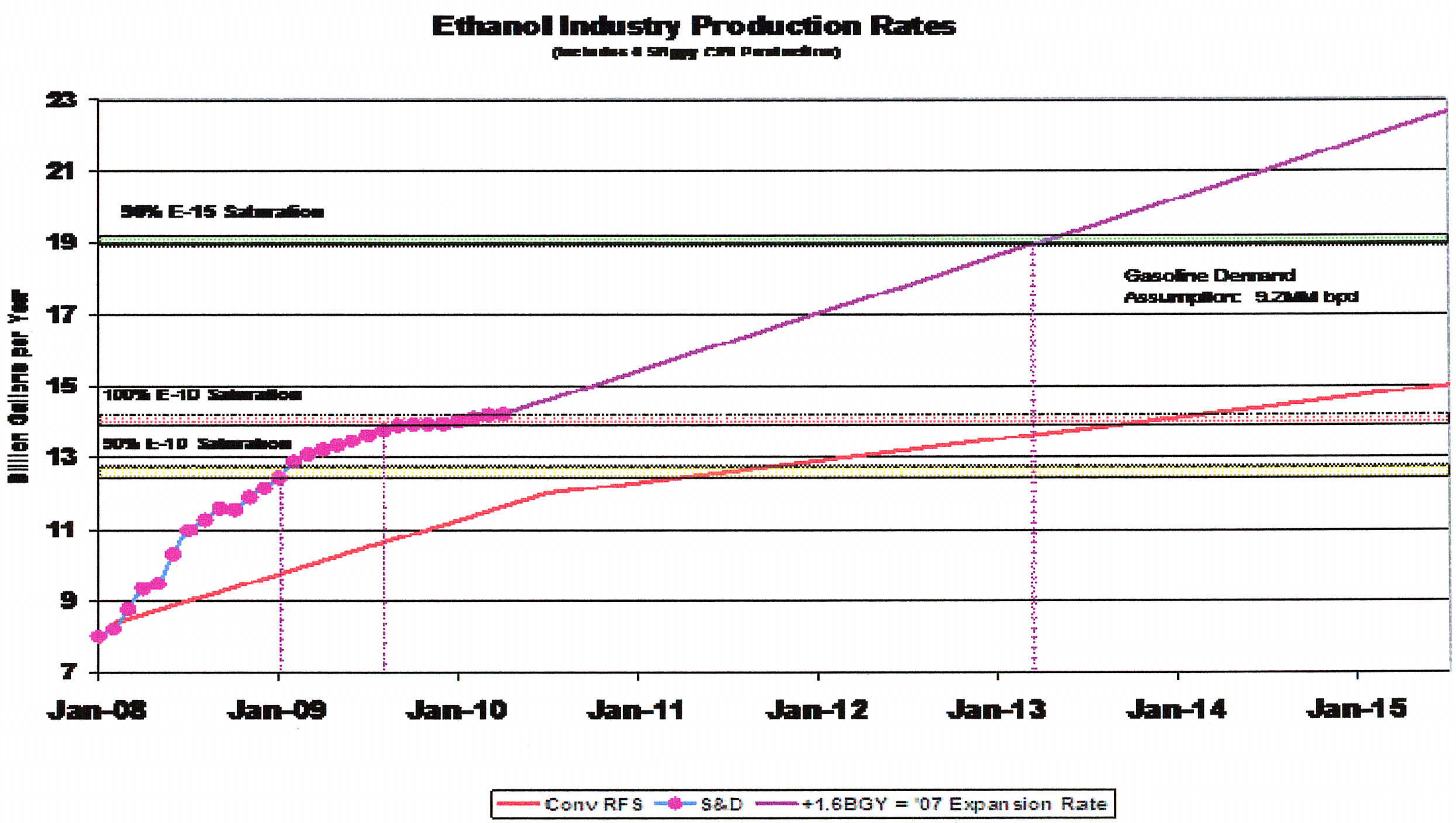
South Dakota Ethanol Producers Association

State of the industry

State of the Industry

"Regulatory EPA Cap" of E10 is destroying margins, stifling growth, and conflicts with EISA 2007.



Regulatory CAP

- The regulatory cap or "blend wall" is the point at which domestic production meets the maximum market demand for E10
- Nationwide, we project hitting 90% market saturation in January, 2009
  - A "*free market*" does not exist as long as the industry is held captive to a maximum of 10% of the market share
  - Nationwide the industry has lost more than $5 Billion this year alone
  - Volatility in the marketplace and a lack of market have led to this crisis
  - SD policy makers should take note that this crisis will deepen unless proactive measures are taken by states and the federal government

Fed & State Solutions

- Increase the base blend above 10%
  - Measures are being taken at the federal level
  - Support from State Legislatures & governors would be helpful
- Demand Side Economics: We need more outlets
  - Flex Pumps or “blender pumps”
  - Ethanol pipelines
  - Flex Fuel Vehicles
  - Strong state & federal policies for domestic, renewable fuels

