



American Forest & Paper Association

DATE: November 10, 2010

TO: Biomass Task Force

CC: Energy Resource Committee
Forest Resource Sector
Government Affairs Resource Committee
Pulp Producers Sector
Wood Products Sector

FROM: Paul Noe
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RE: **Review of Final BCAP Regulations and Key Issues**

Introduction

This memorandum provides a preliminary review of the final regulations for the Biomass Crop Assistance Program issued by the United States Department of Agriculture (USDA) and compares the final regulations with the proposed regulations and AF&PA's main advocacy points. This memorandum is not, and should not be construed as, legal advice on the interpretation of the final regulations. Members should consult with counsel for any definitive legal interpretations of the final regulations.

On October 27, 2010, USDA's Commodity Credit Corporation (CCC) and Farm Service Agency (FSA) issued the final regulations for the Biomass Crop Assistance Program (BCAP). See 75 Federal Register (FR) 66,202 (Oct. 27, 2010).¹ The rule covers the whole BCAP program, including both the matching payments component for the collection, harvest, storage and transportation (CHST) of eligible materials and the supply component providing payments for the establishment and production of renewable biomass crops in selected project areas.

AF&PA raised serious concerns with the proposed rule, asking USDA to revise the matching payment component to minimize market distortions and to implement expeditiously the supply component. Consistent with AF&PA's advocacy, a number of

¹For ease of reference, citations are provided both for the form of the final rule published in the Federal Register on October 27, as well as for the pre-publication version posted to USDA's website on October 22, 2010.

key changes to the final rule, in combination with reduced funding levels, should significantly reduce the market distortions the proposed rule would have created.

The following summarizes key provisions in the final rule.

I. MATCHING PAYMENTS COMPONENT

In its comments on the proposed rule and in meetings with USDA, the Office of Management and Budget (OMB) and Congressional offices, AF&PA advocated that USDA should avoid subsidies that would divert woody biomass from existing higher-value forest products manufacturing. In the final rule, USDA established major new limitations on the CHST matching payments program.

Eligible Material that Qualifies for a Matching Payment

CCC had proposed three options for the CHST matching payments in the draft rule, any of which could have created a highly unlevel playing field for forest products mills for three major reasons. First, while CCC excluded some forms of biomass with higher-value uses, it did not do so for all forms of biomass. Second, CCC favored new energy production over existing energy production (e.g., establishing a historical baseline for existing energy production consumed at a mill and using a tiered approach for payments that would have provided a much richer subsidy for cellulosic ethanol). Third, CCC favored other forms of existing energy production (e.g., biomass-fired utilities, co-fired utilities, and pellet plants), over energy production at forest products facilities, especially with a black liquor exclusion.

The final rule generally limits material eligible for payments to protect existing markets and also adopted a single approach for CHST payments that matches the price paid by biomass conversion facilities (BCFs) for eligible material at \$1 for \$1 up to \$45 per dry ton. CHST matching payments will be available for two years per eligible material owner (EMO). Previous participation under USDA's Notice of Funds Availability (NOFA) counts against the two-year clock, but the clock is stopped between the last matching payment received under the NOFA and the next matching payment received under the final rule. See USDA Fact Sheet on Biomass Crop Assistance Program (Oct. 2010), at p. 2 (attached). All BCAP participants will need to submit new applications, regardless of whether they participated under the NOFA: "Anyone who wants to participate in BCAP, including eligible material owners and biomass conversion facility owners, will need to apply under the BCAP regulations, no one will be grandfathered in based on applications approved under the NOFA." (p. 88; 75 FR at 66,222)

- **Threshold Requirement: Directly from the Land**

All woody biomass, whether from BCAP contract acreage or not, must be collected or harvested "directly from" the land and consistent with a conservation plan, forest stewardship plan, or equivalent plan. §1450.103(a)(2). The final rule preamble explains by way of example that bark, chips and sawdust collected from processed trees after

the trees are delivered to forest products facilities are ineligible for a matching payment because they are not collected or harvested directly from the land. (pp. 23-24; 75 FR at 66,207).²

- Conservation Plans

CCC provided greater flexibility as to what conservation plans are acceptable – recognizing conservation plans, forest stewardship plans, or equivalent plans that comply with CCC guidelines and are approved by the appropriate conservation district. Equivalent plans include the American Tree Farm Program, the Sustainable Forestry Plan,³ [sic] plans created by foresters or third-party forester licensed by the State, and the State Best Management Practices Program. (p. 113; 75 FR at 66,228)

