

2013 SENATE FINANCE AND TAXATION

SB 2309

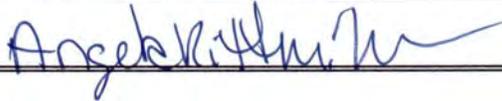
2013 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee Lewis and Clark Room, State Capitol

SB 2309
2/5/2013
Job Number 18285

Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

A BILL for an Act to create and enact subsection 10 to section 57-51.1-03 of the North Dakota Century Code, relating to an exemption from the oil extraction tax; and to provide an effective date.

Minutes:

Testimony Attached

Chairman Cook opened the hearing on SB 2309.

Senator Andrist introduced SB 2309.

Chester Trabucco, Dakota Oil Processing - See attached testimony 1.

Chairman Cook - This plant you're talking about is to be built where?

Chester Trabucco - It's 20,000 barrel a day facility outside of Trenton.

Chairman Cook - Excess diesel fuel that is not sold in the state, you're going to export that out of the state I assume?

Chester Trabucco - We do not anticipate exporting any diesel out of the state. There is already a shortage of 40%. We will distribute all of the diesel within 50-70 miles of the site. Residual fuels, naphtha, and the bottoms would be railed out. Naphtha likely to Canada, and the bottoms likely to be processed further elsewhere, probably the Gulf Coast.

Chairman Cook - If you cannot sell the diesel in state, you are going to have to store it.

Chester Trabucco - We would have to store it if it could not be distributed. As sure as the sun rises, we can sell the diesel. We've talked to all the major distributors, a lot of the producers; they will take every drop we can make.

Chairman Cook - You made the comment that the only refinery in the state is the most profitable in the U.S. When you say that are you referring specifically to the refinery in Mandan, or are you referring to Tesoro, the company that owns the refinery in Mandan?

Chester Trabucco - I'm referring to the refinery in Mandan, not Tesoro as an organization.

Vice Chairman Campbell - The other refinery that got approval I believe 4-6 months ago, is that a traditional refinery?

Chester Trabucco - The Three Tribes one will be a more complex refinery. We are a boutique refinery, 20,000 barrels a day. I think one of their interests is to provide jet fuel to the military. We aren't going to do that additional level of processing.

Vice Chairman Campbell - If this gets real challenging, with your logistics outbound, let's say you couldn't store it, how far could you truck it out and be competitive? How far can you go?

Chester Trabucco - We know what the logistics charges are to rail out. (20:50)

Senator Triplett - Your proposing that we add an exemption in to our state law just as the industry is pressing us to get rid of all the exemptions for the production of oil and telling us what they really want is just a stable tax environment for the long term without exemptions. Why is it that we should be favorably considering this when we are being asked to do the opposite in the production side?

Chester Trabucco - Our position on that is simply that as long as the exemption is there it's a tool for us to provide you the producers to work on some kind of arrangement whereby if they provide us crude we can split that exemption, whatever it is. (23:35)

Senator Triplett - Why is it even necessary then if you're not expecting to use it and don't expect it to have much impact?

Chester Trabucco - A few years ago there was this thing called the mortgage crisis that caused a very down economy and it got banks to be very skittish. From a purely financing standpoint, this is still going to require, it's a \$200 million project. We don't expect to invest any less than \$100 million of private capital into this project. From an underwriting standpoint, we've moved from thinking it would be \$60 million in private capital to \$80 million, it's probably going to be up to \$100 million, why, because this industry is volatile. That is why some of the returns that you see that people get so concerned about, you have to look at that imbalance of the 150 refineries that have closed around the world in the last 3-4 years. You can't predict the future. (25:34)

Jeffery Lincoln, Dakota Oil Processing - See attachment 2.

Senator Miller - Do you have any relationship data between the price at the pump for diesel versus what the price of crudes been doing in this region?

Jeffery Lincoln - I don't have the data for the price at the pump but I have almost 6 years of detailed data of the price at the racks, which is the wholesale price and I can provide that to the committee. (44:31)

Chairman Cook - Your cost to product diesel fuel goes up, the crack spread becomes smaller, correct?

Jeffery Lincoln - Correct.

Chairman Cook - As the price of crude oil goes down, the crack spread becomes smaller?

Jeffery Lincoln - Actually, I said something incorrect. Our price to product is not reflected in the crack spread. The crack spread is simply based on the market prices. Our estimated cost to produce a barrel is \$4.10 per barrel is what it should cost us to produce. The remainder of the cost that get us to a critical position, which is the \$11 crack spread, is our financing cost and carrying cost and transportation cost, etc.

Vice Chairman Campbell - Worst case scenario, the fracking business goes away and your main resource is dead, can you support this almost quarter billion dollar plan? Can you support this project if your raw product dries up?

Jeffery Lincoln - If there is no Bakken crude, this particular refinery doesn't work. Most of the refineries in the United States, 10 years ago when they were doing their strategic planning thought the future was going to be in heavy Canadian, either western Canadian select or other blends of Canadian and most of them changed over and most of them will use a blend of different products. Our refinery will only be built to handle light sweet Bakken crude, API 38-41. The plant will be optimized to use only that fuel. (48:14)

Senator Miller - How did you arrive at the \$11.00?

Jeffery Lincoln - At that point you can no longer meet your economics and you're in a loss scenario.

Senator Miller - So that's your breakeven point?

Jeffery Lincoln - At that point you are making economic decisions and ultimately what you would wind up doing is, as you start coming toward that point and your economic are going south you are looking at turning off the refinery, shutting it down.

Senator Miller - So you're well below your breakeven point at \$11.00?

Jeffery Lincoln - You're at your break point, we are going to run the thing economically. If it's not going to work it's not going to work. That is also one of the advantages that we are looking to do to ensure the investment value to the stockholders. A modular design can be relocated, so the investment cost of \$83 million in processing equipment, literally all of that can be relocated economically so you retain that value.

Chairman Cook - But to be located to where you can use sweet Bakken crude.

Jeffery Lincoln - Or Eagle Ford. The beauty of the crude that is coming out of most of the formations in North Dakota is it is very consistent. Eagle Ford is all over the place but it's all sweet and light.

Senator Miller - How many of these smaller distilleries are there out there?

Jeffery Lincoln - The EIA data will have a listing of about 136 refineries that are greater than 3,000 barrels a day. At that level, under 20,000 they are not particularly economical. There has not been a new refinery built in the United States, a standalone refinery since 1977 in Indiana. (51:10)

Senator Dotzenrod - You mentioned if this project were built and it was successful then we should see diesel prices become more stable and take the peaks off, some of these run ups in diesel prices will fade away and we'll get a stable and maybe even declining diesel price. If that happens then does that reduce the crack spread?

