



Energy Resources UPDATE

Spotlight on Biodiesel

The biodiesel industry is on a course of steady growth. The Environmental Protection Agency (EPA) reported that U.S. biodiesel production hit a record 1.1 billion gallons in 2011, up from the previous high of 690 million gallons in 2008. Biofuels, such as bioethanol and biodiesel, are clean-burning fuels that are used as alternatives to, or blended with, traditional petroleum-based fuels. This article will cover some of the primary factors driving growth in the biodiesel industry.

The EPA's Renewable Fuel Standard (RFS2), which was expanded in 2007, has been one of the catalysts for growth. On July 1, 2010, RFS2's biomass-based diesel requirement became effective, requiring for the first time that a certain percentage of the diesel fuel consumed in the United States be made from renewable sources, with a target of 800 million gallons for 2011. The industry exceeded that requirement with 1.1 billion gallons for the year. This excess supply may have also been influenced by the expiration of the blenders' tax credit on Dec. 31, 2011. Under RFS2, up to 20 percent of a company's 2012 obligation can be met through 2011 renewable identification numbers (RINs) (discussed later); therefore, it is likely that companies were trying to take advantage of the credit prior to its expiration. Though RFS2 is thought to create a stable demand for biodiesel for the foreseeable future, the 2011 overproduction may reduce demand in 2012.

The cooperation of automotive manufacturers is critical to the success of the biodiesel industry. While biodiesel can be used in its pure form for fuel, it is typically blended with or used as an additive to petroleum based diesel fuel. According to the National Biodiesel Board (NBB), a nonprofit trade association, biodiesel blends can generally be used in conventional diesel engines with no modifications to the engine. The NBB cites Ford, General Motors, Volkswagen, Volvo and Mack Trucks as a few of the many companies to have approved biodiesel blends

for use in their engines ranging from 5 percent biodiesel blends (B5), to 20 percent biodiesel blends (B20).

Pricing Challenges

Many factors influence demand for biodiesel. Pricing is, of course, the No. 1 factor. The biodiesel industry has historically relied on various federal and state tax incentives to bring the price of biodiesel down to a level competitive with petroleum-based diesel. Of these incentives, the one with the greatest impact was the federal blenders' tax credit. The credit provided a \$1 per gallon excise tax credit for the first party to blend pure biodiesel (B100) with petroleum-based diesel. The blenders' tax credit first became effective on Jan. 1, 2005, before expiring Jan. 1, 2010, and subsequently reinstated for 2010 on Dec. 17, 2010. The credit expired again on Dec. 31, 2011. Biodiesel production for 2010 was a paltry 315 million gallons in part due to the lapse of the blenders' tax credit and the uncertainty as to its renewal. The effect on the industry was profound with companies closing plants or filing for bankruptcy. It is uncertain whether the blenders' tax credit will be reinstated for 2012. The current political and fiscal climate adds to such uncertainty. While there is a recognized need to promote renewable fuels, such incentives may be sacrificed as part of any deficit reduction package.

As demand is highly correlated to the price of biodiesel compared to petroleum-based diesel, a rise in worldwide oil prices increases the competitiveness of biodiesel. Biodiesel pricing is also highly impacted by the cost of its feedstock. Historically, the feedstock of choice was soybean oil; however, soybean oil commodity prices have fluctuated greatly over the last several years with such prices hovering at or near their highest levels since 2007. Producers have been migrating to lower cost feedstock such as inedible corn oil, used cooking oil and inedible animal fats.

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Biodiesel production capacity will also play an important factor in pricing in the coming years as more plants come online and production exceeds current RFS2 standards, potentially putting downward pressure on pricing if production exceeds demand. The EPA created a renewable identification number (RIN) system to track renewable fuel production and compliance with RFS2. RINs are generated when each gallon of biodiesel is produced and is typically attached to the fuel when sold. For each gallon of pure biodiesel produced, 1.5 RINs are generated. RINs, however, can be detached from the produced biodiesel and traded as a separate commodity. RINs are used to demonstrate compliance with RFS2 and can be obtained by producing renewable fuels, buying fuel with the RINs attached or buying RINs that have been separated from the underlying fuel produced. Once used for a compliance period, RINs are retired. RINs therefore have a substantial value in and of themselves and can often represent a significant portion of the price of a gallon of biodiesel.

The biodiesel industry has experienced rapid growth in the last few years and, though uncertainty looms large in the near future, continued scientific breakthroughs and technological improvements make it an exciting industry to follow.

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