Comments to the Senate Finance Committee
on the Alternative Fuel Mixture Tax Credit

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Appleton Papers
Wisconsin

Buckeye Technologies
Tennessee

Finch Paper
New York

Lincoln Paper & Tissue
Maine

Mid-America Packaging
Arkansas

Old Town Fuel & Fiber
Maine

Port Townsend Paper
Washington

Thilmany Papers
Wisconsin

Introduction

We are a coalition of small and medium-sized American pulp and paper manufacturers that directly employ more than 6,500 men and women, support several thousand additional jobs, and serve as the economic anchor in rural communities in nine states coast to coast. Our businesses are part of one of the last great American manufacturing strongholds, employing 1 million Americans, producing $200 billion in sales, and accounting for 6 percent of the U.S. manufacturing GDP.

We believe compelling public policy, energy policy, environmental policy and tax policy considerations support maintaining the Alternative Fuels Mixture Tax Credit (the credit) for biofuels derived from spent pulping liquors through 2009, and extending it for at least three years. We recognize that there are concerns with the structure of current law and support making appropriate modifications to address these concerns.

Our industry leads the world in the production and use of renewable energy. We convert what was once considered wood waste into a major source of clean, renewable energy to help power our mills. The environmental benefits of this commitment are significant. We've eliminated the need for approximately 6.5 billion gallons of fossil fuels annually that would otherwise have been burned to power our mills. Waste streams have been reduced and air quality improved. Our customers have had continued access to environmentally friendly, sustainable products because our mills have continued to produce products from responsibly harvested trees grown in well-managed forests. The alternative is buying lower-cost pulp imported from countries with less stringent forestry restrictions and practices, such as Indonesia, Brazil and China, involving the harvesting of rainforests and requiring millions of gallons of fossil fuel to be burned to ship the products to the U.S.

The economic benefits are just as significant: Our businesses have continued to provide thousands of well-paying manufacturing jobs in rural communities where sustainable and stable employment is elusive. We support not only the jobs of our direct employees, many of whom are represented by the United Steelworkers and other unions, but also those of thousands of independent foresters, harvesters, truckers, contractors, vendors, suppliers and small businesses who serve and depend on our mills for their livelihood. In many communities, we are the largest private-sector employer, an economic mainstay and a major state, local and school taxpayer. For many middle-class Americans in small, rural towns, a job in the local paper mill is a job to be cherished: It provides the wages and benefits with which to build a home, raise a family, send a child to college and plan for a secure retirement.

While the eligibility of black liquor for the Alternative Fuel Mixture Tax Credit has been questioned, the reality is the credit was sound public policy when Congress created it and continues to be so. It has been eminently successful in incentivizing and rewarding environmentally beneficial behavior. By fortunate circumstance of timing, it has also produced enormous economic benefits for the nation, many states, and small, rural communities coast to coast.

We respectfully urge Congress to retain the credit through the end of 2009 and to reform and extend it for at least three additional years. We look forward to working with Congress to help shape a policy that retains the valuable environmental, economic and trade benefits of this credit while controlling its cost to ensure that it remains a true incentive.

We thank you for considering our views.

Application of the Alternative Fuel Mixture Tax Credit to Black Liquor is Sound Economic and Environmental Policy

Like thrifty cooks who put all the leftovers to good use, our companies derive energy by combusting the biomass left over in the pulping liquid known as black or red liquor. Like many in our industry, our mills began using this biofuel years ago because it reduced our costs, helped us ensure the quality of our products, and improved our environmental performance. At the time there was no federal tax incentive to do so; it was simply a good business decision. As an early innovator in the use of biofuels, our industry was doing the right thing environmentally long before there was a tax benefit associated with it.