Jeffery Lincoln - Theoretically it could and it's market pressure. If any increase in supply to the marketplace will cause the supply curve to shift to the right and the price should go down. As you face competition our crack spread should go down. (53:40)

Senator Dotzenrod - The naphtha product you show here on your chart and your talking that would go to Canada, how dependent is the success of the project on being able to market and get that naphtha up to Canada and have it used in that application?

Jeffery Lincoln - The Canadian market is kind of like, that's the steadiest market because there is actually a diluent pool in Enbridge. Enbridge will take it in and price it and they consistently need a supply of it based on what is going on there. (55:12)

Senator Burckhard - This refinery is going to be ready to go by the end of what year?

Jeffery Lincoln - 2014, and I have to say we do not have complete financing and without complete financing that thing slips away.

Senator Miller - How long do you need this backstop in order to guarantee you're...

Chester Trabucco - If the situation that exists today that causes the Mandan refinery to be one of the most if not the most profitable in the country continues to exist this could be as soon as a 3-4 year payback. (56:54)

Mel Falcon briefly spoke, again conveying some of the testimony in attachment 1.

Chairman Cook - Your looking at the possibility of the state issuing bonds, you'd like this possible exemption on the extraction tax, so if I'm hearing you right, to be successful and get your financing, you need the state of North Dakota as a partner to assume some of the potential risk. Is that correct?

Chester Trabucco - That is a fair statement.

Chairman Cook - What are we getting in return?

Chester Trabucco - You're getting jobs, the potential of a stabilized resource in the way of diesel, price stabilization, the expertise that is required to run the refinery is likely going to come from your universities, it's a self-propelling industry. (1:02:59)

Senator Dotzenrod - If we build this refinery, and we are already exporting fuel, you mentioned the naphtha going to Canada, this isn't going to be part of that export picture if I understand it that you intend that the diesel that's going to be produced will be kind of regionally consumed in our area. It may mean that some of the stuff that we are buying from other parts won't be bought anymore and that may become available to export, but, it does appear that, I assume that what we are exporting is the part that is made in to gasoline, that is the diesel fuel that we produce in the country probably gets used in this country.

Chester Trabucco - That is correct.

Senator Dotzenrod - What part of that goes to gasoline? There must be part of this chart that you are showing that is part of that?

Chester Trabucco - The naphtha segment of that spectrum goes to gasoline.

Senator Dotzenrod - And you've already mentioned that is something you intend to export.

Chester Trabucco - That actually falls under the category of exporting to another country because it's exported to Canada. (1:05:04)

Senator Oehlke - You mentioned need for the ability to do this funding for about 10 years. The bill says 2026, is that because you won't be up to speed really running probably until 2016 roughly?

Chester Trabucco - There's probably a 12 year window in there that gives us that hedge for a 2 year period to make sure we get up and running.

Chairman Cook closed the hearing on SB 2309.

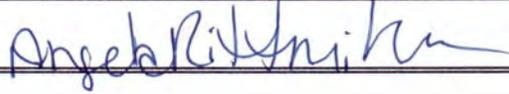
2013 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee Lewis and Clark Room, State Capitol

SB 2309
2/11/2012
Job Number 18717

Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

A BILL for an Act to create and enact subsection 10 to section 57-51.1-03 of the North Dakota Century Code, relating to an exemption from the oil extraction tax; and to provide an effective date.

Minutes:

Committee Work

Chairman Cook opened discussion on SB 2309.

Chairman Cook - This is an exemption of the extraction tax on oil that is used by a particular refinery. I don't believe the bill says that the refinery has to be located in North Dakota; it has to be refinery that is using Bakken crude. Refineries don't pay the extraction tax. The oil industry and the royalty owners pay the extraction tax. How in the world are you going to buy Bakken crude on the market, get it to the refinery, and then somehow figure out who paid the extraction tax that should be exempt. To me it's unworkable. Furthermore, what I see with this is they are asking the state to take from the taxpayers of North Dakota to potentially assume some financial risk for a diesel refinery in case it wasn't profitable. I do believe that refineries are exempt from sales tax if they were to build one of these. We also have a refinery now that looks like it's going to get up and going right out of Dickinson with no incentives. I see very little reason why we should pass this out.

Senator Dotzenrod - I don't know how many refinery projects there are. I heard earlier in the session there were 3. The one that the announcement was made last week out of Dickinson, it looks like a little bit bigger project, I don't know if they are going to be coming in and we are going to find they will be needing some help, but it does appear that is a project that has got a lot more investor strength than this one. The thing that struck me about the hearing we had is that the people involved making the presentation, at least the one that did most of the speaking looked like he had a lot of experience in this and he knew what he was talking about, but I left the hearing feeling that essentially we were by passing this bill, we were sort of agreeing that we were satisfied that the integrity and the ability to follow up, we were essentially investing that in these people. I was a little uncomfortable with that idea. (4:30)

Senate Finance and Taxation Committee

SB 2309

2/11/2013

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Senator Triplett - My concern with this proposal was their description of the fact that they have already purchased the land and they already have permits they need so it's like, then why do you need us to backstop it for you if you've already made the decision to go ahead. Based on that fact I would move a **Do Not Pass**.

Seconded by **Senator Oehlke**.

Roll Call Vote 7-0-0

Carried by **Senator Triplett**.

FISCAL NOTE
Requested by Legislative Council
01/24/2013

Bill/Resolution No.: SB 2309

- 1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

| | 2011-2013 Biennium | | 2013-2015 Biennium | | 2015-2017 Biennium | |
|----------------|--------------------|-------------|--------------------|-------------|--------------------|-------------|
| | General Fund | Other Funds | General Fund | Other Funds | General Fund | Other Funds |
| Revenues | | | | | | |
| Expenditures | | | | | | |
| Appropriations | | | | | | |

- 1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

| | 2011-2013 Biennium | 2013-2015 Biennium | 2015-2017 Biennium |
|------------------|--------------------|--------------------|--------------------|
| Counties | | | |
| Cities | | | |
| School Districts | | | |
| Townships | | | |

- 2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

SB 2309 creates an oil extraction tax exemption for certain months depending on refining margins.

- B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

- A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

Although we are unsure of some of the bill's features - such as if it is limited to North Dakota refineries - we believe the current forecast for the 2013-15 biennium would likely rule out the exemption provisions of SB 2309 from taking place in 2013-15 biennium.