- Limitations on Biomass from Land Other Than BCAP Contract Acreage

To be eligible for a matching payment, woody biomass harvested or collected from land other than BCAP contract acreage must:

- be “[b]yproducts of preventative treatments that are removed to reduce hazardous fuels, to reduce or contain disease or insect infestation, or to restore ecosystem health” §1450.103(a)(3);⁴
- not “otherwise be used for higher-value products” §1450.103(b)(3);and
- not be “separated from” an eligible material used for a higher-value product in order to be used for heat, power, biobased products, or advanced biofuels. §1450.103(b)(4).

First, the “byproducts of preventative treatments” limitation should reduce significantly the volume of biomass outside of BCAP contract acreage eligible for matching payments. It appears that what is considered “preventative treatments” may be determined through FSA implementation of the program, including at the county level.

Second, even if the biomass is a byproduct of a preventative treatment, it would be ineligible for a payment if it “would otherwise be used for higher-value products.” USDA does not clarify the process for making such determinations, but it apparently will be done during the BCAP approval process.

In the proposed rule, CCC stated its goal “to avoid diverting any materials potentially eligible for BCAP matching payments from existing value added production processes

² Notwithstanding CCC’s threshold requirement, the statute does not require that biomass actually originate directly from the land. Indeed, the statute refers to wood waste and residue. Pub. L. 110-246, 122 Stat. 2066, Sec. 9001(12); 7 U.S.C. 8101(12) (Farm Bill definition of “renewable biomass,” which is incorporated by reference into the BCAP definition of “eligible material.” 122 Stat. 2090, Sec. 9011, 7 U.S.C 8111(a)(6)).

³ In a November 4 meeting with AF&PA and other forest products industry stakeholders, USDA explained that the Sustainable Forestry Initiative qualifies as an acceptable plan.

⁴ Biomass harvested from Federal lands must comply with requirements for old-growth maintenance, restoration, and management direction provided by 16 U.S.C. 6512 for Federal lands. § 1450.103(a)(3)(ii).

already occurring in the marketplace” (75 FR at 6266). However, the proposed rule did not apply this principle to pulpwood – only to “wood wastes and residues...that are typically used as inputs for higher value-added production (i.e., particle board, fiberboard, plywood, or other wood product markets).” (75 FR at 6266). The final rule has expanded the limitation to pulpwood, saw timber, and other woody biomass used for higher-value products. It defines “higher value product” as “an existing market product that is comprised principally of an eligible material or materials and, in some distinct local regions, as determined by the CCC, has an existing market as of October 27, 2010. Higher-value products may include, but are not limited to, products such as mulch, fiberboard, nursery media, lumber, or paper.” §1450.2

Third, matching payments are not authorized for otherwise eligible material that after delivery to a BCF must be “separated from” an eligible material used for a higher-value market product in order to be used for heat, power, biobased products, or advanced biofuels. To be eligible, materials cannot be “collected or harvested” after transport and delivery, nor “collected or harvested” by separating from higher value material to be used for heat, power, bio-based products or biofuels. This limitation excludes from eligibility most of the biomass used to power forest products mills. Specifically, it excludes black liquor and any bark, branches, sawdust, or other biomass that is separated from eligible material at the millsite.

- Black Liquor

Although USDA no longer explicitly excludes black liquor from the list of eligible materials as it had done in the proposed rule, USDA clearly intends that the final rule makes black liquor ineligible for a matching payment. In the preamble, USDA states:

“Any eligible material used in the manufacturing process that can be attributed to the creation of black liquor cannot qualify for matching payment because the eligible materials (non-Federal pulpwood trees) immediate, principal higher-value purpose is wood pulp for paper manufacturing and the creation of the black liquor is a byproduct of the production process.” (p. 24; 75 FR at 66,207-8).

