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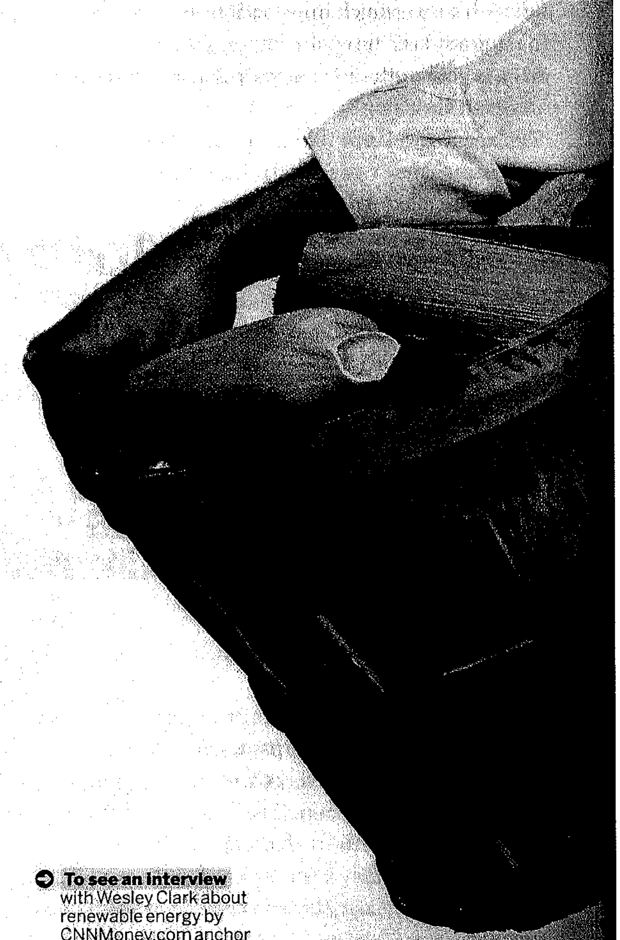
FIELD GENERAL

Triumphant just a few years ago, the ethanol industry now finds itself embattled. Environmentalists are turning their backs on it, and it's even catching flak for higher food prices. Enter Wesley Clark to rally the troops.

BY JON BIRGER
PHOTOGRAPH BY BEN BAKER



IF EVER THERE WERE an industry in need of a general, it's the ethanol industry. Already under siege from food companies blaming biofuels for rising grocery prices, ethanol companies are now seeing their profit margins crushed by falling prices for their product. Compounding the problem, many environmentalists—who five minutes ago seemed to be in ethanol's corner—have turned against the corn-based fuel.

Reporting for duty in ethanol's counterattack: Wesley Clark, the retired four-star general and former NATO commander, who signed on in February as co-chairman of an upstart ethanol trade group called Growth Energy. Clark, 64, has fully embraced the private sector since ending his run for the Demo-

To see an interview with Wesley Clark about renewable energy by CNNMoney.com anchor Poppy Harlow, go to **fortune.com/video.**

MAKE CORN, NOT WAR CLARK SAYS ETHANOL CONFERS BOTH ECONOMIC BENEFITS, BY CREATING JOBS, AND NATIONAL-SECURITY ONES, BY DISPLACING OIL.

cratic presidential nomination in 2004. In addition to co-chairing Growth Energy, Clark is on the board of Dutch wind-turbine maker Juhl Wind and serves as chairman of the New York investment bank Rodman & Renshaw. At Growth Energy, Clark has lobbied against efforts in California to hold ethanol accountable for deforestation in Brazil, he's pushed back against claims that diverting corn to ethanol drives up food prices, and he's spoken out in favor of a Growth Energy proposal to increase the maximum allowable ethanol blend in conventional gasoline to 15% from 10%.