- B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

- C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*



Name: Kathryn L. Strombeck

Agency: Office of Tax Commissioner

Telephone: 328-3402

Date Prepared: 02/04/2013



Date: 2-11-13
 Roll Call Vote #: 1

**2013 SENATE STANDING COMMITTEE
 ROLL CALL VOTES
 BILL/RESOLUTION NO. 2309**

Senate Finance & Taxation Committee

Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: Do Pass Do Not Pass Amended Adopt Amendment
 Rerefer to Appropriations Reconsider

Motion Made By Senator Triplett Seconded By Senator Oehlke

| Senators | Yes | No | Senator | Yes | No |
|----------------------------|-----|----|-------------------------|-----|----|
| Chairman Dwight Cook | X | | Senator Jim Dotzenrod | X | |
| Vice Chairman Tom Campbell | X | | Senator Connie Triplett | X | |
| Senator Joe Miller | X | | | | |
| Senator Dave Oehlke | X | | | | |
| Senator Randy Burckhard | X | | | | |
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Total (Yes) 7 No 0

Absent 0

Floor Assignment Senator Triplett

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SB 2309: Finance and Taxation Committee (Sen. Cook, Chairman) recommends DO NOT PASS (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). SB 2309 was placed on the Eleventh order on the calendar.

2013 TESTIMONY

SB 2309

1

Background Information

February 5, 2013

Subject: Hearing re:HB 2309, North Dakota State Legislature

From: Dakota Oil Processing

For: Senate Finance and Taxation Committee

Background Information Included:

- 1- The general discussion of the proposed changes in plain language
- 2- Talking points in bullet format
- 3- Benefits of the refinery
- 4- Trenton Diesel Refinery Fact Sheet with illustrations
- 5- Facts re: Trenton Diesel Refinery
- 6- Detailed discussion, basis of recommendation

1

MEMORANDUM

For: North Dakota State Senate, Finance and Taxation Committee
Senator Dwight Cook, Chairman, Finance and Taxation Committee
Senator Tom Campbell, Vice Chairman -- Natural Resources Committee
Senator Randall A. Burckhard
Senator Joe Miller
Senator Dave Oehlke
Senator Connie Triplett

cc: Senator Stan Lyson, Chair -- Natural Resources Committee
Senator John Andrist
Representative Gary Sukut

FROM: Chester Trabucco and Mel Falcon of Dakota Oil Processing

DATE: February 4, 2013

RE: General Discussion - Proposed Legislative Changes to facilitate the development of additional refining capacity in North Dakota.

Dakota Oil Processing, LLC is the company that has resulted from the studies conducted with State support since 2006 to determine ways to improve infrastructure in the state based on the on-going oil field development. Dakota Oil currently is in financing to develop a refinery at Trenton, North Dakota that would process up to 20,000 barrels of Bakken crude oil daily and produce up to 8,000 barrels of diesel fuel which is chronically short in the state.

In order to facilitate the development of this new infrastructure Dakota Oil is proposing that the State modify legislation to empower the Pipeline Authority to support this project financially, and to further facilitate the private financing of this and other facilities and projects. (These changes are embodied in HB 10310. Additionally these changes request that under very specific and limited conditions that the oil extraction tax be abated to enhance the viability of the refinery once operational if extremely adverse economic conditions arise. (This change is embodied in SB 2309).

Changes and Enhancement of the Pipeline Authority Act – (HB 1031)

The pipeline authority has the authority to finance, plan, jointly own or in other ways facilitate the development of pipelines in the state. It could construct or own such facilities using grants or loans, limited to a total cost of not more than \$800-million. The legislation proposed would bring petroleum refining facilities under the same authority; however the proposal will be that the authority only initially uses the powers to facilitate the financing of the refinery proposed at Trenton.

The specific mechanism proposed to be used in this case is *conduit lending*, in which the Pipeline Authority would issue bonds and the proceeds be used to make loans to the developer who would repay the loans, the proceeds of which are used to repay the bonds. Using the Authority and this conduit financing method, neither the taxation authority nor credit of the state are pledged towards this private venture.

One of the key issues in this legislative proposal is to for the first time appropriate funds to create a reserve account to be administered by the Pipeline Authority. This reserve account would hold funds that could secure the loans, which could be used not only for this project but also to facilitate other projects that were envisioned under the original legislation that created the Pipeline Authority. Dakota Oil suggests that this initial appropriation be in the amount of \$200-million, 25% of the cap originally established for the Authority. This funding would fence or put aside these financial reserves specifically for state-wide petroleum pipeline and refining projects. This reserve account would allow for better credit terms for the entities that would apply for Pipeline Authority bond support. An alternative way to address this issue would be to pledge future specific revenues such as those from the extraction tax, to facilitate security for the bonds.

Using the Oil Extraction Tax to Provide Credit Support to a Refinery Project (SB 2309)

The second change proposed in legislation is the addition of the proposed refinery in the legislation that allows for the abatement of *Oil Extraction Taxes* under certain specific conditions. These conditions would be those that would exist when the total revenues that could be derived from the sale of the refinery's products, i.e., naphtha, diesel and residual fuel oil, minus the cost of crude oil, do not provide sufficient revenues to sustain operational and debt repayment costs. The difference between the total products resultant from one barrel of crude refining and the cost of the crude itself is called the "crack spread".

The proposed legislation would establish the crack spread methodology and delegate to the Pipeline Authority the responsibility to adopt rules for administering the proposed abatement. Essentially, three revenue streams would be added together for establishing the value of products:

The price of naphtha sold for diluent to heavy oil producers in Canada, minus transportation;
plus,

The price of residual fuel products sold to Gulf of Mexico buyers, minus transportation; plus,

The price of diesel sold locally from the refinery.

From this would be subtracted the cost of crude oil on a per barrel basis, which would be defined as the crack spread.

The Oil Extraction Tax derived from oil processed by the refinery from North Dakota wells would be abated in any month when the spread was less than \$11.00; a threshold estimated that would cover operating and debt service costs of the investment.

The abatement program is proposed to exist for a 10-year period from the commencement of operations.

This abatement provision is anticipated to greatly enhance the ability of the company proposing the legislative change to obtain private financing.

Talking Points, Proposed Legislative Changes, Pipeline Authority and Extraction Tax Abatement

Dakota Oil is proposing two changes to legislation that would facilitate the development of more than \$200-million in petroleum infrastructure in the State of North Dakota:

- Including refineries under the State's Pipeline Authority for financing purposes, and,
- Providing for the abatement of extraction taxes in the event that economic conditions threaten the continued viability of a refinery once in operation.

Pipeline Authority.

Including petroleum refineries under the Pipeline Authority, and creation and funding of a reserve account to enable the Pipeline Authority's ability to engage in financing activities would accomplish the following actions for the purpose shown:

- Include petroleum refining facilities under the same authority as pipelines to allow financing under the same provisions,
- Allow the creation of a reserve account to back bonds that would be issued by the Authority to improve the credit of loans issued by the authority,
- Suggests the appropriation of 25% of the Pipeline Authority's authorized limit of \$800-million to a reserve account to back such bonds as may be issued by the Authority for the purposes of funding or facilitating the financing or construction of the project contemplated (the Trenton Diesel Refinery) or other projects that may be facilitated by the Authority.