In its response to comments, USDA further states:

“Black liquor is not an eligible or ineligible material, [sic] it is not a feedstock, but rather a product of feedstocks. Eligible materials that can be attributed to the creation of black liquor are materials that were delivered principally for the manufacture of a higher-value product that is not heat, power, biobased products or biofuels, not for the recovery of chemicals where energy is an ancillary side effect and therefore do not qualify for matching payments.” (p. 85; 75 FR at 66,222)

It is possible that the reasoning in this preamble language could be interpreted to exclude not only black liquor, but also possibly tall oil and other by-products of the

pulping process. Under the logic that any otherwise eligible material becomes ineligible if it is “separated from” eligible material used for a higher-value product, biomass used to convert black liquor into advanced cellulosic biofuels at an integrated forest products mill/biorefinery might not be an eligible material.

- Eligible Biomass Used at Forest Products Mills

The only biomass typically used by forest products mills for energy that appears not to be excluded from matching payments is hogged fuel that is a byproduct of a preventative treatment and would not otherwise be used for higher-value products and byproducts of preventative treatments on Federal land.

- Fair Market Value Requirement

Any qualified BCF must agree in writing to “[p]ay fair market value for eligible material regardless of whether the seller has applied for or receives a matching payment” under the CHST component. §1450.101(a)(2)(vi). No payments will be made for eligible material delivered before October 27, 2010, nor for eligible material paid for by a BCF before the CHST application for payment is approved by FSA. §1450.103(b)(1), (2). An eligible material owner’s application must include “[t]he expected, fair market, per dry ton payment rate the owner plans to receive for the delivery of eligible material.” §1450.104(c)(iv).

- EMO Certification

The final rule states that to receive a CHST matching payment, a producer of an eligible crop that is produced on contract acreage, or a supplier (with the right to collect or harvest eligible material and the risk of loss for the material prior to the matching payment), must certify that the eligible material: (1) has been harvested according to a conservation plan, forest stewardship plan, or equivalent plan, and (2) “if not crop residues, are [sic] a byproduct of preventative treatments.” §1450.102(a). A qualified BCF that meets the requirements of §1450.102(a) may be considered an EMO if it otherwise meets the definition. §1450.102(b).

- Biomass from BCAP Acreage

As noted above, under the terms of §1450.103(a)(3), its limitations (preventative treatment; no higher-value use; cannot be separated from otherwise eligible material) apply to land “other than contract acreage.” It is less clear what the limitations are for eligible crops and eligible materials from BCAP contract acreage. USDA indicates in the preamble that, for BCAP contract acreage, the higher-value use limitation will be taken into account during the BCAP contract approval process:

“The 2008 Farm Bill specifies that material removed from Federal land is not eligible if it would otherwise be used for higher-value products. Because the intent of BCAP is to spur new biomass for new markets rather than divert

biomass from existing markets, and in response to comments, this rule extends the higher-value qualification to material from all land not under a BCAP contract (including non-Federal lands). *The exemption for the BCAP contracts reflects that market displacement issues should be taken into account in the BCAP approval process.*” (p. 27; 75 FR at 66,208)(Emphasis added).

USDA’s staff have indicated unofficially that there may be some kind of appeals process for higher-value use determinations.

Moreover, §1450.102 as written indicates that there is a preventative treatment limitation even for eligible material from BCAP acreage. On its face, §1450.102 indicates that to be eligible for a CHST matching payment, a producer of an eligible crop on contract acreage must certify, if it is not crop residues, that the eligible material is a byproduct of preventative treatments. We have explored this issue with USDA, and they are deliberating on their intent regarding eligible crops and other eligible materials from BCAP acreage. It could be that they did not intend the limitation to apply to all materials or in all circumstances on BCAP acreage. If USDA does not intend for the limitation to apply in all cases on BCAP acreage, they may have to take further clarifying actions.

Note also that the preamble states “[e]xisting nonindustrial private forest land with existing tree cover can be entered into contract acreage with an approved project area and be eligible for annual payments, subject to a forest stewardship plan or equivalent plan.” (p. 39; 75 FR at 66,211).

- Eligible Material

USDA will provide on the FSA website a list of eligible materials deemed acceptable to receive a matching payment. §1450.103(a)(1). CCC only provides a sample list of eligible materials in the preamble, however, and it does not suggest that there will be public review process or notice and comment to create or amend the list.

We note that, as required by the statute, “eligible material” does not include “yard waste.” However, CCC broadly defines “yard waste” as, among other things, any renewable biomass generated from municipal or residential land, including urban forestry materials, construction or demolition materials, trimmings from grasses and trees, etc. Yard waste also includes “biomass . . . that otherwise cannot be recycled for other purposes, such as post-consumer waste paper.” §1450.2.

