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June 12, 2014

Dr. Jay Killgo
Superintendent
Vidor Independent School District
120 E. Bolivar
Vidor, Texas 77662

RE: Jefferson Refinery, LLC

Dear Superintendent Killgo:

Our office has received the application for a limitation on appraised value submitted to the Vidor Independent School District by Jefferson Refinery, LLC (Jefferson) under the provisions of Tax Code Chapter 313 on May 21, 2014.

Chapter 313 requires several determinations before we can issue a certificate of limitation authorizing the district to enter into an agreement. This letter addresses the agency's determinations regarding whether the property meets the requirements of Section 313.024 for eligibility for a limitation on appraised value, as required under Tax Code Section 313.025(h), and the requirement that, in order to issue a certificate of limitation, the agency determine that the limitation on appraised value is a determining factor in the applicant's decision to invest capital and construct the project in this state, as required by Tax Code 313.026(c)(2).

**Determination required by 313.025(h)**

Section 313.025(h) states in part:

> "(h) After receiving a copy of the application, the comptroller shall determine whether the property meets the requirements of Section 313.024 for eligibility for a limitation on appraised value under this subchapter."

Section 313.024 defines eligible property, including defining manufacturing as follows in 313.024(e)(1):

> (1) "Manufacturing" means an establishment primarily engaged in activities described in sectors 31-33 of the 2007 North American Industry Classification System.

The project description for this application describes the project, in part, as:

> "...the proposed project that is the subject of this Application is a bitumen blending, offloading, storage and processing facility. Heavy crude oil would be delivered to the Orange County manufacturing facility in jacketed rail cars or tanker trucks from North American suppliers. Bitumen is highly viscous and must be heated to over 200 °F in order to flow; the heavy crude cannot be transported via pipeline due to its high viscosity. With the use of boilers

> to generate steam, the rail cars and tankers would be heated to over 200 °F, at which point the lighter material would be flashed off and the heavier material would be blended with lighter crude oil to produce a feedstock specific to customer needs."

Diluting bitumen is a means of transporting highly viscous petroleum. In its natural form, bitumen is the consistency of peanut butter—too thick for pipelines. Prior to pipelining, the bitumen is thinned by adding light hydrocarbons (typically natural gas condensates). The resulting mixture is called diluted bitumen, or dilbit. The diluent itself does not necessarily become a component part of the product being manufactured, and can be removed after the diluted bitumen reaches its destination. The American Petroleum Institute states [emphasis added], "Bitumen would not flow through a pipeline efficiently, so it is mixed with diluents *to be readied for pipeline transportation* as diluted bitumen, or 'dilbit.' Diluents are usually natural gas condensate, naphtha or a mix of other light hydrocarbons."

This office concludes that the property that is the subject of the application is not eligible property under 313.024, because diluting bitumen does not create a new or different product – merely a diluted one – and the purpose of blending the bitumen is primarily for transportation, prior to the bitumen reaching the refinery. While refining petroleum is in Sectors 31-33 of the 2007 NAICS and is considered to be manufacturing, pipeline transportation of crude oil is in a different sector, Sector 48, of the 2007 NAICS, which is not considered to be manufacturing. Section 313.004 of the Texas Economic Development Act directs the Comptroller to "strictly interpret the criteria and selection guidelines provided by this chapter [Chapter 313]." This letter is notice of the Comptroller's determination that application is not eligible for a limitation of appraised value.

Section 313.025(h) provides an applicant with the opportunity for a hearing conducted by the State Office of Administrative Hearings before this eligibility determination becomes final. To receive an eligibility hearing, the applicant must file a written request for an eligibility determination that complies with the requirements of 34 Texas Administrative Code § 9.1056 with this Division within 30 days after the date of this notice.

**Determination required by 313.026(c)(2)**

As noted above, this letter also addresses the requirement that, in order to issue a certificate of limitation, this agency determine that the limitation on appraised value is a determining factor in the applicant's decision to locate the project in Texas. The requirement that our office make this determination, and state in writing the basis for our determination, was added by the 83rd Legislature after concerns were raised that school districts were entering into Chapter 313 agreements with companies that would have located in the state without the tax benefits granted by Chapter 313.

