UPDATE ON BIODIESEL LEGISLATION

By Bryan Keane

This update discusses three main topics. First, it provides a general overview of biodiesel fuel. Second, it summarizes and analyzes Minnesota's recently enacted biodiesel fuel mandate. Third, it discusses general developments in federal law relating to biodiesel fuel that may impact the Minnesota mandate or simply affect the commercialization of biodiesel fuel.

I. What is Biodiesel Fuel?

As is evident from recent state and federal statutory developments concerning biodiesel fuel (discussed below), the production and commercial use of biodiesel fuel is certainly a developing industry.

“Biodiesel (fatty acid alkyl esters) is a cleaner-burning diesel replacement fuel made from natural, renewable sources such as new and used vegetable oils and animal fats.” (Alternative Fuels Data Center (AFDC) website). Biodiesel fuel alone, or combined with petroleum diesel fuel, can be used in combustion-ignition engines. Currently, blends of up to twenty percent biodiesel with eighty percent diesel fuel can be used in most diesel equipment. “These low level blends (twenty percent and less of biodiesel) don’t require any engine modification and can provide the same pay load capacity and range as diesel.” (AFDC website). At a minimum of two percent biodiesel, the lubricity benefits of biodiesel are still achieved. Pure biodiesel fuel, however, is already compatible with “many” engines manufactured since 1994 with only minor alterations. (AFDC website).

The use of biodiesel has several advantages. First, this fuel is a cleaner burning fuel than petroleum diesel fuel. Second, biodiesel is made from natural and renewable sources, such as vegetable oils, the most prominent of which is soy oil, and animal fats. In fact, “the soy industry has been the driving force behind biodiesel commercialization because of excess production capacity, product surpluses, and declining prices.” (AFDC website). One source estimates “a potential demand for over 300 million bushels of soybeans for domestic biodiesel production by the year 2016.” (Agricultural Marketing Resource Center (AgMRC) website).

Soybean oil, while currently the driving force behind biodiesel commercialization, is not the only source utilized in the production process. Importantly, “fats and greases cost less and produce less expensive biodiesel, sometimes as low as $1.00 per gallon,” as compared to soy biodiesel, in which the “feedstock costs alone ... are at least $1.50 per gallon of soy biodiesel.” (AFDC website). However, “unlike soybean oil, animal fats and waste greases do not have a large supply carryover from which to draw.” John B. Campbell, New Markets for Bio-Based Energy and Industrial Feedstocks: Biodiesel - Will there be Enough?, speech at the Agricultural Outlook Forum 2000 (February 25, 2000).

Recent state and federal statutory developments provide significant opportunities for increased biodiesel production that will undoubtedly impact soybean consumption, as well as other vegetable oil and animal fat consumption.

For more general information on biodiesel, consult the following sources:

Alternative Fuels Data Center:
http://www.afdc.doc.gov/altfuel/bio_general.html

Agricultural Marketing Resource Center:
http://www.agmrc.org/soy/soy.html

Official Site of the National Biodiesel Board:
http://www.biodiesel.org

Regional Biomass Energy Program:
http://www.ott.doe.gov/rbep
II. Minnesota’s Biodiesel Fuel Mandate

The Minnesota legislature recently enacted session law S.F. 1495. 2002 Minn. Laws 1495 (to be codified at Minn. Stat. §§ 239.77, 239.771 (2002)). It became law on March 15, 2002, without the governor’s signature. In short, section 239.77 of this statute requires the use of a certain percentage of biodiesel fuel in diesel engines after a certain date. Section 239.771 enacts a reimbursement schedule for distributors in the event the mandate is repealed within eight years of its effective date. The following is a summary of this legislation:

Definition of “biodiesel fuel”: The statute defines biodiesel fuel as “a renewable, biodegradable, mono alkyl ester combustible liquid fuel derived from agricultural plant oils or animal fats and that meets American Society for Testing and Materials Specification D6751-02 for Biodiesel Fuel (B100) Blend Stock for Distillate Fuels.” § 239.77(1).

Minimum Content (§ 239.77(2)(a)): Section 2(a) of the biodiesel fuel mandate contains the substantive content of the statute. It provides that all diesel fuel “sold or offered for sale” in the State of Minnesota for use in internal combustion engines must contain at least two percent of biodiesel fuel by volume.

Effective Date (§ 239.77(2)(b)): This statute is not effective until the conditions in subsection (b) are met. There are two combinations of conditions that can trigger the implementation of this statute.