In 2005, Congress enacted the Safe, Accountable, Flexible, Efficient Transportation Equity Act (SAFETEA, P.L 109-59), providing for a $.50 per gallon tax credit for the use of alternative fuel mixtures. Our companies applied to the Internal Revenue Service for the credit and were deemed eligible. Eligibility came at a particularly fortuitous time: Demand for paper was declining precipitously as the economy had begun to contract; papermakers responded by sharply eliminating expenses, shutting down production and reducing staff. The global recession that soon followed accelerated the freefall in demand, and prices for paper reached historic lows. An unprecedented restructuring has taken place in our industry: Dozens of mills have been closed and hundreds of thousands of tons of production capacity have been permanently removed, bringing capacity closer in line with demand.

Though the macro-economy is now showing some signs of incipient recovery and paper demand and prices are expected soon to show signs of improvement, the proposal for early termination of the credit for paper mills comes at a particularly vulnerable time. During the worst of the downturn, the credit created the economic justification for our pulp mills to continue to operate. Without the credit, many pulp mills would have been closed, their employees laid off and their products replaced with heavily subsidized, economically less expensive (and environmentally more expensive) foreign imports.

Now, to maintain parity with other industries using woody biomass to generate renewable energy, and to temporarily help our industry stabilize as paper demand begins to recover, we appeal to Congress to retain the credit for this biofuel through December 31, 2009, and to extend it — albeit in a modified form and at a lower cost to the Treasury — for at least three years to ensure that a critically important sector of America's manufacturing base, U.S. pulp and paper mills, can compete successfully with their foreign counterparts and domestic competitors for their raw material; can continue to provide sustainable, high-quality employment in rural communities coast to coast; and continue to contribute meaningfully to American energy independence.

While we are fully aware that the eligibility of black liquor for the credit has been criticized, the reality is that the credit is sound environmental and economic policy that is eminently effective but perhaps too expensive in its current form. The paper industry's use of the credit, while costing more than was anticipated, is entirely consistent with what Congress intended and with public policy that encourages the use of green energy and reduces reliance on fossil fuels.

Disqualifying one biofuel or one major American industry from eligibility is unfair and unsound policy. Rather than eliminating the credit for spent pulping liquors, reforming it to reduce its impact on the Treasury while retaining its incentive power is far more helpful to the long-term interests of our country, thousands of small communities, and our industry. Moreover, the credit has also turned out to be sound economic and trade policy. Far from being a "loophole," the credit actually allows our mills to compete more fairly for the purchase of wood. Other uses of wood are similarly subsidized, ranging from cellulosic ethanol produced to meet a Congressionally-mandated Renewable Fuel Standard, wood pellets subsidized by the EU to meet Kyoto standards, or wood-based power that can access federal and state renewable portfolio standards.

The State of Our Industry: Battered and Smaller but Recovering — And Worthy of Congressional Support

Nationwide, the industry is in deep economic distress brought on by a combination of the dramatic deterioration of the global economy and intense foreign competition. Since 2006, the industry has lost nearly a quarter of a million jobs, or 19% of its total workforce, from a high of nearly 1,300,000 jobs in mid-2006 to less than 1 million jobs at the end of 2008. By way of comparison, during the 2001 recession, demand dropped by approximately 6%, now in 2009 the domestic demand for paper products has plummeted 18% (for the first five months ending in May 2009).

U.S. papermakers are confronting fierce competition from foreign papermakers exporting low-priced commodity grades of paper in the United States. These are often made with lower forestry, environmental, and workplace standards than those with which U.S. mills must comply.

As a result, paper prices have dropped in some cases to 20- and 30-year lows. A recent report by an international consulting and business intelligence firm estimates that, but for the credit, 15 mills in eight states, employing 8,400 men and women and representing 42,000 total jobs, would be forced to close. The same report estimates that all 15 mills spread across eight states would regain economic viability by a return of half of the diminished demand and a 5% improvement in prices.

Consider the effects on one state that is reliant on the industry, Maine. In the mid-1990s, the paper industry in Maine employed nearly 18,000 men and women. Today, with mill closures across the state from Baileyville to Jay, total employment is at 7,000.

The following statistics are compelling:

- Despite its decline, papermaking in Maine still represents nearly 20% of the total manufacturing wages in the state. These wages are twice Maine's average per capita income.