Without support for corn ethanol now, Clark says, the industry won't be able to fund advances in second-generation cellulosic ethanol made from nonfood inputs such as switchgrass. He also contends that the extra 7 billion gallons a year that would be produced with a move to so-called E15 gasoline equates to $10.5 billion that American consumers would no longer be spending on foreign oil. "Some people would rather pay that money out to other countries, because they take a slice of it," Clark says, jabbing at the oil industry. "But I would ask you, What is better for the country?"

The thing is, there are two wars being fought here. There's the public war against ethanol's critics, but there's also a civil war within the ethanol industry itself. And Clark's hiring is the clearest sign yet of how the owners and operators of many of the ethanol plants built since 2005 are pushing back against the industry's old-line leadership.

Just consider which food company Clark chose to mention by name when he accused the food industry of using ethanol as an excuse to hike prices. "The smart people in that market, the food market—the Archer Daniels and the other companies in that market all the time—they know how it works," Clark said at the Alternative Fuels and Vehicles conference in Orlando last April. Even though grain prices fell last year and "speculators lost their shirts, ... the price of food has not fallen."

Why would the spokesman for an organization promoting ethanol single out Archer Daniels Midland? Yes, the company is a giant food processor, but ADM almost single-handedly created the American ethanol industry. Clark says he didn't intend his comments to be critical of ADM but rather of "other companies" that have scapegoated ethanol. But it's hard to believe ADM's inclusion was unintentional.

Growth Energy is positioning itself as a challenger to the Renewable Fuels Association, which until now has been the leading voice of the ethanol industry. Fairly or not, the RFA has long been perceived by some as a lobbying arm of Archer Daniels. That perception is now problematic, as small ethanol producers and their beleaguered investors question whether their interests are still aligned with those of ADM. "You've seen a lot of small ethanol plants go out of business," says one South Dakota farmer and ethanol plant investor, who didn't want to be identified for fear of antagonizing ADM. "The concern is that ADM might not mind seeing that happen to a bunch more."

Ethanol plants are most profitable when the cost of their primary input (corn) is low and the cost of oil (which drives the price of ethanol) is high. Ethanol nirvana was achieved in 2006 when corn cost $2 a bushel and oil was pushing $70 a barrel. Since mid-2006, however, the price of corn has more than doubled, to $4 a bushel (it hit $7 last spring), while the price of oil is back to $70 after some wild gyrations. Even worse, all the new ethanol plants that have come on line have created a glut. Consequently, even though the price of oil has soared 107% since February, ethanol has barely budged, rising only from $1.95 to $2.07 a gallon. "Many ethanol projects find themselves unable to support the debt load taken on at flusher times, making restructurings or bankruptcies inevitable," says Paul Ho, managing director at Hudson Clean Energy Partners. Ethanol producers Verasun and Aventine have already filed for Chapter 11.

ADM, however, can weather the margin squeeze. Not only does it have its profitable food businesses, but its large ethanol plants have lower cost structures than the small operators with which it competes. Moreover, when *Fortune* profiled ADM CEO Patricia Woertz back in 2006, she anticipated an environment like today's. "I come from an industry that understands margins can be the jaws of life or the jaws of death," said Woertz, who ran Chevron's oil-refining operation before joining ADM. "Any industry building capacity as rapidly as the ethanol industry has to ask itself whether margins are going to fluctuate."

ADM recently tried (unsuccessfully) to acquire Verasun's plants out of bankruptcy, and regardless of whether it makes acquisitions, it is likely to emerge from the recession with a greater share of the ethanol market. ADM also stands to benefit if a drop in ethanol production