First, the conditions in clauses (1) and (3) can be met. Clause (1) is fulfilled thirty days or more after the commissioner of agriculture publishes notice in the State Register that the capacity in Minnesota for biodiesel fuel production has surpassed eight million gallons per year. Clause (3) requires that the date of June 30, 2005, has passed. Therefore, under the first possibility, the earliest this statute can become effective is June 30, 2005.

Second, the conditions in clauses (1) and (2) can be met. Again, clause (1) requires publication of notice in the State Register that annual capacity for production in Minnesota has exceeded eight million gallons. Clause (2) ties in federal action on biodiesel fuel. It is fulfilled eighteen months after the commissioner of agriculture publishes in the Register that “a federal action on taxes imposed, tax credits, or otherwise” results in a two cent or more per gallon reduction in price for fuel sold in Minnesota that contains “at least two percent biodiesel fuel oil.” Therefore, the earliest this statute can become effective under this combination of conditions is eighteen months from the commissioner’s publication in the Register of the two cent reduction in price.

Exceptions (§ 239.77(3)): The biodiesel fuel mandate does not apply to all uses of diesel fuel in internal combustion engines. Subsection (3) exempts three primary uses.

First, the mandate exempts “motors located at an electric generating plant regulated by the Nuclear Regulatory Commission.” This exemption, however, lapses thirty days after the Nuclear Regulatory Commission approves the use of biodiesel fuel for its motors.

Second, the mandate exempts railroad locomotives.

Third, the mandate exempts off-road taconite and copper mining equipment and machinery.

Distributor Expense Reimbursement (Section 2, § 239.771): In the event that the legislature repeals the biodiesel fuel mandate within eight years of its effective date (not the enactment date), section 239.771 provides for partial reimbursement for those distributors (blenders) that “updated” their equipment to comply with this statute.

First, to be eligible, a distributor must have made “capital expenditures necessary to adapt or add equipment to blend biodiesel fuel oil” with diesel fuel. Section 2(b) warns distributors that the commissioner can only reimburse if there is “detailed proof of expenditures made solely to comply with the mandate.”
Second, after the distributor establishes detailed proof, the commissioner shall reimburse up to eighty percent of the distributor’s expenditures if the mandate is repealed within two years of its effective date. While the statute mandates some reimbursement, it appears that the exact amount of reimbursement is left to the discretion of the commissioner, subject to the condition that the reimbursement not exceed eighty percent. The highest possible reimbursement, or in the words of the statute, the “amount eligible to be reimbursed,” decreases by ten percent each year after two years from the effective date (year three, seventy percent; year four, sixty percent; year five, fifty percent; year six, forty percent; year seven, thirty percent; year eight, twenty percent). Following eight years from the effective date, the mandate no longer protects the distributors in case of repeal.

If you would like to review the Minnesota biodiesel statute, please refer to the following link:
http://www.revisor.leg.state.mn.us/slaws/2002/c224.html

III. Developments in Federal Law Relating to Biodiesel Fuel

Energy Policy Act of 2002

The Senate inserted into its Energy Policy Act of 2002 several provisions that will, if enacted, dramatically impact the current status of biodiesel fuel. The House of Representatives, however, did not insert the biodiesel language into its bill that passed the House (H.R. 4). As of this date, House and Senate conferees are in conference committee determining how to reconcile the different bills. The following provisions, therefore, may or may not be included in the final bill to be passed by Congress:

Reduction of Motor fuel Excise Taxes: The Senate bill amends the Internal Revenue Code, 26 U.S.C. §§ 4041, 4081, to reduce excise taxes on blenders of biodiesel V fuel mixtures. Biodiesel V includes fuel derived solely from virgin vegetable oils for use in diesel engines, including derivatives of soybeans, mustard seeds, etc. The bill states: “In the case of the removal or entry of a qualified biodiesel mixture (as defined in an amendment to section 40B below) with biodiesel V, the rate of tax [as set forth in section 4081(a)] shall be the otherwise applicable rate reduced by the biodiesel mixture rate (if any) applicable to this mixture (as defined below).” Pursuant to the amended section 40B of the I.R.C., the biodiesel mixture rate of a mixture with only biodiesel V is “1 cent for each whole percentage point (not exceeding 20 percentage points) of biodiesel V in such mixture.” For example, if the mixture is composed of two percent biodiesel, then the mixture rate is two cents. Therefore, the rate of the excise tax on blenders for the two percent mixture would be reduced by two cents under this bill.