- As the second largest producer of paper in the U.S., the Maine paper industry contributes $1.5 billion to the state's GDP. For each direct job there is a 5-7 times job multiplier. It is the "backbone" of the state's economy.

- Paper mills represent 60-80% of the tax base in their host towns.

- Preserving these remaining papermaking jobs is vital to the economic health of the entire state.

The declines in demand and price are expected to level off as the economy strengthens. For the foreseeable future, however, U.S. paper manufacturers will still face the daily challenge of competing with foreign manufacturers whose mills operate with, in many cases, significant government subsidies and far less stringent environmental and labor standards.

Early termination of the eligibility of black liquor for the credit would punish a critical U.S. industry in the early stages of a fragile recovery on which thousands of jobs and communities depend for engaging in a behavior that is good for the environment and that advanced Congress' interest in encouraging the use of biofuels. Early termination of the credit will mean closure of numerous pulp mills because the manufacture of pulp utilizing wood prices inflated by new market entrants — such as the pellet industry — will not be economically competitive with importation of foreign pulp from Brazil, Indonesia, and other countries. Retaining and temporarily extending the credit will allow the industry to regain its competitive balance, protect jobs, and continue contributing to the national reduction in reliance on fossil fuels.

Not a Loophole — Misconceptions About the Paper Industry's Eligibility for the Credit

The proposal for early termination of the credit for black liquor appears to be motivated, at least in part, by misconceptions about the paper industry's use and eligibility for it.

One of the most common misconceptions is that the paper industry somehow exploited a "loophole" to obtain tax credits for an old technology that is unlike what Congress intended to support and unlike the other (intended) beneficiaries of the program. In fact, the technologies and fuel used by paper mills follow the requirements that are spelled out in the law. The use of black liquor to create energy is no different than a seafood processing facility burning fish oil to heat its plant, or a waste grease collector burning waste in an engine to create power. Like black liquor, these liquid fuels are used to create energy. There is no distinction in the Internal Revenue Code between "new" and "old" users. It would be unfair and unfortunate public policy to exclude one eligible, vital American industry or one type of liquid fuel from eligibility only because it was more widely used than Congress anticipated and that its claims were more costly than projected.

Another misconception is that the credit was meant only to apply to fuels in passenger vehicles, motorboats or airplanes. On the contrary, the Code and the legislative history reveal a conscious effort by Congress to provide tax credits for the use of alternative fuel mixtures in static, heating and steam generation modes. The original Senate Amendment to the initial bill stated unequivocally that: "The mixture must be sold by the taxpayer for use as a fuel in a highway vehicle or used by the taxpayer as a fuel in a highway vehicle." However, the subsequent Conference Report stated that: "The mixture must be sold by the taxpayer producing such mixture to any person for use as a fuel or used by the taxpayer for use as a fuel." The reference to "highway vehicle" was removed. Indeed, the Conference Report made clear that the mixture credit applied to any use as a fuel when it gave the following example: "For example, the taxpayer produces fish oil in its trade or business. The taxpayer uses this fish oil to make a blend of 50 percent fish oil and 50 percent diesel fuel to run in a generator that is part of the taxpayer's trade or business. The use of the fish oil-diesel blend made by the taxpayer qualifies as a use in the blender's trade or business."

The Internal Revenue Service reinforced the non-transportation use of the credit when issuing guidance in 2006, stating that: "A mixture is used as a fuel when it is consumed in the production of energy. Thus, for example, a mixture is used as a fuel when it is consumed in an internal combustion engine to power a vehicle or in a furnace to produce heat." Clearly, Congress intended non-highway use to qualify or it would have accepted the Senate Amendment version and not the (enacted) Conference Report version of the credit.