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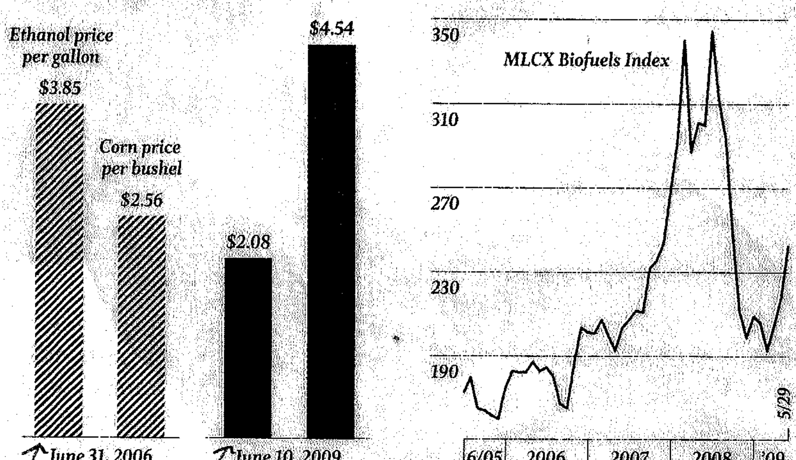
Living on the Margin

WHEN CORN WAS CHEAP, WALL STREET POURED MONEY INTO ETHANOL. BUT PRICIER CORN AND CHEAPER ETHANOL HAVE DIMMED INVESTORS' INTEREST.



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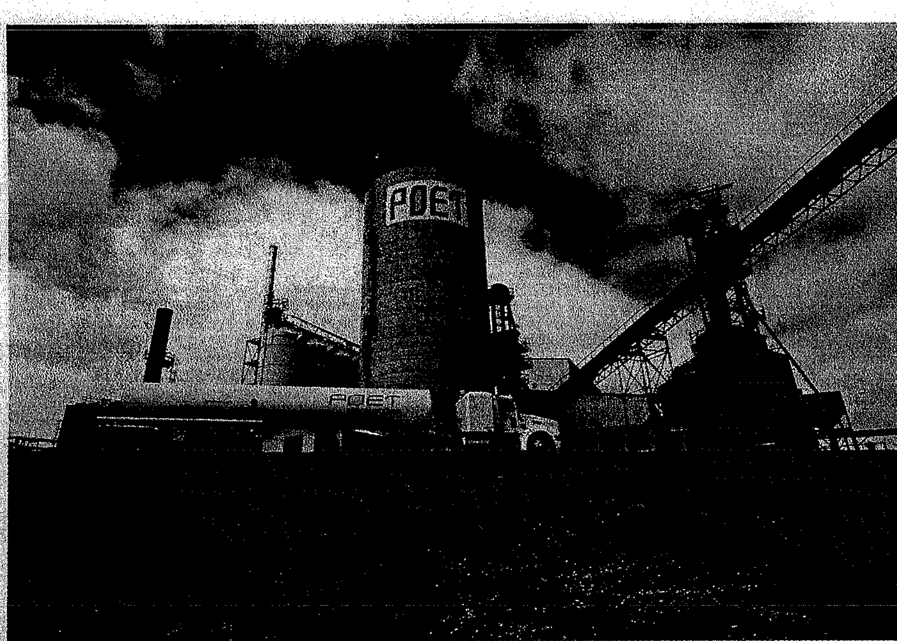
translates to lower corn prices and thus wider food-processing margins. "It's to ADM's advantage to have some of the capacity shut down and tighten up the supply side of the equation," says Ian Horowitz, a biofuels analyst at Soleil Securities.

Into this fray has stepped Growth Energy. While Clark is the group's public face, the power behind it is his co-chairman, Jeff Broin, the 43-year-old CEO and founder of privately held Poet Energy. Poet surpassed ADM in annual ethanol production in 2007 and is now the largest ethanol producer in the U.S., producing more than 1.5 billion barrels a year, the equivalent of about 1% of U.S. gasoline sales. Yet because ethanol is Poet's sole business, and because Poet typically owns only minority stakes in the ethanol plants it builds and operates, Broin's financial interests are more closely aligned with the small plants' than with ADM's. If ethanol prices don't rebound, says one RFA board member, "nobody has more to lose than Jeff Broin."