Bottom Line

- The South Dakota ethanol industry and the agriculture economy are under considerable financial stress
- Consumer choice should be supported through Flex Pumps (blender pumps).
  - Today, there are approximately 20 in the entire state. They are not a “threat” to government revenues. Today’s tax environment is unstable and damaging the market opportunity.
- Proactive measures that benefit both the industry and state government should be sought and mutually agreed upon
- Now is not the time to penalize a South Dakota industry by arbitrarily increasing taxes

Next: Current Environment in SD

- SDCL – let's clarify
- Proposal to solve the problem
- How administration is taxing mid-level blends
- Tax examples & revenue opportunities
- We need the legislature to solve the issue

SD Tax Rates

Different tax rates do not equate to subsidization.

10-47B-4. Fuel excise tax rates. The fuel excise tax rates for the tax imposed by this chapter are as follows:

(1) Motor fuel (except ethanol blends, E85 and M85 blends, and aviation gasoline)--$.22 per gallon;

(2) Special fuel (except jet fuel)--$.22 per gallon;

(3) Ethanol blends--$.20 per gallon;

(4) Aviation gasoline--$.06 per gallon;

(5) Jet fuel--$.04 per gallon;

(6) E85 and M85--$.10 per gallon;

(7) E85 and M85 used in aircraft--$.04 per gallon;

(8) Liquid petroleum gas--$.20 per gallon;

(9) Compressed natural gas--$.10 per gallon.

Source: SL 1995, ch 71, § 4; 1st SS 1997, ch 1, § 1; SL 1999, ch 59, § 1.

Solving the blender pump taxation issue

The South Dakota Legislature is responsible for determining taxation. For the sake of solving the issue and alleviating the financial stress on South Dakota's ag industry, the SDEPA would support a tax measure that is <u>mutually agreed upon.</u>

Proposal:

1. All motor fuels taxed at .22 per gallon
2. Re-clarify that fuels are taxed "at the rack" if necessary (see current SDCL)
3. No ASTM standards and remove penalty
4. Remove "blender" language
5. Denatured Ethanol (not ethanol blends) becomes taxed at a specific rate per gallon

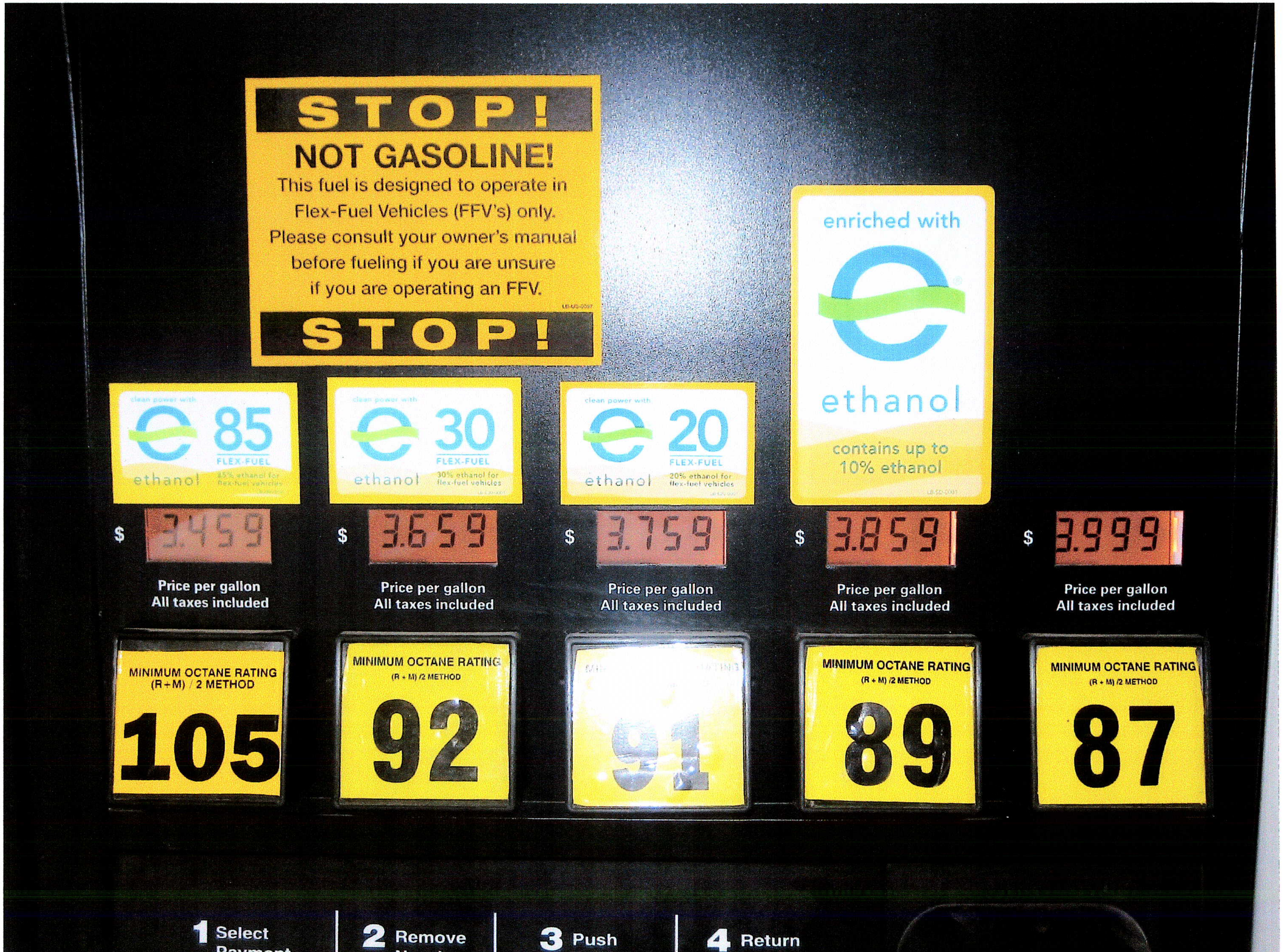
How are mid-level blends being taxed today?