A third misconception is that use of the credit somehow circumvents the spirit of the statute to promote a new or changed behavior, not simply reward existing activities. Again, the legislative history is instructive. Clearly, there is no basis to support any distinction between "new" and "existing" use of liquid fuels derived from biomass. There is nothing in the legislative record to suggest that Congress intended the credit to be limited to "new" biofuel uses. The statute simply grants a credit to a taxpayer who creates the mixture and uses it in its trade or business. Congress knows well how to limit credits to new uses or new facilities. Indeed, energy tax laws are replete with examples of subsidies and incentives available only to facilities "placed in service" after date of enactment. In this instance, Congress elected not to make such distinction, and for good reason.

A fourth misconception is that the biofuel tax credit eligibility of mills that manufacture paper from trees (referred to as virgin pulp mills) has somehow adversely affected mills that manufacture paper from recycled fiber/feedstock. However, an examination of the industry, and recent economic performance indicators, clearly shows that there is no evidence of damage to recycled paper companies at the hands of the virgin pulp producers. To the contrary, in many cases, products from the two types of manufacturing facilities do not even compete head to head in the market place.

The majority of recycled paper products made in the United States fall into two product categories — newsprint, and packaging board. As for newsprint, the facts are clear: virgin product is not made with fiber from a kraft or sulfite pulp mill (i.e. a mill that produces black or red liquor as part of its industrial process). Thus, any swings between the prices of virgin and recycled newsprint in the market should properly be attributed to some dynamic other than the availability of the Alternative Fuel Mixture Tax Credit to kraft and sulfite paper mills that do not produce newsprint.

Packaging board, the other type of product that could be manufactured from recycled content, includes boxboard and containerboard. Here the statistics suggest that virgin producers have reduced production by twice the amount of recycled mills (since the start of 2009, recycled boxboard production is down by 6% compared to a drop of 12% for virgin boxboard). Similarly, with regard to containerboard, industry statistics show that both virgin and recycled products have seen a 14% drop in production. Thus, there is no evidence through the first five months of 2009 that the credit has somehow tilted the playing field and caused a swing from recycled to virgin feedstock. While recycled paper products producers do not create biofuels as part of their industrial process, it is important to remember that they have long benefited from federal, state and local government initiatives that mandated wastepaper collections and recycled-paper purchasing programs. Far from adversely affected by government subsidies, for much of recent history these companies have often been the beneficiaries of layered government support that resulted in lower-cost fiber and higher prices than achieved by virgin mills.

Finally, there is the assertion that the credit has caused mills to combust significantly more liquid fossil fuels than otherwise necessary in order to qualify. To the contrary, the credit has not resulted in a significant net increase of fossil fuel combustion. The addition of 0.1% fossil fuel should not lead to any increase of fossil fuel use on a net basis. This is because the Btu value of the fossil fuel that is being added to make the mixture improves the fuel value of the mixture and allows the creation of more energy. This helps reduce the amount of fossil fuel that is burned in other energy generators at paper mills and also in the so-called "flame stabilization" burners in black liquor boilers.

Preliminary information from some of the mills in our coalition shows that, in some instances over some periods, the mills have used slightly less fossil fuel than they might have in the absence of the credit and the mixture requirement. In other cases, the plants have used slightly more, but in no case can we document a circumstance in which the facilities have increased their consumption of fossil fuels by more than one tenth of one percent. In any event, since black liquor is a viable biofuel on its own, we support modification of the current law in future years to eliminate the requirement that taxpayers constantly mix a minimum amount of diesel fuel into the biofuel in order to be eligible for the credit.

In the final analysis, keeping U.S. pulp mills operating not only protects thousands of U.S. jobs, it likely results in significantly lower overall consumption of fossil fuels. When an American paper company decides to shut down its pulp mill, the following happens: The remaining paper mills jobs are immediately rendered more vulnerable unless the company can find a reliable, cost-competitive pulp producer that is capable of furnishing pulp of the precise quality specifications necessary to produce the company's paper product. The biofuel once produced in the company's now-shuttered pulp mill is no longer available and the paper company will likely have to shift to fossil fuels to generate power for its mill. If the company is successful in identifying a replacement pulp producer, the likelihood is that producer is a foreign company that can afford to produce and sell pulp at a lower cost mainly because it is not obligated to meet higher environmental and labor standards. The shipment of the foreign producer's pulp to the United States will necessitate the burning of millions of gallons of fossil fuel. Therefore, extending the credit for three years will help ensure less fossil fuel consumption, not more.