Oil Extraction Tax Abatement

The Company requesting the change to provisions of the Oil Extraction Tax law proposes that the tax revenue would be abated from oil taxed in the state and processed by the refinery, in any month in which the total revenues from the refined products of each barrel of crude exceed the cost of one barrel of crude oil by less than \$11.00. The calculation would be based on the sale prices as follows:

The net of:

- Sale price of naphtha to heavy oil diluent consumers in Canada, minus transportation, plus,
- Sale price of residual fuel oil to Gulf of Mexico buyers, minus transportation, plus,
- The price of diesel sold locally, minus,
- The price of crude oil purchased from North Dakota wells.

These changes would greatly enhance the ability of the company to obtain private financing.

The requested legislative addition would be in effect for a period of 10 years from commencement of operations, which is expected before the end of 2014.



Dakota Oil Processing, LLC

January 3, 2013

Memorandum

Subject: Benefits of the Trenton Diesel Refinery

The Trenton Diesel Refinery will have high net positive effects on the local, regional and national economy. The refinery will represent a major increase in refining capacity in the region, will create positive economic activity and new, high quality permanent jobs. It will also reduce some of the adverse impacts of the intensive oil field activities. The refinery will add value to the natural resources being produced in the state and contribute to the local economy in numerous ways.

Infrastructure development:

- The Trenton Diesel Refinery is sited at the intersection of a major state highway and a railroad mainline, where another company has already invested tens of millions of dollars in rail and petroleum infrastructure. This investment is leading to other investments including petroleum storage and pipelines. The refinery is sited to efficiently enhance this energy center as envisioned by local and regional leaders and planners.
- The refinery will cause additional new investments in water production and purification and additional electric and natural gas distribution capacity in the region.
- The refinery will add significantly to regional fuel refining capacity, increasing the availability of diesel to support continued well field development and support agricultural activity, mitigating the affects of this increased demand, particularly for diesel fuel.

Reduction in road miles:

The site is located centrally in the oil field development, and much closer to much industrially activity than the nearest fuel distribution points at Glendive, Montana and Minot and Mandan, North Dakota.

- The location will significantly reduce the distance driven by fuel distribution vehicles, improving safety and reducing wear on state highways. As much as 10,000 heavy truck miles per day hauling fuel from current sources could be eliminated by the development of the refinery at Trenton.

Jobs:

- The refinery has been estimated to employ as many 124 full time high skill permanent direct jobs.
- The induced multiplier is estimated at a low of 3.2 and a high exceeding 9, meaning that at least 396 permanent full time jobs will be created by this investment in North Dakota and theoretically, over 1,000 jobs could result.
- The annual direct payroll is estimated at over \$12-million.

Economic Impact:

- The initial investment in new infrastructure is estimated at more than \$200-million.
- The annual revenue is estimated at over \$700-million, provided a major value-added industrial activity to compliment the natural resource extraction industry.



Dakota Oil Processing, LLC

The Trenton Diesel Refinery Fact Sheet

August 16, 2012

The Company

Dakota Oil Processing is a North Dakota Limited Liability Company formed for the express purpose of building a diesel refinery near Trenton, North Dakota. The Company is in its development stage and has completed the studies, planning and permit applications necessary to construct a 20,000 barrel per day diesel refinery in North Dakota in the Bakken oil play near Williston, North Dakota.

The Bakken Oil Play

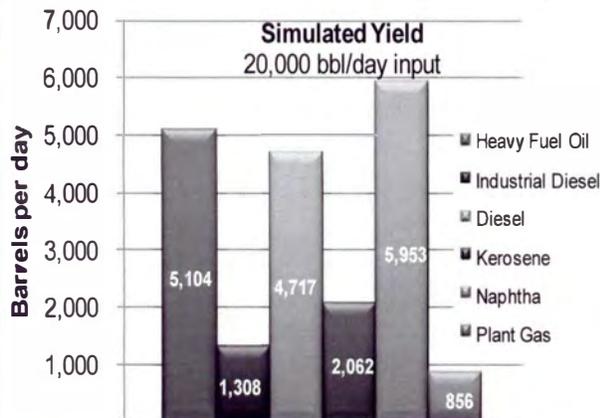
The Bakken oil play covers a massive area encompassing much of western North Dakota, northeast Montana and southern Saskatchewan. A geological formation some 10,000 feet deep, this shale formation was estimated by the US Geological Service to have up to 4.4-Billion barrels of recoverable crude oil, while industry experts estimate up to 24-Billion barrels. This discovery, first made in 1951, was not considered significant until 2004, when the employment of horizontal drilling and hydraulic fracturing ("fracking") in combination demonstrated that this "shale oil" could be efficiently and economically produced. Today approximately 200 drilling rigs are using these techniques developing new wells at the rate of one each eight weeks or less. Production in the Bakken has reached nearly 700,000 barrels a day surpassing both California and Alaska to become the second highest producing oil state in the US. Each month that rate is increasing by approximately 3%, with currently over 7,000 wells producing. The infrastructure is not keeping up with the production: rail is supplementing the pipeline capacity to transport the crude to refining centers to the east and south. This has left the price of the crude depressed, occasionally by more than 10% below other benchmark crudes.

The Site

The site selected for the refinery is adjacent to the Burlington Northern-Santa Fe railroad intersection with North Dakota State Highway 1804 known as Marley Crossing, approximately 16 miles southwest of Williston. This site is also home to the new Savage Services unit train and rail transloading facility located immediately east and north of the rail crossing. The Mondak Energy Alliance has identified this area as an 'Energy Center' with suitable land available for industrial development to support the burgeoning oil field development industry that is supporting the more than 200 active drilling rigs developing the Bakken oil play.



Bakken Crude—The Feedstock



A key driver for the plants development is the rapidly growing availability of the sweet light Bakken crude oil. This crude is sweet, as defined by the industry as crude with less than 5,000 parts per million sulfur. Bakken crude typically has less than 1,500 parts per million. This crude is also light (low in density) at API specific gravity of 39-41, compared to the API gravity of 39.6 for West Texas Intermediate, the US benchmark crude oil. The laboratory distillation of Bakken crude shows high yields of naphtha and mid-distillates (kerosene and diesel) and low residual fuel oil and asphaltenes. This results in high yields of the target product: diesel fuel for the trucks and equipment fueling the development of the Bakken oil field.

A laboratory analysis of this crude and modeling the proposed refinery using this crude resulted in the production of distilled products as shown in the figure to the left.