Credit for Biodiesel Used as a Fuel: The Senate version of the 2002 energy bill also amends the Internal Revenue Code, 26 U.S.C. § 40, by adding section 40B, which provides a tax credit for biodiesel blenders. This section grants to blenders fuel credits for using a qualified biodiesel mixture. This section defines a qualified biodiesel mixture as a “mixture of diesel and biodiesel V or biodiesel NV which (i) is sold by the taxpayer producing such mixture to any person for use as a fuel, or (ii) is used as a fuel by the taxpayer producing such mixture.” The taxpayer, to be eligible to receive the credit, must certify with the producer of the biodiesel V that the fuel is in fact biodiesel V. According to the Biodiesel Bulletin of May 1, 2002 (A Monthly Newsletter of the National Biodiesel Board), this section offers a half cent per percent up to twenty percent tax credit for biodiesel made from recycled oils and animal fats. This provision provides an incentive to produce and use biodiesel fuel.

The excise tax reduction and fuel credit are extremely important to the implementation of Minnesota’s biodiesel fuel mandate. The effective date of the law potentially depends, in part, upon federal action resulting in a price reduction of biodiesel fuel. §239.77(2)(b)(2). The first element in determining the effective date requires publication of notice in the State Register that annual capacity for production in Minnesota has exceeded eight million gallons.
§239.77(2)(b)(1). However, clause (2), which ties in federal action on biodiesel fuel, must also be fulfilled. It is fulfilled eighteen months after the commissioner of agriculture publishes in the Register that “a federal action on taxes imposed, tax credits, or otherwise” results in a two cent or more per gallon reduction in price for fuel sold in Minnesota that contains “at least two percent biodiesel fuel oil.”

The current Senate bill would potentially satisfy the requirements set forth under clause (2) if the blender passes the savings on to the consumer. The Minnesota statute requires a two cent or more reduction for biodiesel fuel containing “at least two percent biodiesel fuel oil.” Under the federal plan, the excise tax alone, without even considering the fuel credit, potentially would satisfy this requirement. The excise tax would be reduced by a cent per each percent of biodiesel fuel in the mixture. A two percent reduction, therefore, would reduce excise taxes by two cents, thereby fulfilling the state requirement. This federal action, if enacted, would potentially speed up the process of implementing the biodiesel fuel mandate in Minnesota. However, the effective date still would depend upon how quickly biodiesel production in Minnesota reaches eight million gallons per year.

**Biodiesel Fuel Use Credit Expansion:** Another section of the Senate’s energy bill provides for a biodiesel credit expansion for federal fleet vehicles. Under the current law, the use of biodiesel fuel in federal fleet vehicles can only satisfy fifty percent of the alternative fueled vehicle requirements. 42 U.S.C. § 13220(b). This bill would amend that provision so biodiesel use can satisfy “more than 50 percent of the alternative fueled vehicle requirements under this title, title IV, and title V.” Also, it would amend that provision to allow biodiesel fuel use credits “to satisfy 100 percent of the alternative fueled vehicle requirements of a fleet or covered person under title V for one or more of model years 2002 through 2005.”

**Biobased Energy Incentive Act of 2002 (S. 1960):** This proposed bill has been referred to the Senate Committee on Agriculture, Nutrition, and Forestry. If enacted, it would amend the Biomass Research and Development Act of 2000 to provide that biodiesel be included as a biobased energy product, thereby providing an incentive to produce certain commodities. The bill states: “The Secretary shall establish a biobased energy incentive program under which the Secretary shall make payments to eligible producers to promote the use of eligible commodities to produce biobased energy products.” It defines the terms as follows:

**Eligible commodities** are “wheat, corn, grain, sorghum, barley, oats, rice, soybeans, sunflower seeds, rapeseed, canola, safflower, flaxseed, mustard, crambe, sesame seed, cottonseed, and cellulosic commodities (such as hybrid poplars and switch grass).”

**Eligible producer** is a “producer that uses an eligible commodity to produce a biobased energy product and enters into a contract with the Secretary to increase the use of eligible commodities to produce biobased energy products during 1 or more fiscal years.”

Moreover, this bill authorizes the Secretary to institute a program “to encourage wider availability of biobased energy products to consumers of gasoline and diesel fuels.”

If you would like more information on the topics covered in this issue of *Ag-Coop News*, please contact the Agriculture and Cooperatives group chairs:

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