POET ENERGY THE OPERATOR OF ETHANOL PLANTS LIKE THIS ONE IN GLENVILLE, MINN., POET HAS DISPLACED ARCHER DANIELS MIDLAND AS THE NATION'S BIGGEST PRODUCER. IT IS BEING PINCHED BY LOW PRICES.

In an interview, Broin dodged any questions related to his differences with the RFA, although he certainly implied that the RFA hasn't been promoting ethanol aggressively enough. "We just felt it was time for a new, more aggressive voice," says Broin, a former RFA board member. "There are topics that Growth Energy wants to move forward that just weren't moving forward in the past." The RFA's response? "The notion that any group could be more aggressive than the RFA is laughable," says RFA spokesman Matt Hartwig.

Even before oil and ethanol prices collapsed, Broin was steamed at the RFA for what he perceived as the organization's slow response to last year's anti-ethanol PR campaign by the Grocery Manufacturers Association, sources say. The GMA laid blame for higher food prices on the greater share of the U.S. corn crop being used for ethanol. It certainly didn't help that ADM is a GMA member. ADM spokesman David Weintraub says that while the company "agrees more often than not" with the GMA, "we've made clear that we fundamentally disagree with their stance and oppose their advocacy on this issue."

Broin's concerns about the GMA campaign proved well founded. The RFA's internal polling shows a five- to 10-percentage-point drop in public support for ethanol since the GMA campaign began, says the RFA board member, adding, "We were caught with our pants down." Support for ethanol in Congress has taken a hit too, says Mark McMinimy, a political analyst at Concept Capital.

"MANY ETHANOL PROJECTS FIND THEMSELVES UNABLE TO SUPPORT THE DEBT LOAD TAKEN ON AT FLUSHER TIMES, MAKING ... BANKRUPTCIES INEVITABLE."

It was against this backdrop that Broin shocked the RFA last September by pulling out Poet and the Poet-run plants to form Growth Energy and then hiring Clark to front the new group. "I think he's had a definite impact," Broin says of Clark. "We're obviously dealing with a smear campaign against ethanol, and his credibility is exceptionally high." Broin describes Growth Energy as "bipartisan," but his key hires clearly reflect the fact that Democrats control all the levers of power in Washington these days. In addition to making Clark his co-chairman, Broin hired Tom Buis as Growth Energy's CEO. Buis may not be a household name to most *Fortune* readers, but in the farming world he's a superstar. Before joining Growth Energy, Buis was president of the powerful National Farmers Union. And before that, he was the top agriculture staffer for former U.S. Senate majority leader Tom Daschle. Were it not for President Obama's self-imposed ban on hiring ex-lobbyists, Buis would have surely made the short list for Secretary of Agriculture.

To get a sense of how high the stakes are for Growth Energy and the rest of the ethanol industry, take a look at the SEC filings of Northern Growers, the holding company for Poet's 75-million-gallon-a-year ethanol plant in Big Stone City, S.D. In 2006 the plant made $52.8 million in profit on only $123 million in revenue. By 2008, however, Northern had swung to a $5.3 million loss on $171 million in revenue, and its future seems in jeopardy. The company's 2008 annual report warns that Northern is in violation of a loan covenant with U.S. Bank, and that U.S. Bank could "accelerate the payment of all outstanding principal or foreclose on the [$44 million] loan."

For Poet, which owns a 22% stake in Northern, Big Stone City's woes have already meant the loss of $5.7 million in dividends. But just as important are the myriad fees Poet collects. In 2008 Northern paid Poet $587,089 in management fees, $1.4 million in marketing fees for selling Northern's ethanol, $532,832 in licensing fees for Poet's ethanol-making technology, and $4.6 million in "denaturant" fees, which cover the cost of adding chemicals to ethanol in order to make the grain alcohol undrinkable. (Why the federal government thinks it's a good idea to force ethanol companies to add costly toxins to their product is another story.) All in all, Poet collected $7.1 million in such fees from Northern last year.