The Trenton Diesel Refinery

Fact Sheet

The Refinery

The Trenton diesel refinery's configuration was determined after several detailed studies were accomplished over a 4-year period. These studies included several market analyses, the composition of the light sweet Bakken Crude, its properties and the likely products that would be derived from its distillation (refining processes), the permitting and regulatory requirements and an evaluation of the cost and time required to complete the project. The configuration selected for the refinery is based on the design study completed by the Company in 2011. The proposed plant and facility include:

- A 20,000 barrel per day atmospheric tower distillation unit and associated boilers, desalters and other equipment (the "topping plant").
- An 8,000 barrel per day distillate hydrotreater and its associated hydrogen generator for the purposes of removing sulfur to attain Ultra Low Sulfur Diesel (ULSD) now required for on- and off-road use in the United States,
- A naphtha stabilizer to stabilize the naphtha for shipment by rail,
- A 667,500 barrel tank farm, and,
- A truck loading and unloading facility for loading products and unloading crude oil.

The Company has acquired options on a 100-acre site suitable for the refinery and a major expansion in the future. The site will include administration, control, maintenance and other structures as well as water treatment and other facilities.

Project Cost and Schedule

The project cost estimate was completed as part of the 2011 design study. Major cost items include the refinery battery (the refinery processing plant itself) support facilities, and the other essential components of the processing facilities including the tank farm, loading racks water treatment, and fire prevention facilities. The cost estimate has been adjusted to account for cost escalation since the time of the design study. The cost of the refinery and all associated facilities, including tank farm, loading racks, buildings, water treatment and other features is currently estimated at more than \$195-million. The cost of startup and other costs will bring the total cost to nearly \$207-million, not including crude oil. The project is currently in the financing stages of development.

Given the efficiency of fabrication of all battery components in a factory controlled setting, the time to construction the complete facility is estimated at approximately 22 months, which can be affected by the extremes of the North Dakota winter months.

Current Status

The project has completed preliminary planning and has received the North Dakota State Department of Health Air Quality Permit to Construct (February 2012). The Company has an option on 100 acres of land purchased specifically to site the refinery. The project is currently seeking both equity and debt financing for the project. The company intends to break ground in 2012 and be fully operational in mid-2014.



Dakota Oil Processing, LLC

For more information regarding the Trenton Diesel Refinery, contact:

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jlincoln@dakotaoilprocessing.com



Trenton Diesel Refinery

Factoids

Dakota Oil Processing, LLC

- Location** Williams County North Dakota, three miles southwest of Trenton and approximately 16 miles southwest of Williston. The site is located just east of the Montana border, near the intersection of North Dakota State Highway 1804 and the Burlington Northern-Santa Fe Railroad mainline tracks.
- Site** Located south of 42nd Street NW in Buford Township, the site is located on 100 acres of industrial zoned land previously dedicated to agriculture (farmland).
- Permits** The air quality permit to construct was issued by the State of North Dakota in February 2012. The facility is considered a minor point source for airborne contaminants.
- Production** The plant will have the capacity for 20,000 barrels per day, processing North Dakota sweet light (Bakken) crude. The plant expects to run at approximately 16,400 barrels a day initially.
- Outputs** The refinery will refine crude into product streams from light gas ends to atmospheric tower bottoms (Heavy Fuel Oil).
Plant gas, butane and propane - less than 400 barrels a day that will be re-injected as fuel gas to the plants heaters and boilers.
Light and Heavy Naphtha: these products, approximately 30% of the output stream, most likely will be shipped by rail to Canada to be used as a diluent for heavy tar sands oil.
Kerosene and Diesel: these two mid-distillates will be blended to maximize the production of diesel fuel, the primary product for which the plant is designed. At full capacity the plant could produce up to 8,000 barrels a day of quality diesel fuel (40% of the input) for the local off- and on-road market.
Industrial Diesel and Heavy Fuel Oil: The plant will produce approximately 30% of it's output stream as #4 and #6 Diesel, which will be sold at a premium to vacuum gas oil to other refineries as feedstock for further processing by catalytic cracking or coking.
- ULSD** The plant will produce up to 8,000 barrels per day of Ultra Low Sulfur Diesel (ULSD) to conform to the 2014 mandated standards of the US Environmental Protection Agency.
- Water** The plant will use up to 165 gallons per minute of processing water and will result in 125 gallons of treated wastewater.
- Electrical Power** The plant will use slightly less than 5 megawatts of power.
- Natural Gas** The plant will include a hydrogen generator to produce hydrogen from natural gas which is used to hydrotreat the diesel fuel to reduce the sulfur content to near zero. The plant will produce and use approximately 4-million ccf (100-cubic foot units) of hydrogen a day from the locally abundant natural gas.
- The Plant** The plant will include the atmospheric tower (topping plant), a naphtha stabilizer to treat the naphtha so it can be safely transported by rail, a distillate hydrotreater to remove the sulfur, and an amine stripper and other equipment to remove and separate the sulfur into it's stable and safe non-polluting solid form.
- Tank Farm** The refinery will include tank storage for up to 667,500 barrels of petroleum products and water, including crude oil, all separated refined products and fire water.
- Loading Racks** The refinery will include the capability to load up to 5 road tankers at a time with up to 8,000 barrels (328,000 gallons) of refined products a day on a sustained basis or up to 14,000 barrels on a peak period (588,000 gallons).
- Rail Shipments** The output of the plant, including the naphtha, industrial and heavy fuel oils not distributed locally are expected to be shipped to blenders or other refineries by rail.

MEMORANDUM

**TO: Senator Stan Lyson, Chair -- Natural Resources Committee
Senator John Andrist
Representative Gary Sukut**

FROM: Chester Trabucco and Mel Falcon of Dakota Oil Processing

DATE: January 3, 2013

**RE: Detailed Discussion - Proposed Senate Bills on North Dakota Refinery
Financing**

The purpose of this memorandum is to discuss how the State of North Dakota (“State”) Pipeline Authority can help finance a privately owned refinery, and to exam ways in which State Oil Extraction Taxes could be used to offset future declines in the crack spread between crude and diesel. Dakota Oil Processing, along with Craig Richards of Walker Richards, an Alaskan law firm specializing in oil and gas issues, have drafted a funding formula for the state to provide an abatement of tax revenues collected under the State’s Oil Extraction Tax on oil refined at the facilities.

The Pipeline Authority

North Dakota, like many other states, has created public authorities to help in the construction and financing of various public and private enterprises. For instance, it has created the Public Finance Authority, which among other items acts as a municipal bond bank, to assist political subdivisions in issuing debt on better terms. The legislature has also created the Pipeline Authority (“Authority”),¹ which like the Public Finance Authority is governed by the North Dakota Industrial Commission. “The authority may participate in a pipeline facility through financing, planning, joint ownership, or other arrangements” meaning it has broad power to directly construct and/or own such facilities, or to aid in their financing including by providing grants or making loans.² The Authority’s total indebtedness, not counting issuance costs, credit enhancements, reserve funds, or refinancings, cannot exceed \$800 million.³ This summary of the proposed legislation assumes the Authority would participate in the construction of a new refinery only through financing activities, and not have an equity or other ownership position, although as indicated that would be allowed. Additionally, it is assumed the meaning of “pipeline facilities” under N.D. Cent. Code § 54-17.7-02.6 will be amended via our proposed legislation to include refining facilities before the Authority can participate in their financing.

