

CountryMark

Submitted testimony
for the U.S. Senate Committee on Environment and Public
Works

Legislative Hearing on S. 1733, “Clean Energy Jobs and
American Power Act.”

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As Congress proceeds with consideration of S. 1733, “Clean Energy Jobs and American Power Act,” CountryMark believes it is important for Congress to know about the companies this legislation will impact and how this legislation as currently drafted will affect companies such as CountryMark.

CountryMark’s History

CountryMark’s history dates back to the 1920s, when several local Indiana farmer-owned cooperatives joined together to collectively purchase lubricating oils for their farm equipment. By 1930, seventy-seven of these farmer-owners formed the Indiana Farm Bureau Cooperative Association (IFBCA).

With the discovery of oil in the Illinois Basin in the late 1930’s, IFBCA’s farmer-directors saw the need for better quality and more reliably supplied fuels. In pursuit of these goals they began construction of an IFBCA financed refinery in southwestern Indiana. The selected location was ideally situated between the Illinois Basin crude oil fields and the Ohio River barge traffic.

Refinery construction was completed in 1940 and crude processing of 2,500 barrels per day (BPD) (35 million gallons per year) started in April of that same year. IFBCA’s initial investment was \$330,000 for the refinery, crude oil pipelines, and truck fleet. At the time, the new farmer-owned cooperative had 60 employees and anticipated annual sales for refined products of \$1 million.

By the late 1940s, IFBCA was fully involved in drilling for crude oil, refining crude oil into fuel, and distributing its end products to its farmer owners. In the 1950s, IFBCA’s operation expanded to justify construction of a 238-mile proprietary pipeline. The

pipeline was constructed to better transport and distribute refined products from the refinery in Mt. Vernon, Indiana through the Indianapolis area and north to Peru, Indiana. CountryMark's flagship product, *Super Diesalex-4*, was introduced to the agricultural market in 1961 and the current version of this fuel remains the company's marquee product today. In 1991, IFBCA merged with CountryMark to form the current cooperative.

Eighty-nine years later, CountryMark owns and operates over 400 miles of crude gathering pipelines serving the Illinois Basin, a 26,500 BPD (400 million gallons per year) refinery, and a 238-mile proprietary pipeline – as well as five product terminals. Since IFBCA's refinery investment in 1940, CountryMark's assets have grown to nearly \$600 million. CountryMark now employs approximately 350 people and in 2008 annual sales were \$1.3 billion.

CountryMark fuel and lubricants are delivered daily to individuals, companies, farms and government entities throughout Indiana and the neighboring states of Michigan, Ohio, and Illinois. CountryMark's fuel products power approximately 75% of Indiana's production agriculture industry, as well as, about half the public school buses that deliver Indiana children to school each day.

Over the years, CountryMark's facilities and processes have been updated as fuel technology and refining innovation has occurred. CountryMark has actively promoted the growth and adoption of renewable fuels. CountryMark has been a longtime proponent of ethanol blended gasoline, and the majority of CountryMark gasoline contains ethanol. Also, in partnership with Indiana's soybean growers, CountryMark is the state's leader in the offering of biodiesel. In fact, the Central Indiana Clean Cities Alliance estimated that 85% of all biodiesel sold in the state in 2008 was sold at one of CountryMark's four Indiana petroleum terminals. By focusing on the integration of American-sourced petroleum and biofuels, CountryMark has emerged as a recognized leader within the Indiana energy industry.

CountryMark - A Legacy of American Energy

CountryMark is Indiana's only American-owned oil refining and marketing company and is recognized nationwide as a leader in the distribution of biodiesel and ethanol.

CountryMark fuels are all-American fuels. The CountryMark refinery uses 100% American crude oil sourced from the Illinois Basin, a 53,000 square mile depression underneath most of Illinois, western Indiana, and western Kentucky. This light, sweet, American crude oil, domestically refined, helps reduce dependency on foreign oil, strengthens domestic energy security, and fuels the American production agriculture economy.

Our all-American operation produces an important financial consequence in our region as well. By sourcing American crude oil, more money remains in the Midwest, supporting

local economies. CountryMark purchases over 9.5 million barrels of crude oil per year. In 2008, that meant \$800 million went into the Indiana, Illinois, and Kentucky economies. This money constitutes revenue in the Midwest economy to over 40,000 people and supports employment of over 14,000 in Illinois alone, and as many as 20,000 people in the tri-state area. Since none of the major oil companies operate in the Illinois Basin, CountryMark has emerged as the dominant purchaser of the area's crude. To support continued development of this American resource, CountryMark recently began partnering with local oil-producing companies to invest in additional well drilling.