Biomass Exports/Advanced Biofuels

The definition of “advanced biofuel” includes various fuel derived from renewable biomass, including “biofuels derived from cellulose, hemicellulose, or lignin . . . and biofuel derived from waste material” and “other alcohols produced through the conversion of organic matter from renewable biomass, and other fuel derived from cellulosic biomass. (§ 1450.2) In the preamble to the proposed rule, CCC indicated

that, in addition to being “eligible materials,” wood chips, briquettes and wood pellets would qualify as “advanced biofuels.”

In the proposed preamble, CCC stated that a BCF is a facility that “converts or proposes to convert renewable biomass into heat, power, biobased products, or *advanced biofuels, such as wood pellets, wood chips, or briquettes.*” (75 FR at 6267)(Emphasis added.) AF&PA argued in its comments and in meetings with USDA and OMB that USDA should not include wood pellets, wood chips or briquettes as “advanced biofuels.” To do so, AF&PA argued, would allow the facilities producing these materials to have a double opportunity. Since those products are “eligible materials,” the facilities producing them could receive matching payments when they delivered them to a BCF. Of much greater concern, however, was that if those facilities, such as pellet mills, could qualify as BCFs by claiming they produced “advanced biofuels,” they could claim 100 percent of the maximum matching payment of \$45 per dry ton. This would have exacerbated the growing trend of biomass exports out of the United States. (On the other hand, when the materials are exported out of the country as “eligible materials,” presumably the foreign purchasers could not be qualified as BCFs).

In the final rule and its preamble, the language italicized above was dropped as AF&PA advocated, which may indicate that wood pellets, chips and briquettes are no longer considered to be advanced biofuels.⁵

“Related-Party Transaction” Restriction

In the proposed rule, CCC had changed the “arm’s-length transaction” restriction in the NOFA to a restriction based on a “related-party transaction,” which meant “a transaction between two or more ready, willing, and able organizations, trades, or business [sic] (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) substantially owned or controlled directly or indirectly by the same interests, as determined by the Deputy Administrator.” (proposed § 1450.2, 75 FR at 6282). CCC stated that this restriction “will not render stockholders of a privately or publicly held company who deliver eligible material to that company ineligible; nor will members of a cooperative who deliver eligible material to that cooperative be considered ineligible.” (proposed 75 FR at 6268). While this was an improvement over the NOFA, AF&PA noted that the “related-party transaction” requirement in the proposed rule did not appear to resolve concerns about market-based transactions in the forest products supply chain between some closely affiliated companies.

In the final rule, CCC removed the reference to “related party transaction” from §1450.102. CCC also added the new provision requiring that BCFs pay “fair market

⁵ In response to comments, CCC states that “[b]ased on the definition in the BioPreferred Procurement Program, which states that products with significant market penetration as of 1972 are not considered biobased products, then plant nurseries, sawmills, particleboard, facility, composing facilities, and charcoal facilities may not qualify as biomass conversion facilities because these products do not meet the definition. The facilities, however, can qualify as biomass conversion facilities for purposes of heat, power or biofuels generation provided that the eligible materials meet the specifications of §1450.103. “ (p. 75-76; 75 FR at 66,220).

value” for eligible material “regardless of whether the seller has applied for or will receive a BCAP matching payment.” (p. 125; 75 FR at 66,231) “The ‘fair market value’ is new requirement that biomass conversion facilities not have a different payment rate for BCAP participants than for other biomass sellers.” (p. 127; 75 FR at 66,231).

Program Funding/Duration

As AF&PA advocated, the funding for the BCAP program has shrunk substantially, which will further reduce its market distorting impact. Originally, USDA proposed to fund the total BCAP program for \$2.636 billion, with the CHST matching payments component being funded for 2010-2013 for a subtotal of \$2.1 billion. (75 FR at 6277). USDA proposed to fund the supply component, including years 2010-2012 for establishment cost share and technical assistance, with annual payments spanning 2010-2026, for a subtotal of \$536 million. (Id.).