A standard way for governmental authorities to participate in project financing is through conduit lending. Under conduit financing, an authority issues bonds, and then lends the funds

¹ N.D. Cent. Code § 54-17.7 *et seq.*

² *Id.* at §§ 54-17.7-06 and 54-17.7-04.1.

³ *Id.* at § 54-17.7-04.6.

via a loan agreement to a private entity that will use them to construct a project. The private entity promises some or all the future revenues generated from the project to the authority, which the authority in turn pledges to pay back the bonds. Typically, the taxation power of the state is not pledged, meaning the bondholders' security for repayment is limited to the revenues and assets of the project. Additionally, authorities often have a reserve account that is also pledged to repay the bonds in the event project revenues are insufficient. The amount of the reserve account can be established by negotiation with lenders or their underwriter, or it can be a large pool of capital contributed by the state for which multiple bond issues have access. Although the specific amount of such a reserve is not a topic of the legislation, Dakota Oil Processing is suggesting that Legislature appropriate \$200 Million, or an amount equivalent to 25% of the Pipeline Authorities total capacity.

Private entities will do conduit borrowing through an authority for several reasons, including to benefit from its better credit rating or to access tax-exempt financing. It is unlikely tax exempt financing will be available for a refinery project (unless directly owned and operated by the Authority), so the primary reason a private entity would borrow through the Authority – rather than borrowing directly from lenders – is to get better credit terms. However, an authority cannot borrow on better terms than the underlying project unless something more than project revenues and assets are pledged to its bondholders. Additional items that can be pledged by an authority include, without limitation: (1) funds in a reserve account; (2) future revenues paid the authority by the state; or (3) revenues from other projects in which the authority participates. Since the Pipeline Authority has no other projects at this time, it is appropriate to look at establishing a reserve account and the possibility of pledging future State revenues to pay back bondholders.

Pledge of the Authority's Reserve Fund

N.D. Cent. Code § 54-17.7.-07.4 authorizes the Authority to establish a reserve fund in support of debt it issues. It also provides the Authority shall pay into the fund all monies appropriated by the legislative assembly for that purpose, proceeds of evidence of indebtedness required by contract to be placed in the fund, any money it elects to put in reserve, and any other monies made available for placement into the fund. This is similar to the reserve fund established for the State's Public Finance Authority under N.D. Cent. Code § 6-09.4-10. As discussed during our meeting, the Authority apparently has no funds in a reserve fund at present.

Perhaps the simplest way for the Legislative Assembly to aid in the financing of a refinery would be to appropriate funds for placement into a reserve fund, which could then be irrevocably pledged by the Authority to bondholders in the event project revenues were insufficient to make debt service payments. In effect, such monies would be set aside as collateral within the Authority's reserve fund to guarantee payment on debt service up to the amount of the fund. The Legislative Assembly also provided that the Authority must include in its biennial request for funding any amount necessary to restore any reserve fund to the balance contemplated by the lending documents.⁴ Finally, after all the bonds to which a reserve fund is pledged are repaid, the balance of the reserve fund can be transferred back to the general fund.

⁴ *Id.* at § 54-17.7-07.5.

As applied to the proposed project, the amount in the reserve fund need not equal the entire cost of the refinery, nor even the amount financed by debt, to assist project financing. Lending specialists familiar with the terms of the proposed deal should be consulted as to how large the reserve fund would need to be to allow the Authority to borrow at the desired credit rating (but it is believed via our counsel that the aforementioned \$200 Million would be an appropriate funding level given the size and scope of the Authority).

Also N.D. Cent. Code § 54-17.7-07.5 seems to contemplate that the Authority can establish multiple reserves accounts, but at least § 54.-17.7-07.4 reads as if the Authority shall have one reserve account. It would be helpful, but maybe not necessary, to amend the legislation to specifically provide the Authority may establish more than one reserve account, and that it has the power to pledge any reserve account to one or multiple set of bondholders on such terms as it deems appropriate. Thus if the Legislative Assembly were to appropriate funds for a reserve account for a refinery, the Authority could contractually ensure that bondholders of the refinery that they would have sole access (or priority access) to the moneys in reserve. Alternatively the appropriation for the reserve fund could be drafted in such a way that it could only be used to backstop the refinery project. We have provided language that allows for that flexibility in the Pipeline Authority proposed amendment.

Pledge of Future Revenues Paid the Authority by the State

Another way conduit lending of a private project through the Authority could experience credit benefits would be if additional State funds were pledged to support the bonds. This can occur in several ways. For instance, authorities may be granted the power to intercept state funds unrelated to the project that are going to the entity for whom the financing benefits.⁵ The State could also agree to make a full faith and credit pledge on the Authority's bonds, thus guaranteeing their repayment (this would make them "general obligation bonds"). Or via a more limited use of the State's taxing power, the State could pledge tax revenues from a particular tax – such as the Oil Extraction Tax – to be made available under enumerated conditions for repayment of the bonds or funding of a reserve account. Our second Bill having to do with the Abatement of the Extraction Tax addresses the latter approach.

In public finance, a bond backed by a non-binding commitment for a state to seek appropriation of revenues to pay debt service or fund up a reserve account is called a "moral obligation bond."

It appears that Legislative Assembly can provide for a continuing appropriation, which occurs automatically without the need for a recurring appropriation each year, but it must be revocable by future Legislatures. Such a mechanism would be more favorably received than a standard moral obligation bond, because the appropriation would not have to be sought when needed but instead would be automatic unless the Legislature actively voted to change the law.

⁵ The Public Finance Authority may intercept and use to pay bondholders state funds that would otherwise go to a local school district. N.D. Cent. Code § 6-09.4-23.

Using the Oil Extraction Tax to Provide Credit Support to a Refinery Project

DOP has suggested that an abatement or appropriation of Oil Extraction Taxes on oil processed at the refinery, levied under N.D. Cent. Code § 57-51.1 *et seq.*, could be used to support the project. DOP has indicated the desire for a ten year program whereby state funds would be available when free cash flow from the refinery drops in any month below the level required to cover operating expenses and debt service. While several options were explored DOP and its counsel decided upon the following approach and proposed legislation accordingly: Oil Extraction Tax revenues being made available directly to the project by the Legislative Assembly in the event crack spreads drop.

