiatives are in the demonstration phase and could become commercially available in the next few years. These technology breakthroughs are an important part of our nation's future renewable energy generation and should not be disadvantaged, just as existing technologies should not be singled out for exclusion.

Conclusion

AF&PA opposes early repeal of the forest products industry's renewable energy from the alternative fuel mixture tax credit. The proposed changes undermine clean energy generation and green jobs. Maintaining this tax credit directly translates into saving clean energy jobs. Without it, tens of thousands of these good-paying jobs and the families, businesses and communities they support are at great risk in the worst economy in 70 years. The tax credit also supports clean energy generation at a critical time—a priority of Congress and the Administration that papermakers and their employees support. Our industry should be rewarded and not be penalized for our early efforts to produce and use clean and efficient energy. We look forward to working with Congress so that important support for renewable energy in the forest products industry, and its contribution to our nation's clean energy goals, can continue.

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