Section 313.026 states in part:

> (c) The comptroller may not issue a certificate for a limitation on appraised value under this chapter for property described in an application unless the comptroller determines that:
>
> (2) the limitation on appraised value is a determining factor in the applicant's decision to invest capital and construct the project in this state.

The comptroller is **unable to determine** that the limitation on appraised value is a determining factor in the applicant's decision to invest capital and construct the project in this state, and therefore, the comptroller will not issue a certificate for a limitation of appraised value, and the district may not approve the application, as noted in Section 313.025(d-1).

In reviewing the application and information available, the comptroller notes the following:

- In 2010, $300,000 in Hurricane Ike Disaster Area Revenue Bonds were allocated by the Jefferson County Industrial Development Corporation to Jefferson Refinery LLC. While the details of the company financing are unknown, it is highly unlikely that Jefferson could access this financing if they do not locate in or near the proposed site at Port of Beaumont. Interest paid to the bond holders on these bonds is intended to be tax-free, potentially making this financing more attractive than other methods of finance.
- In August 2013, the Beaumont Business Journal published an article that relies heavily on interviews with multiple representatives from Jefferson Energy Companies (the parent company of Jefferson Refinery) as well as representatives of the construction company building the proposed project. That article states "Construction of Phase Two of the Jefferson transload railport is scheduled to begin as Phase One nears completion. Phase Two will include bitumen unloading stations that can accommodate jacketed railcars, so-named because they are built to have steam injected to heat the railcar and permit the crude inside to flow."
- In December 2013, the applicant began operations on the site for the Port of Beaumont Petroleum Transload Terminal LLC, a subsidiary of Jefferson Refinery LLC (referred in bond documents as POB I). POB I accepts light crude via train for further transport via barge or pipeline. This existing company operation also relies on the rail and port access, and is complementary to the proposed bitumen transportation project. POB I was funded using $46.8 million in Hurricane Ike Disaster Area Revenue Bonds.
- In December 2013 (prior to the school board approving consideration of the first Chapter 313 application) a company presentation to the Southeast Texas Regional Planning Commission includes a slide titled "Jefferson Transload Railport," with the following bullets "Next July the ability to unload 120 bitumen crude rail cars from Canada" and "Ability to blend domestic light sweet crude with heavy Canadian crude."
- The company website states as one feature of the "state-of-the-art Jefferson Terminal": "steam to heat facilities to unload and store bitumen and other heavy crudes" and further states "Projected completion of the full facility is December 2014." Another "feature when complete" that is noted is "Handle Heavy Crude: The terminal will have heated unloading, piping, and storage to accommodate heavy Canadian crudes."
- In January 2014, the bitumen blending operation was the subject of a "Preliminary Remarketing Circular Dated January 6, 2014" that proposes to remarket $115 million in Hurricane Ike bonds in December 2015. This document notes that the owner of the new operation is the Port of Beaumont Petroleum Transload Terminal II LLC, and is referred to as POB II. According to that document:
    - The applicant has a 10 year lease, with 2 automatic renewals of 10 years each, on the property where POB I and POB II are located.

- The Port of Beaumont has reported investing $36 million in infrastructure to support the related businesses announced by the company. A similar investment by the Port was also reported in the August 2013 article in the Beaumont Business Journal.
- TxDOT and the Port have reportedly committed another $10 million in infrastructure improvements to support POB I and POB II.

Based on the reported commitments by the Jefferson County Industrial Development Corporation, the Port of Beaumont, Orange County and the Texas Department of Transportation related to the site, as well as the fact that this the intent to build this project was disclosed by the company on several occasions, all before the December 2013 Chapter 313 application, the comptroller is unable to determine that the limitation on appraised value is a determining factor in the applicant's decision to invest capital and construct the project in this state and will not issue a certificate of limitation for this application.

Should you have any questions, please contact me by e-mail at robert.wood@cpa.state.tx.us or by phone at (512) 463-3973.

Sincerely,

Robert B. Wood
Director, Economic Development and Analysis

cc: Jefferson Refinery, LLC