If the Legislative Assembly funded a reserve fund in the Authority that was several hundred million dollars, as the State of Alaska has done with its various public authorities, such a reserve fund would allow for excellent credit ratings on refinery debt – even if it backed other projects – because the reserve fund would be collateral greater than the entire financing. Thus if a reserve fund is large enough, say approaching the amount of a project financed by debt, there is little advantage to having a refunding mechanism for the reserve fund. However, if there is a smaller reserve fund, then bondholders will look favorably on a mechanism that replenishes it as the fund is spent down.

North Dakota Constitution prohibits Oil Extraction Taxes to be irrevocably pledged to the repayment of bonds for a project such as a refinery. However, a moderate reserve fund in combination with a non-binding moral commitment – particularly a continuing appropriation – to refund the reserve fund with revenues collected from Oil Extraction Tax on refined barrels could be a powerful financing tool. A final issue is when the reserve fund would be funded. Traditionally it would be before or at time of financing. If a reserve fund was to be funded later, for instance out of project revenues by the operator or by a pledge of Oil Extraction Taxes on oil refined at the facilities then its value to bondholders is reduced. In such a situation the reserve fund is not available if initial debt service payments cannot be made because of cost overruns, project startup delays, or a drop in the crack spread before the reserve fund is fully funded. Thus bondholders will look more favorably on the initial reserve being funded at or before financing. This could occur by a onetime appropriation by the Legislative Assembly, or less preferably by borrowing funds at financing sufficient to fund the reserve account.

Oil Extraction Taxes on Refined Barrels Paid Directly to the Refinery in the Event Crack Spreads Drop

The proposed legislation would allow for the Oil Extraction Taxes to be made available directly to the refinery in the event crack spreads fall below a defined amount. This concept is not wholly foreign to the Oil Extraction Tax, although it does raise significant issues under North Dakota Const., art. X, § 12 which prohibits the disbursement of public funds without an appropriation of the Legislature. As discussed in *Sunbehn Gas, Inc. v. Conrad*, 310 N.W.2d 766

(N.D. 1981), Initiated Measure No. 6, as modified by the Forty-Seventh Session of the North Dakota Legislature, provided that forty-five percent of the tax would be allocated to the state school aid program, ten percent to a special trust fund, and forty-five percent to the general fund. The North Dakota Supreme Court found although dedicated appropriations of this sort cannot be made without a constitutional amendment, the applicable provisions were constitutional because they allocated the funds without a mandatory appropriation.⁶ “Although Initiated Measure No. 6 allocated or divides oil extraction tax funds among the various objectives of the measure, it leaves the appropriation of such funds for legislative action.”⁷ N.D. Cent. Code § 57-51.1-07 as in effect still contains similar mandatory allocations of the Oil Extraction Tax. It thus appears a fund could be created within the State government in which Oil Extraction Taxes are allocated when collected for the purpose of being available to the refinery. However, monies in such a fund must be appropriated before they can go to the refinery. That appropriation can be by individual acts of the Legislature or on an ongoing basis via a constitutional amendment. Additionally, although further discussion may be merited with the Legislative Council, it would initially appear a continuing appropriation from the fund could be authorized, but as discussed because it could be repealed by the Legislative Assembly it would be a revocable, non-mandatory moral obligation.

It is worth noting that N.D. Cent. Code § 54-17.7-07.3 currently provides that Pipeline Authority bonds “are not subject to taxation by the state or any of its political subdivisions and do not constitute a debt of the state of North Dakota within the meaning of any statutory or constitutional provision and must contain a statement to that effect.” Thus financings through the Authority cannot be backstopped by the full faith and credit of the state or its tax revenues without amendment of existing law.

⁶ *Sunbehn Gas*, 310 N.W.2d at 769-770.

⁷ *Id.* at 770.

Introduction

Trenton Diesel Refinery

January 2013

Dakota Oil Processing

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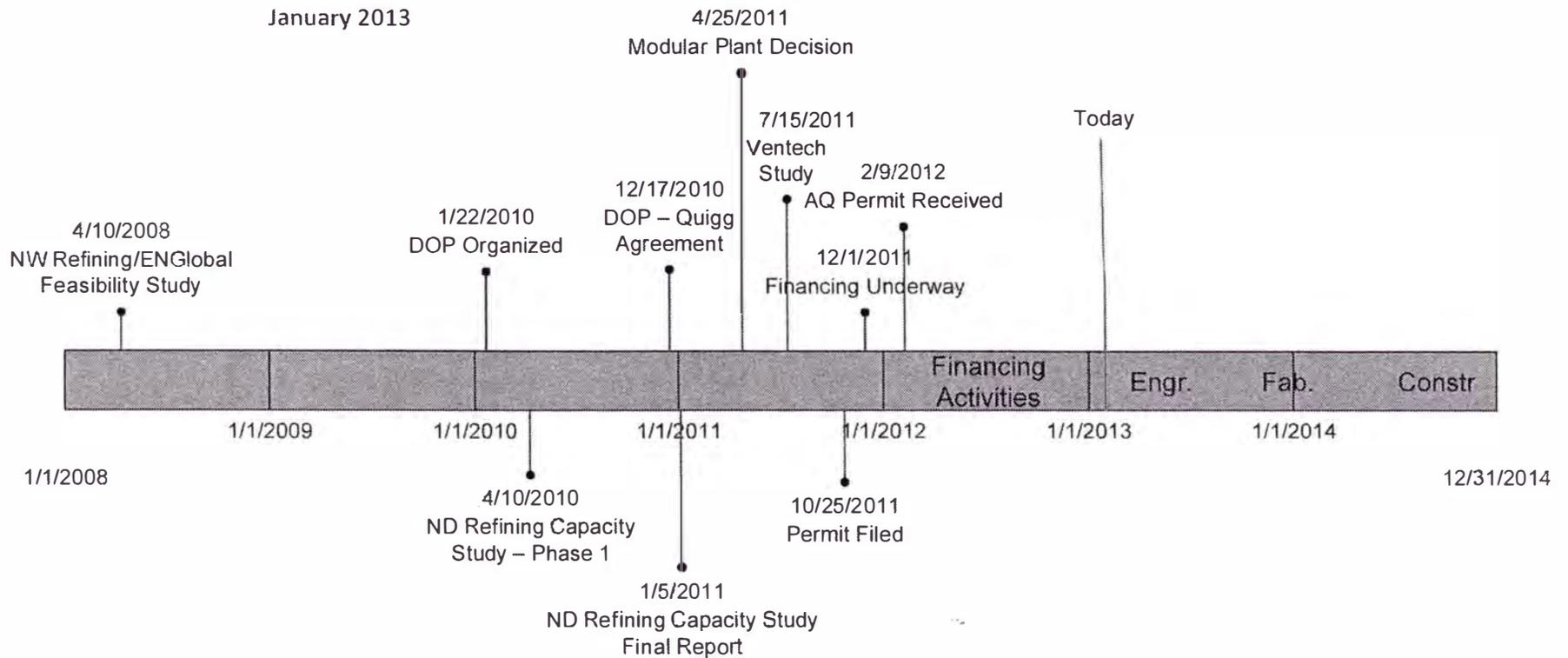
Background

