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Koch brothers enter ethanol market to make money

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Jeremy Bezdek admits that the proposal he made to his bosses at Koch Industries Inc. sounded like a career killer.

Back in 2010, the oil-refining executive urged Charles and David Koch to expand into renewable fuels, an ailing industry created by the kind of government mandates the billionaire brothers have spent part of their fortunes trying unsuccessfully to overturn. Today, Koch is the fifth-largest U.S. ethanol producer and in August opened a $100 million plant that makes biodiesel.

“It did surprise people” when the free-market-preaching Kochs agreed to jump into the highly regulated world of renewable fuels, said Bezdek, the vice president of the Koch-owned Flint Hills Resources LLC in Wichita, Kansas. “Our company philosophy is against all subsidies.”

Koch has become “a big player” in renewable fuels, said Jason Ward, an analyst at Northstar Commodity Investments in Minneapolis. (Photo: i Stockr/Thinkstock)

So why did the Koch brothers -- who founded the libertarian think tank Cato Institute and oversee a huge conservative political network that’s spending $750 million between 2015 and 2016 -- end up in a business built around a 2007 law requiring refiners to use a specific amount of renewable fuel in every gallon of gasoline? Bezdek says the answer is simple: They could make money.

Six years ago, the ethanol industry was in crisis. New plants built to capitalize on the fuel mandate were mired in red ink because of surging costs for corn, the main raw material, and surplus fuel-making capacity. More than a dozen producers filed for bankruptcy protection starting in 2008, including one of the biggest, VeraSun Energy Corp., which went out of business and sold its plants.

That led to a lot of renewable-fuel assets that could be acquired cheaply enough to make them profitable investments, especially for a big oil refiner like Koch, Bezdek said in a telephone interview. Valero Energy Corp., America’s top independent oil refiner and the fourth-largest U.S. ethanol producer, has employed a similar growth strategy to take advantage of an industry that generated about $44 billion in output last year.

‘Big Player’

Koch has become “a big player” in renewable fuels, said Jason Ward, an analyst at Northstar Commodity Investments in Minneapolis. “They weren’t five years ago.”

Wichita, Kansas-based Koch, one of the largest privately held U.S. companies, has deep pockets. It has annual revenue of about $115 billion and made more than $80 billion of acquisitions and investments since 2003, according to its website. In addition to a petroleum business that can process more than 600,000 barrels of oil a day, Koch owns paper maker Georgia Pacific as well as companies involved in pipelines, chemicals, plastics, agricultural services and cattle ranches.

The businesses have made Charles Koch, the chairman and chief executive officer, and David Koch the seventh- and eighth-richest men in the world with a combined net worth of $100 billion, according to the Bloomberg Billionaires Index.

Buying Opportunities

“There have been opportunities to buy some of the best plants” to make renewable fuels, especially when the health of the industry failed, said Bezdek, who earned his finance degree at the University of Kansas in 1996 and started work at Koch’s oil-refining business almost two decades ago.

Koch’s initial foray into renewable fuels, through its Flint Hills unit, was the 2010 purchase of two ethanol plants in a bankruptcy sale from Hawkeye Energy Holdings LLC. That was followed by additional purchases as the industry was rocked by high debt, oversupply and volatility in crude oil and corn prices. The company now has a total of six plants in the corn-growing states of Iowa and Nebraska, as well as one in Georgia, and enough capacity to produce 820 million gallons of ethanol annually.

“I think it did surprise people, initially, when we made the first couple of acquisitions,” Bezdek said. “Had margins stayed really strong during this entire time frame, we wouldn’t have been as successful, because the need by some to sell plants wouldn’t have been there.”

Upping Ante

Most of those assets already were able to produce ethanol. But Flint Hills upped the ante when it invested $100 million to complete construction of a biodiesel plant in Beatrice, Nebraska, with partner Benefuel Inc. The facility, which opened in August, is unusual because it can convert multiple feedstocks -- from soybean and corn oil to recycled cooking grease -- into fuel and products used in food and pharmaceuticals.

“Flint Hills had become an important player in the biofuel world before the opening of the Beatrice plant,” said Heather Zhang, an analyst at Prima Markets in Naperville, Illinois. “The new plant will just make the firm have better competitive advantages over other similar firms.”

The idea, according to Bezdek, is to create a business that doesn’t need government mandates, which the Kochs continue to oppose.

A 2007 energy law, known as the Renewable Fuel Standard, requires refiners to use escalating amounts of biodiesel and ethanol. The mandate has received increased scrutiny in recent months as prices surged for the credits used to track compliance. Refiners have complained, and billionaire Carl Icahn, who owns an 82 percent stake in refiner CVR Energy Inc., said trading of the Renewable Identification Numbers (RINs) is “rigged.” Ethanol production in 2016 has been at a record pace, due in part to cheap corn.

While Koch Industries declined to make either of the brothers available for an interview, an April 2015 letter to U.S. lawmakers from the company’s Washington lobbyist, Philip Ellender, said the mandate system needs to be dismantled.

“The RFS is an unqualified failure that should be repealed in full,” Ellender wrote. “We bought these ethanol plants despite the RFS, not because of it.”

The Koch brothers have long campaigned for reduced government involvement. They provide millions in financial support for conservative groups they have founded, including Freedom Partners and Americans for Prosperity.

While the mandate for using renewable fuels has increased, federal subsidies associated with ethanol expired in 2011. A dollar-per-gallon credit for blending biodiesel is still in place, though its set to expire at the end of this year. The industry is lobbying for an extension.

To prepare for a mandate-free world, Flint Hills is examining technology that will make its byproducts more marketable. Ethanol plants that distill corn produce dried distillers grains that are fed mostly to livestock and cattle. The company wants to create a product that is palatable to more kinds of animals, including fish.

“Charles is a big believer in free markets,” Bezdek said, adding that the company still wants the government to dump its mandate on renewable fuel use. “We’re fine if it goes away.”