Scenario:

- Flex Pump retail owner buys/stores E-0 and E-85 in two separate tanks;
- Retailer pays tax on E-0 (.22pg) & E-85 (.10pg) at the rack per 10.47B-5;
- Retailer runs the already taxed fuels through a Flex Pump;
- Assuming E-0 and E-85 are blended = equivalent tax rate on E20 is .192 pg;
    - Akin to buying & paying tax on chocolate syrup and whole milk and making chocolate milk
- Department of Revenue & Regulation has implemented a reporting system whereby the retail station then submits and pays the difference to the state
    - Akin to paying an additional retail tax on your chocolate milk

.20 - .192 =.008pg X # of E20 gallons sold (remitted to state)

- SDCL appears ambiguous on the matter – but this conclusion (current process) is difficult to interpret.


STOP!
NOT GASOLINE!
This fuel is designed to operate in Flex-Fuel Vehicles (FFV's) only. Please consult your owner's manual before fueling if you are unsure if you are operating an FFV.
STOP!
enriched with
ethanol
contains up to 10% ethanol
85
FLEX-FUEL
ethanol
30
FLEX-FUEL
ethanol
20
FLEX-FUEL
ethanol
$ 3.459
$ 3.659
$ 3.759
$ 3.859
$ 3.999
Price per gallon
All taxes included
MINIMUM OCTANE RATING
(R+M) / 2 METHOD
105
92
91
89
87
1 Select Payment
2 Remove
3 Push
4 Return

Tax Rate Examples

.09 per gallon of ethanol:

E10 = 20.7 pg, E15 = 20.05 pg, E20 = 19.4 pg, E85 10.95 pg

.08 per gallon of ethanol:

E10 = 20.6 pg, E15 = 19.9 pg, E20 = 19.2 pg, E85 = 10.1 pg

.07 per gallon of ethanol:

E10 = 20.5 pg, E15 = 19.75 pg, E20 = 19.0 pg, E85 = 9.25 pg

.05 per gallon of ethanol:

E10 = 20.3 pg, E15 = 19.45 pg, E20 = 18.6 pg, E85 = 7.55 pg

.02 per gallon of ethanol (E10 Delta):

E10 = 20.0 pg, E15 = 19.0 pg, E20 = 18 pg, E85 = 5.0 pg

Assessment

- All tax rates higher than .03 per gallon of ethanol will likely require 2/3 vote
- SDEPA will support a mutually agreed upon tax rate
- Forever eliminates .02 differentiation between E0 and ethanol blended fuels
- Mutually agreed upon tax rate can benefit SD consumers and a struggling SD industry
- All revenues tied to fuel excise tax are declining sources –
  - Therefore it's impossible to be "revenue neutral"
  - Fact is, any rate above .03 per gallon of ethanol will increase SDHTF revenues

<u>2007: 231MG E10 used taxed @ .20 per gallon = $46.2M</u>

New rate scenarios:
@ .03 tax rate = $46.431M = 230K additional revenue
@ .05 tax rate = 46.9M = $700K additional revenue
@ .07 tax rate = $47.36M = $1.15M additional revenue

Legislative Solution

- SDEPA & Department of Revenue & Regulation (DRR) agree to concept
  - DRR continues to express an interest in resolving this matter
- SDEPA believes the legislature should have a say in final tax rate
- Currently, administration is taxing per SDCL plus an administrative tax (as discussed)
- This proposal, potentially a tax increase per SDCL would actually <u>decrease</u> mid-level blend taxes relative to what the administration is doing today
- Solution provides greater consumer choice & assists a struggling industry
- SDEPA strives to achieve an amenable agreement
- Proactive solution – that SDEPA would support.
- Potential to increase SDHWTF revenues