CountryMark's operations employ 350 workers, nearly all in the rural economy of southwest Indiana and southeast Illinois. In Posey County, Indiana alone, nearly \$27 million in wages and benefits are provided every year. These wages are over twice the local average and are paid mostly to hourly workers with little or no opportunity for other employment equivalent to CountryMark. In addition to the positive financial impact of CountryMark's crude purchases and payroll, the company placed over \$200 million into the local economy for the purchase of other goods and services.

CountryMark's Cooperative System

Unlike most other fuel refiners, CountryMark is a cooperative business. CountryMark is owned and controlled by its member cooperatives that are in turn owned and controlled by individual farmers within our trade territory. CountryMark's Board of Directors is comprised of farmers. Over 100,000 farmers in Indiana, Michigan, and Ohio participate in these local cooperatives who own CountryMark. Each year, profits are distributed back to these farmers via the cooperative system. Over the past five years, CountryMark has returned over \$90 million in cash to the member cooperatives. These distributions remain in local communities where the dollars support the local economy. This annual distribution of profits represents a critical financial connection between CountryMark, our member cooperatives, and the 100,000 farmer-owners that have equity in the cooperative system.

Beyond distribution of profits, CountryMark represents a significant capital investment by our regional farmer-owners. The ownership of gasoline and diesel manufacturing represents vital, vertical integration of farmer's production agriculture operations. This investment by CountryMark's farmer-owners represents a time-honored business model of joining resources for the common purpose of purchasing vital goods and services in a manner they simply couldn't do individually.

CountryMark's cooperative purpose is to produce wholesale gasoline and diesel fuel for retail sale through the local member farmer cooperative network. Due to this mandate, we have a unique mission compared to the conventional oil refineries in the country. This mission is the core meaning of farmer cooperative ownership. As said by one farmer, "When it is time for the combine to run, the fuel had better be available." This was never more apparent than during hurricanes Katrina and Rita early in the harvest season of 2005. At a time when much of our nation's refining capacity was crippled, every single

farmer co-op member was able to get the fuel they needed to operate their farm equipment.

Simply put, CountryMark's cooperative purpose is to supply vital goods and services to farmers. CountryMark's mandate is to supply these fuel needs even when purely capitalistic market forces might dictate otherwise. The needs of our farmer-owners are our single organizing principle. CountryMark was created to exclusively meet these needs, and our cooperative ownership ensures fidelity and accountability to our farmer-owners, not external shareholders. As a result, our farmer-owners unquestionably rely upon CountryMark for goods and services necessary for production agriculture, profit sharing, and repurchase of ownership once the farmer retires from operation.

Impact of Cap-and-Trade Legislation

We are still reviewing the details of the Chairman's amendment released October 23, 2009, and the accompanying EPA analysis. Our remarks are focused on concerns that are intrinsic to any cap-and-trade system. Even though CountryMark has not had time to thoroughly understand all of the details of S. 1733, we do consider S. 1733's cap-and-trade regime problematic for the reasons we set out below.

As one of the country's smallest refineries, CountryMark has built a durable operation by disciplined capital spending, controlling operating costs, and providing value-added goods and services to our farmer-owner customers. Our efforts to provide value-added goods include providing products that are sustainable to our farmer-owner customers. Our decision to actively promote the adoption of renewable fuels was an example of this. In our view, the market for renewable fuels is strong over the next 10 years and beyond – if further development is allowed. Our customers want the supply of these fuels to increase, and CountryMark is evaluating ways to increase the distribution and production of renewable fuels.

CountryMark's distribution of renewable fuel was not inspired by a government mandate. Instead, CountryMark has been a long time proponent of ethanol blended gasoline, and the majority of our gasoline contains ethanol. In addition, CountryMark is a recognized leader in blending biodiesel. For a refinery of our size, location, and ownership, blending renewable fuels such as ethanol and biodiesel makes economic sense and is a prudent business decision. As America transitions to renewable fuels, CountryMark and our farmer-owners will be critical to the success of this transition.