Disqualifying One Biofuel is Flawed Energy Policy That Threatens to Undermine the Paper Industry

The pulp and paper industry is a major purchaser of forest biomass that it turns into wood-based pulp for the ultimate manufacture of paper. It competes for this raw material with other industries that already are the beneficiaries of significant federal, state and foreign incentives. Eliminating the credit for black liquor will further distort the market for wood as a raw material by giving unfair advantage to industries that use the same wood for non-paper purposes.

Consider Congressional support for cellulosic ethanol. Recent changes to the federal Renewable Fuels Standard require cellulosic ethanol to supply 16 of the 36 billion gallons of alternative fuels by 2022. To meet these goals, both Congress and the Administration have adopted aggressive incentives including a per-gallon subsidy ($1.01 per gallon) that is twice the level of the credit for black liquor; accelerated depreciation; loan guarantees; and the full support of the Department of Energy, the Department of Agriculture and other federal agencies seeking to implement President Obama's Directive of May 5, 2009, to "develop a comprehensive approach to accelerating the investment in and production of American biofuels and reducing our dependence on fossil fuels" and allocating $786 million in stimulus money to expand commercialization and provide funding to biorefineries. Few of these programs are available to existing paper mills, which have been "biorefining" since the 1930s.

Other examples of support for biomass abound. The EU's implementation of Kyoto has created a strong overseas market for U.S. producers of pellets. These pellets, made from the same wood that could be used to support mill jobs in the United States, are being exported to Europe where the producers are paid a premium for creating sustainable fuel to satisfy a myriad of subsidies including Kyoto mandates, feed-in tariffs, and renewable energy obligations.

The broader economic benefits of producing pellets here in the U.S. pale when compared to those obtained by using that same ton of wood to produce paper. Recently, the State of Maine convened a task force on the future of the pellet industry. The Task Force correctly observed that "[p]ellet jobs do not compare to pulp and paper mill jobs" and noted that a million-ton pulp mill sustains 600 employees compared with only 25 jobs for a typical 200,000-ton pellet facility.

The Maine Pulp and Paper Association reached a similar conclusion in its study. Assuming that all of the wood used in Maine's pulp mills was used for wood pellet manufacturing, and using the current number of workers employed per ton of pellets produced, MPPA concluded that the existing workforce of 8,000 paper manufacturers and payroll of approximately $500 million would be replaced with 1,250 jobs with a collective payroll of $42.5 million. The same holds true for any other renewable energy industry that utilizes woody biomass feedstock which, as the table below demonstrates, receive federal and state incentives equal to the credit for black liquor. If Congress removes entirely the credit for black liquor, it will unfairly reward one industry at the expense of the other.

Table 1

Fuel	Incentives in Original Units	BTU's per Unit	$ per Million BTU's
Cellulosic Ethanol	$1.01 per gallon	76,000 BTU's per gallon	$13.29
Open-Loop Biomass*	$0.03 per kWh	3,412 BTU's per kWh	$8.79
Black Liquor	$0.50 per gallon	57,000 BTU's per gallon	$8.77

**Assumes existing PTC of $0.01 per kWh plus a state renewable energy credit in certain markets of $0.02 per kWh.*

A just-released study from the Environmental and Energy Study Institute (EESI) also stressed the importance of maintaining policy neutrality as to energy sources and supporting alternative fuels like black liquor. EESI, founded by a bipartisan Congressional caucus, concluded in a report issued July 6 that biomass is a "renewable, low-carbon feedstock that can substitute for fossil fuels in the production of energy and other products — a potentially important tool in the national strategy to reduce greenhouse gas emissions and resist global climate change." To achieve this goal, EESI published a series of recommendations including, importantly, a "level playing field" of incentives across all users of biomass. EESI reported that "many stakeholders stress[ed] the importance of providing a level playing field for all uses of woody biomass that achieve intended goals — electric power, heat, and biobased products, as well as liquid fuels" (emphasis added). The EESI study, "Sustainable Forest Biomass: Promoting Renewable Energy and Forest Stewardship," was the result of a non-partisan collaboration involving state and private foresters, conservationists, forest scientists, representatives of the private sector, and many federal and state agencies.