Without a rebound in ethanol prices, companies like Northern face an uncertain future and Poet a diminished one. Seeking to stimulate demand, Growth Energy has petitioned the EPA for a waiver that would allow oil refiners to increase the maximum amount of ethanol in gasoline to a 15% blend from the current 10%. (Given tax credits and the low price of ethanol right now, most refiners would probably move quickly to a 15% blend.) "You're dealing with an industry in which demand has contracted, and what you need to get it back on course is a market opportunity," says Clark. "That's one reason we're going for E15." Clark also makes an economic case for E15: "Ethanol is a $66-billion-a-year industry with almost 500,000 jobs. If we go to E15, median estimates say you'll create another 130,000."

The RFA signed on to Growth Energy's E15 petition, but it's not expecting quick approval. Thus, the RFA is also urging the EPA to consider a less dramatic interim move to E12, which the RFA believes the EPA could approve now without going through a lengthy application process.

If the EPA sides with Growth Energy, it will be over the objections of an odd coalition of automakers, boating groups, environmentalists, and food companies that contend that not enough testing has been done on E15. Mat Dunn, legislative director for the National Marine Manufacturers Association, says there's evidence ethanol causes corrosion, overheating, and other problems in many boat engines. Dunn says that a move to E15 could void warranties of millions of recreational motorboats currently on the water. "I sympathize that these guys are struggling, but so is everybody else," says Dunn. "Our position is to ask the EPA to look at the science and not force this new fuel on the marketplace before determining the real effects."

"YOU'RE DEALING WITH AN INDUSTRY IN WHICH DEMAND HAS CONTRACTED, AND WHAT YOU NEED TO GET IT BACK ON COURSE IS A MARKET OPPORTUNITY."

DISSIDENT JEFF BROIN, POET'S FOUNDER AND CLARK'S CO-CHAIRMAN, WANTS TO SET NEW GOALS FOR THE ETHANOL INDUSTRY.

Even if the EPA does approve E15, corn ethanol won't have much of a future unless the ethanol lobby beats back environmental restrictions on ethanol related to something called "indirect land use." Says Buis: "If you adopt this, you not only destroy ethanol and biodiesel in America, you'll destroy American agriculture."

The indirect land use argument was first made in a February 2008 study published by Princeton professor Tim Searchinger and several co-authors. Searchinger's basic premise is that when U.S. corn is taken out of the food supply for ethanol, one indirect result is deforestation elsewhere in the world, particularly in Brazil. Third World farmers are forced to plow new fields in order to compensate for the decrease in food supply. Factor in deforestation, and corn ethanol is actually less carbon-friendly than oil, according to Searchinger: "We found that corn-based ethanol, instead of producing a 20% savings, nearly doubles greenhouse emissions over 30 years."

In April the California Air Resources Board accepted indirect land use when it issued new carbon standards designed to cut carbon emissions by 80% by 2050. If the standards go into effect as planned in 2011, it would lead to sharp curbs in ethanol sales in California. Moreover, the governors of 11 Northeastern states have endorsed similar proposals, and now the EPA is considering its own indirect land use standard.

JinMing Liu, a biofuels industry analyst with Ardour Capital, says the ethanol industry must find a way to counter the indirect land use argument. "If not," says Liu, "it's a fatal blow." A former Columbia University research scientist, Liu is dubious of Searchinger's claims and says that the ethanol industry "just didn't work hard enough" to combat them. Buis agrees.

Both Clark and Buis contend that the facts don't support Searchinger's thesis. "Rainforest deforestation in Brazil fell by half at the same time that we doubled ethanol production," Clark says. He adds that he has no problem incorporating indirect impacts when evaluating the pluses and minuses of various fuels. He just wants to make sure oil gets similar treatment. "In the whole 20th century, what you've seen is that the struggle for access to petroleum is a struggle of armies and navies that results in war," he says. "I participated in this in my 34 years of military service, and I can tell you that none of *those* indirect impacts apply to corn-based ethanol. Nobody goes to war about growing corn."

At least not literally. ■

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