Our experience provides an important message to Congress. CountryMark has been able to produce ethanol blended gasoline and provide biodiesel to our customers because we were free to invest our limited capital on strategic projects that stood on their own merits. This experience inspires a central criticism of cap-and-trade legislation. By requiring CountryMark to divert our finite capital to purchase allowances, the government has essentially taken away our ability to make positive decisions regarding the expansion of

renewable fuels. Assuming the cost of allowances are not so great as to force us out of the market altogether, this diversion of our limited capital resources to the government will prevent us from making additional investments that promote renewable fuels.

The reality of a viable renewable fuels industry is that it will be regional in nature. Transportation of both renewable feed stocks and fuels will be vital in ensuring economic sustainability well into the future. Renewable fuels production will not develop along the lines of the centralized petroleum refining in the gulf coast, where crude oil is pumped or shipped vast distances to be refined. To keep the cost of bio-fuels low for consumers, efficiency will be important. Production facilities will need to be close to both the feed source and the product distribution network. CountryMark and our cooperative members are well positioned to participate in the regional renewable fuels industry. CountryMark is already a recognized leader in renewable fuels distribution in the nation. Cap-and-trade legislation will force an undue economic burden on CountryMark, forcing us out of the development of more renewable fuels. If this is allowed to happen, a key contributor to the future renewable fuels industry will be lost forever.

Our second concern of cap-and-trade legislation is that the refining industry is viewed as one-size-fits-all. The capital that is extracted from companies of CountryMark's size will have a negative impact. While we had annual sales of \$1.3 billion in 2008, our net profits are exceedingly modest. In the past five years, our average annual net income has been \$37 million. This pales in comparison to the large amounts of profit we hear discussed when the refining sector is discussed in Washington. While the large integrated oil producers and refiners may have made record profits in the billions, CountryMark and other small business refiners did not. We do not have the capital resources that the major, integrated producers and refiners have and, therefore, we cannot absorb liabilities such as those embodied in carbon credit purchases and continue to conduct our business undisturbed.

These differences are important in understanding how any cap-and-trade regime will impact the market in which a small business refiner exists. There are important structural differences between refiners in the market place that will bear on the relative impacts. Our markets are priced in the tenths of a penny and are extremely price elastic – two tenths of a cent can push a product out of the market. CountryMark competes with much larger multinational, integrated oil companies with substantial earnings from oil production, petrochemical manufacturing, and other highly diversified operations. With multiple production stages at which to off-load costs, vertically integrated producer/refiners have pass through options that could lead to their fuel prices being below those of small business refiners with few or no off-load options.

CountryMark, like all small business refiners, is not a vertically integrated company. We do not own our own production like many large companies. To provide perspective, CountryMark represents 0.15 percent of the total U.S. refining industry's capacity. However, cap-and-trade legislation as drafted provides no meaningful distinction between these large, multinational companies and very small, farmer-owned companies like CountryMark. If the cap-and-trade legislation passes without recognition of the

different structural and financial capabilities of these two segments of our industry, the first casualty will be companies such as CountryMark that today are one of only a few petroleum refiners providing 100% American energy to the marketplace.

Thirdly, cap-and-trade legislation is the single biggest threat to the viability of CountryMark, the investment of our farmer cooperative owners, and the survivability of the cooperative system. CountryMark's analysis of the mechanics of cap-and-trade show that the cost of carbon allowances far exceeds our capital resources by a huge margin. The costs are nearly insurmountable. As a result, we must choose to either absorb the costs of purchased carbon allowances or pass these costs to our customers. Our latest estimate is that the cost of carbon taxes on CountryMark will exceed \$100 million per year for both our direct manufacturing emissions and emissions produced from consuming our product. This burden, compared to our average annual net income over the past five years of \$37 million per year, clearly indicates the magnitude of the current legislation's impact on our economic sustainability.

Passing these costs along to our customers presents equally difficult choices. Our farmer-owner customers already operate on very thin margins. The added fuel inputs costs are likely to outstrip their operating margins in the first year of any cap-and-trade regime.