After studying the effect of disparate energy tax policies on a limited yet renewable resource, and in consultation with a broad group of stakeholders, EESI concluded that:

> "Federal energy policy (both existing and proposed) contains a wide array of renewable energy incentives, most of which apply to energy from woody biomass. Not infrequently, however, these incentives draw distinctions between bioenergy and other renewable and among specific biomass feedstocks, production practices, and end uses (transportation fuels, electricity, and thermal energy). If renewable energy incentives do not include equitable treatment for all forms of renewable energy, market forces are unable to act on the full spectrum of possible solutions. *Technology-neutral policies best ensure that government incentives achieve the greatest overall emissions reductions in the most efficient and cost-effective manner."* (emphasis in original)

Without judging whether any one incentive is preferable over another, EESI correctly "recommend[ed] the broadest possible inclusion of feedstocks, technologies, and end uses, so that sustainable biomass resources can be used efficiently and flexibly as possible to help meet the requirements."

Conclusion and Recommendation: Continue to Treat Black Liquor as Eligible Alternative Fuel But Control the Cost of the Credit

While black liquor should continue to be treated as an alternative fuel eligible for the tax credit, Congress should amend the credit program to address several legitimate public policy concerns that have been raised.

For example, the requirement that taxpayers blend diesel fuel to the biofuel in order to qualify for alternative fuel credits should be eliminated. In the case of spent pulping liquors, the need for additional fossil fuel is largely limited to startup of the boilers, and sporadic flame stabilization (to ensure that the boiler operates consistently). If the credit rules were modified to allow eligible recipients to limit their fossil fuel consumption to startup and flame stabilization purposes, we believe that this would eliminate the concern regarding federal subsidization of new fossil fuel consumption.

Similarly, we recognize the concern with the cost of the credit to the Treasury. Notwithstanding the meritorious underlying activity that is being rewarded with tax credits, the net impact on the Treasury of the pulp and paper industry's credit claims is growing out of proportion to the impact of the other industries utilizing the credit. The credit should be retained and its cost controlled with any of several mechanisms including, for example, imposing a per-company or per-facility cap on the amount of the credit that can be claimed. It is also possible to gradually reduce the credit over a two- to three-year period while transitioning to a new incentive that is consistent with current Administration and Congressional policy to rapidly decrease reliance on foreign oil. Alternatively, Congress could create a credit for which our industry is eligible, such as the incentive for capital investment in green energy and manufacturing technology, or enhance the existing IRC section 45 open-loop biomass tax credit.

Consistent with the Senate Finance Committee's demonstrated support for energy policy neutrality, our companies believe as a general rule that all industries providing similar energy-related public benefits should be treated equally. This standard of parity should apply whether these benefits are contained in non-tax renewable energy standards or in renewable electricity and biofuel tax credits.

Given all of the above, our coalition of companies respectfully urge Congress to reform and extend the Alternative Fuel Mixture Tax Credit rules to allow continued participation by U.S. paper and pulp companies. Extension of these companies' eligibility for bioenergy produced from spent pulping fuels will keep companies out of bankruptcy; maintain employees' high-wage union jobs; sustain entire rural communities; continue important environmental benefits, and contribute to America's growing energy independence.

As the tax-writing committees move to debate this important issue it is our sincere hope that we can continue to serve as an information resource. Members and staff with an interest in learning more about this topic are encouraged to contact Mark L. Behan of Behan Communications Inc. at mark.behan@behancom.com or at (518) 792-3856, or any of the following members of our coalition:

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