BCAP is authorized through fiscal year (FY) 2012. In the final rule, the CHST matching payments program is only allotted \$132 million for FY2011 as well as for FY2012, for a subtotal of \$264 million. The supply component is funded for \$193 million, including establishment cost share for FY2011 and FY2012, with annual payments spanning FY2011-2026. (p.130; 75 FR at 66,232). These funding levels are below the caps imposed by the 2010 Supplemental Appropriations Act (Pub. L. 111-212), which limited BCAP funding to \$432 million in FY2011. By comparison, during the implementation of the Notice of Fund Availability, \$250 million was expended in roughly one quarter year of BCAP matching payments. See USDA Fact Sheet on BCAP, at p. 1.

II. SUPPLY (ESTABLISHMENT AND ANNUAL PAYMENTS) COMPONENT

The supply component of BCAP (the so-called “establishment and annual payments component”) provides both establishment payments and annual payments for entities with eligible land located within a project area designated by CCC.

Obligations

Among other requirements, the project sponsor must submit to CCC a proposal that describes the sources of renewable biomass, eligible land, and eligible crops that may be enrolled within the proposed project area. The proposal also must include a letter of commitment from a BCF to use eligible crops produced in the project area for BCAP purposes and specifies the geographic boundaries of the project area, which must be located near a BCF. §1450.201. Project sponsors can include groups of producers or BCFs. (p. 30; 75 FR at 66,209).

All participants subject to a BCAP contract must demonstrate compliance with the conservation plan through self-certification subject to spot checks. §1450.206(a)(6). All participants with any share of the payment are jointly and severally responsible with the other contact participants for compliance with the provisions of the BCAP contract and the BCAP regulations, and for any refunds or payment adjustments that may be

required for violations of any of the terms and conditions of the contract and regulations. §1450.206(a)(8).

Establishment Payments

Producers can receive up to 75 percent of the costs of establishing non-woody perennial and woody perennial crops specified in the conservation, forest stewardship or equivalent plan. §1450.213. There are no establishment payments for annual crops.

Annual Payments

Producers in BCAP project areas can receive annual payments for up to 15 years for woody biomass (annual and perennial). §1450.205. Upon sale of the crop, annual payments are reduced by the following amounts:

- 1 percent if the biomass is sold for cellulosic biofuels with 60 percent lower greenhouse gas emissions under the RFS regulations;
- 10 percent if the biomass is sold for advanced biofuels
- 25 percent if the biomass is sold for heat, power or biobased products
- 100 percent if the biomass is sold for anything other than heat, power, biofuels or biobased products. §1450.214.

Eligible Land

Eligible land for the supply component must be either agricultural land or “nonindustrial private forest land,” a term used in the statute. §1450.204(a). Eligible land does not include land owned by Federal, State, local or municipal governments, native sod, or land enrolled in the Conservation Reserve Program, the Wetlands Reserve Program, or the Grassland Reserve Program. §1450.204(b).

In the proposed rule, CCC barred publicly traded corporations or legal entities principally engaged in the production of wood products from the supply component of BCAP by incorporating the definition of nonindustrial private forest land used in two other USDA regulations (36 CFR 230.2 and 36 CFR 230.31). The final rule does not purport to bar publicly traded corporations. It defines “non-industrial private forest land” as defined in the Cooperative Forestry Assistance act of 1978 (16 U.S.C. 2103a), as “rural lands with existing tree cover, or suitable for growing trees, where the land is owned by any private individual, group association, corporation, Indian tribe, or other private legal entity.” §1450.2. The preamble to the final rule explains that the proposed rule “incorrectly excluded publicly traded corporations and accordingly has been revised in this final rule to remove that exclusion. That is consistent with the 2008 Farm Bill.” (p. 64; 75 FR at 66,217).

AF&PA argued in its comments on the proposed rule that there was no policy rationale for USDA barring either publicly traded corporations or companies principally engaged

in the production of wood products from participating in the supply component of BCAP.⁶

Conclusion

USDA made significant changes to the proposed rule to minimize market distortions, consistent with comments AF&PA submitted. The results also are consistent with the Forisk research on forest resource availability and the RISI study on jobs from various biomass uses, as well as the white paper on BCAP prepared by Roger Sedjo at Resources for the Future. It will be important to remain engaged with USDA to ensure that the implementation of the rule reflects its stated intent.

Attachment

⁶ It is not clear whether the final rule, like the proposed rule, excludes legal entities principally engaged in the production of wood products from the supply component of BCAP. CCC also does not address whether the land of TIMOs and REITs qualifies as “nonindustrial private forest lands.”