If required to purchase allowances exceeding \$100 million per year CountryMark could be rendered insolvent. The end of CountryMark as a business would not only deprive our Midwest economy of the investments described above, but would even more significantly, seriously impair our local farmer-owned cooperatives' balance sheets. The insolvency of CountryMark would trigger a cascade of financial doubt through the farmer cooperative system. CountryMark bankruptcy would require the write down of currently viable assets on the cooperative system's books. Local cooperatives, which in turn would be impacted by the loss of equity, would see their ability to borrow money, at a time of economic stress due to volatile input prices, undermined. The violence of these economic forces could drive local cooperatives out of business, which in turn would significantly impair farmer's ability to pursue their livelihood. As a result of this cascade, the currently drafted climate change legislation threatens the basic farmer cooperative system.

Such a financial series of events would have far-reaching consequences for production agriculture and our national economy and must be avoided. CountryMark bankruptcy and the financial damage to our farmer cooperative system will not be the end of the impacts felt on our nation's future. The survivability of the farmer cooperative system, and CountryMark, is vital to the development and implementation of future renewable fuels.

Another concern of cap-and-trade legislation is that as currently drafted it will inadvertently reduce the quantity of diesel fuel available to the marketplace. Current renewable fuels focus on increasing availability of ethanol fuels to replace petroleum-based gasoline. Similarly, nearly all of the federal Renewable Fuel Standard is focused upon ethanol as a replacement for gasoline. However, the commercial viability of a

suitable diesel fuel replacement is years behind the ethanol curve. Furthermore, renewable fuels standard regulations virtually eliminate the viability of increasing the use of soy-based diesel fuels because of the alleged impact on worldwide land use changes.

Today, there is no comparable technology to produce enough renewable diesel fuel to replace the large volumes of diesel fuel now used within the nation's economy. By raising the cost of petroleum gasoline through cap-and-trade, less of it will be consumed. This will reduce crude throughput rates in the nation's petroleum refineries, necessarily reducing the co-production of conventional diesel fuel. This will disproportionately increase diesel fuel prices, significantly impacting diesel-consuming industries such as U.S. production agriculture. In the end, this legislation will increase the cost and decrease the supply of diesel fuel that is vital to our rural economy and negatively impact the local family farms that Americans are counting on to supply the renewable bio-based feed stocks for the renewable fuel industry.

Additionally, cap-and-trade legislation disadvantages domestic refiners when compared to foreign competition. The petroleum industry is currently at very low utilization rates which are causing temporary and permanent shutdowns of American refineries. Even though domestic refineries are shutting down due to high supply and low margins, finished products such as gasoline and diesel fuel continue to be imported into country. A cap-and-trade system will increase the production costs for domestic refineries and further erode refining margins. Specifically, refiners are required to purchase allowances for both their facility carbon emissions and those for the combustion of their refined products. Facility carbon emissions make up 10-25% of the total requirement for a given refiner. Even though imported diesel and gasoline products will require allowances, foreign refineries may not have similar cap-and-trade requirements for their refining operations. Therefore, they will have an economic advantage of up to 25% over domestic refiners. This will lead to additional shut-ins of domestic refineries and the unintended consequence of increasing reliance not only on foreign crude oil but also foreign refined finished products.

Lastly, when these consequences are combined, the cumulative impact of a cap-and-trade regime on CountryMark is to fundamentally shift the terms upon which our future is decided. Our survival and growth to this point has been based on our expertise in refining, understanding of our farmer-owner customers, and the agriculture economy. Under a cap-and-trade regime, the importance of our expertise to our long term survival is vastly diminished. Instead of relying on the knowledge and business sense we've developed over 80 years, we will be compelled to gamble our future on skills we don't have – trading insights, hedge strategies, market leverage, credit strategies, etc. These are the skills and expertise that cap-and-trade legislation elevates to dominate our future success or failure. We think it is unfair to disturb the economy so profoundly as to alter through legislation the basic proposition under which our markets have operated successfully for decades. We have survived by being good at running a farmer-owned refinery. Cap-and-trade will destroy that proposition in favor of survival of companies who have good hedge skills, large capitol reserves to gamble in the commodities market and fortuitous credit strategies.

CountryMark urges Congress to reject this legislative proposal and re-think the important strategies needed for this nation to reduce its carbon emissions, develop viable renewable gasoline and diesel fuels, and avoid destruction of critical aspects of our economy in the process. The legislation as currently drafted does not achieve these goals. Instead, the legislation has the potential to drive all-American companies such as CountryMark out of business. However, the goals are achievable through a transparent and practical dialogue with small business refiners such as CountryMark and America's Production Agriculture Industry.