As U.S. gov't cuts back on biofuel, some rue 'collateral damage'

By Cezary Podkul

NEW YORK, Dec 11 (Reuters) - Ben Wootton was just getting ready to bring his company out of bankruptcy last month when word from Washington stopped him in his tracks.

Instead of an expected pick-up in sales for the biofuel-based diesel that he makes from recycled cooking oil at a suburban Harrisburg, Pennsylvania, plant, demand is likely to drop due to a proposed freeze on U.S. consumption mandates.

"I won't be alive, for sure," said Wootton, who runs the 1.5 million gallon per year Keystone Biofuels plant.

Wootton and others like him are venting their frustrations at the U.S. Environmental Protection Agency, which they say is penalizing makers of so-called advanced biofuels like biodiesel in rules proposed last month that are primarily directed at curbing consumption quotas for ethanol in 2014.

The disappointment highlights the difficult task ahead of the EPA - and President Obama - as they try to enforce a troubled 2007 law aimed at reducing U.S. dependence on foreign oil. Predicting that gasoline demand would continue to rise, Congress mandated increasing amounts of ethanol and other biofuels to be blended into U.S. fuel production. The goal was to cut oil imports and reduce carbon emissions - all while building a home-grown biofuel industry and creating jobs.

But with gasoline demand falling, the law's bespoke goals have made it impossible to please everyone, leaving makers of advanced biofuels like biodiesel particularly vulnerable.

Advanced biofuels have not been around as long as traditional corn ethanol and require investment in new plants, technologies and processes to bring them to market.

With the EPA proposing to cut 2014 advanced biofuel blending mandates to about 2.2 billion gallons from 2.75 billion this year, those investments look a lot less certain. One type of advanced biofuel - biodiesel made by producers like Wootton - would stay frozen at 1.28 billion gallons through 2015.

So while corn ethanol proponents have lashed out at President Obama and the EPA for backing down on ambitious 2014 targets, frustrations may run deepest among those in the advanced sector like Wootton, who took out loans and burned through savings to invest in the space.

"We're the collateral damage," said Michael McAdams, president of the Advanced Biofuels Association, which represents 44 companies active in the sector.

Already, some larger companies are putting the brakes on investment in the space.

"For Abengoa, any additional investment in the U.S. biofuel space is on hold until we see where the final EPA rule comes out," said Javier Garoz, chief executive of Abengoa Bioenergy. The company had just spent $500 million to develop a new plant in Kansas that would make advanced ethanol from non-food sources when it learned of the cut.

MARKETPLACE REALITIES

Advanced biofuel manufacturers feel frustrated as they say the mandate changes proposed for their sector are harsher than changes put forward for corn ethanol.

They argue that because advanced biofuels are less carbon intensive than traditional corn ethanol, they can do more to further the EPA's goal of reducing emissions from petroleum-based fuels - and therefore should be mandated at higher levels.

Christopher Grundler, the top EPA official at a hearing on the proposal last week, told Reuters that the agency has been dealt a difficult hand in administering the law.

"I think just about everyone will stipulate that what Congress imagined, and the pace Congress imagined in 2007, is not feasible today," Grundler said.

"What we tried to do in the proposal is find the right balance between the goals of the law to grow these renewable fuels while at the same time recognizing the realities that we see today in the marketplace."

Those realities include a 10 percent "saturation point" beyond which it is hard for the U.S. market to blend more ethanol into gasoline, Grundler said. Thanks to falling demand, the market reached that point earlier than expected, he said.

To fix the problem, the EPA came up with a new process for setting the mandates, which involves scaling them to fit supply and demand dynamics of the market, starting with ethanol.

That allowed the agency to reduce corn ethanol down to about 13 billion gallons for 2014, just under 10 percent of gasoline supply, versus 14.4 billion envisioned under the 2007 law.

CAN'T PAY THE BANK

Wootton, the Pennsylvania-based producer, had declared bankruptcy in March under a $12 million debt load, but recently found an investor willing to get his business running again.

Wootton had just signed the agreement in early October, when word leaked out that the EPA was looking to keep biodiesel frozen at 1.28 billion gallons a year.

Now, even he admits he wouldn't invest in the business.

"If this thing holds out and they keep it at 1.28, I wouldn't invest," Wootton said. At the EPA hearing last week, he waited 14 hours to get his chance to ask the agency to set the mandate higher when it finalizes the rules next year.

The National Biodiesel Board (NBB), which represents the industry, forecasts that producers are on pace to make 1.7 billion gallons of the fuel in 2013 - and that keeping the mandate frozen could in effect cut demand in half.

The drop in demand could cost some 8,000 jobs, according to an estimate commissioned by the group.

"We've built our industry on the promise of solid policy that we've had for five years and we don't know why the Obama Administration is backtracking on it," Anne Steckel, NBB's vice president of federal affairs, told Reuters last week.

Grundler, the top EPA official at the hearing, said the 1.28 billion gallon proposal is just a minimum, and actual consumption could be higher. But that's little consolation for plant owners like Stu Lamb of Viesel Fuel, a Florida-based producer that in July had just opened a new plant that will produce about 5 million gallons of biodiesel a year.

Lamb took out a $5 million loan to finance the project and hire 45 workers. He said he may now struggle to repay.

"I feel betrayed," he said.