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Dakota Oil Processing Development Timeline

January 2013



Background - Timeline

- 2006 – Extensive study commissioned to assess feasibility of a second oil refinery in North Dakota
- 2008 -- Unique Opportunity to permit a diesel-based refinery in the epicenter of both the source (crude) and the use (diesel) was identified by Dakota Oil Processing
- 2009 – DOP secures first of two Air Quality permits to construct a diesel topping plant in ND
- 2010 -- DOP teamed with Quigg Oil Processing to gain marketing, project management and financing expertise

Background - Timeline

- 12/2010 -- DOP Ramps up Development Activities
- 4/2011 -- DOP engages Ventech Engineering to complete feasibility and design study centered on a 20,000 bpd diesel refinery in the middle of the play in North Dakota
- 11/2011 – DOP completes financing package and begins structured finance marketing activities
- 12/2011 – Property zoned industrial
- 2/2012 – New Air Quality Permit
- 8/2012 – DOP Property purchased by principal
- 2012 – DOP pursues financing

Scope

Major Plant Components

Outside the Battery Limits (OSBL)

- Tank Farm, 667,500 bbl
- Administration, Maintenance, Control Buildings, warehousing, security, fire station
- Water Treatment
- Fire Protection
- Truck Loading Rack (6 bays)
- 100- acre site capable of expansion

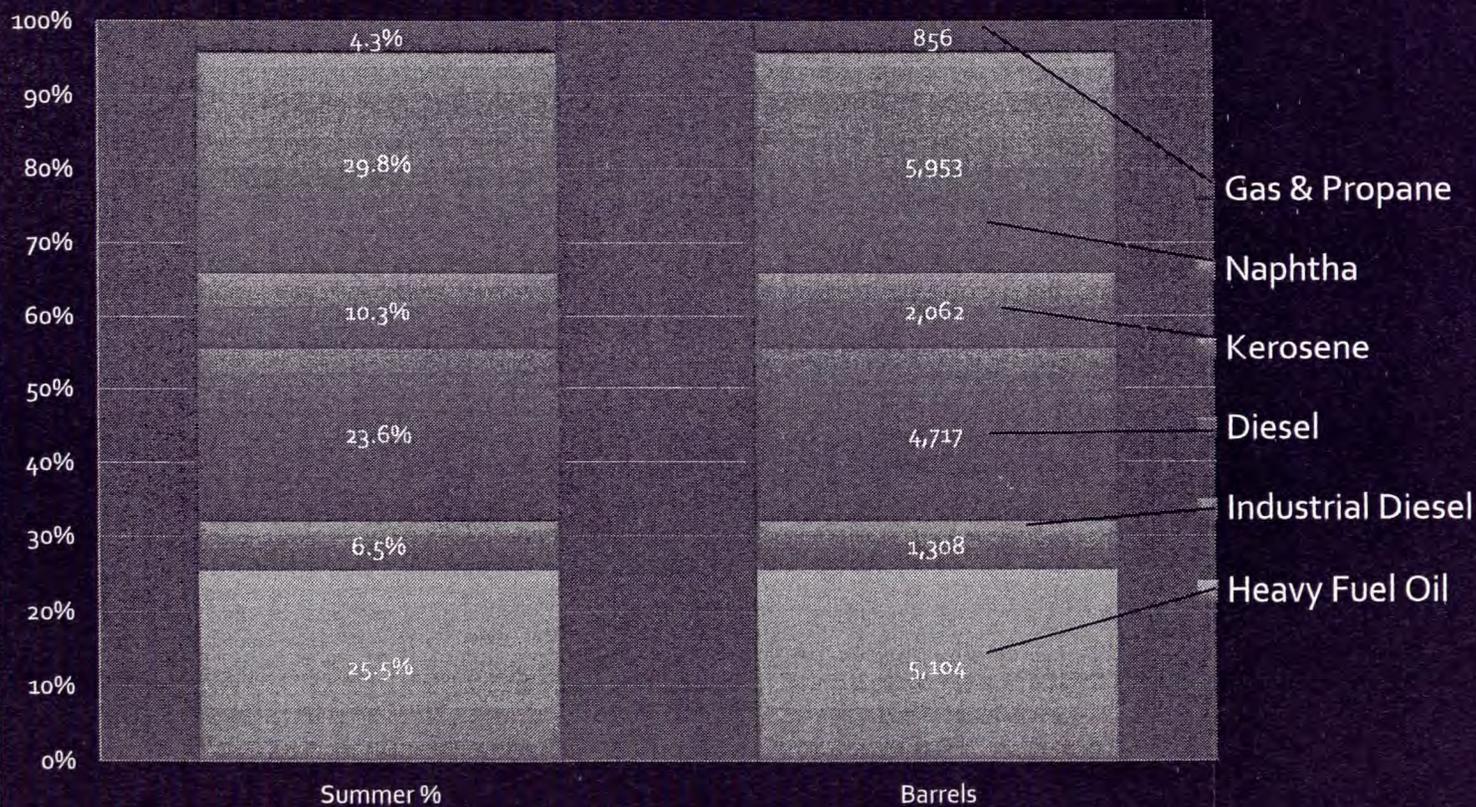
Scope - ISBL

20,000 BPD Diesel Hydroskimming Plant

| | | |
|-----------------------------------|--------|--------|
| Crude Distillation Unit | 20,000 | bbsd |
| Naphtha Stabilizer | 6,500 | BPSD |
| Mid Distillates Hydrotreater Unit | 8,000 | BPSD |
| Sour Water Stripper | 25 | GPM |
| Amine Regeneration Unit | 15 | GPM |
| Sulfur Recovery Unit (Lo-Cat) | 1 | TPD |
| Hydrogen Generation Unit | 4 | MMSCFD |
| Utilities Package/Pipe Racks | | |
| OSBL Tanks | | |
| OSBL/Truck | | |
| Loading/Unloading/Roads/Paving | | |

Projected Output – Bakken Crude

Plant Yield – 20,000 bbl/day
Summer Run



Dakota Oil Processing

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Cost and Schedule

- Total including startup: \$206.9-million
- Time to complete fabrication, delivery and erection: 18-24 months *
- Fabrication in Houston, delivered to the site, erected in less than 16-weeks

* Depending on start date – based on weather

Permitting

Dakota Oil Processing

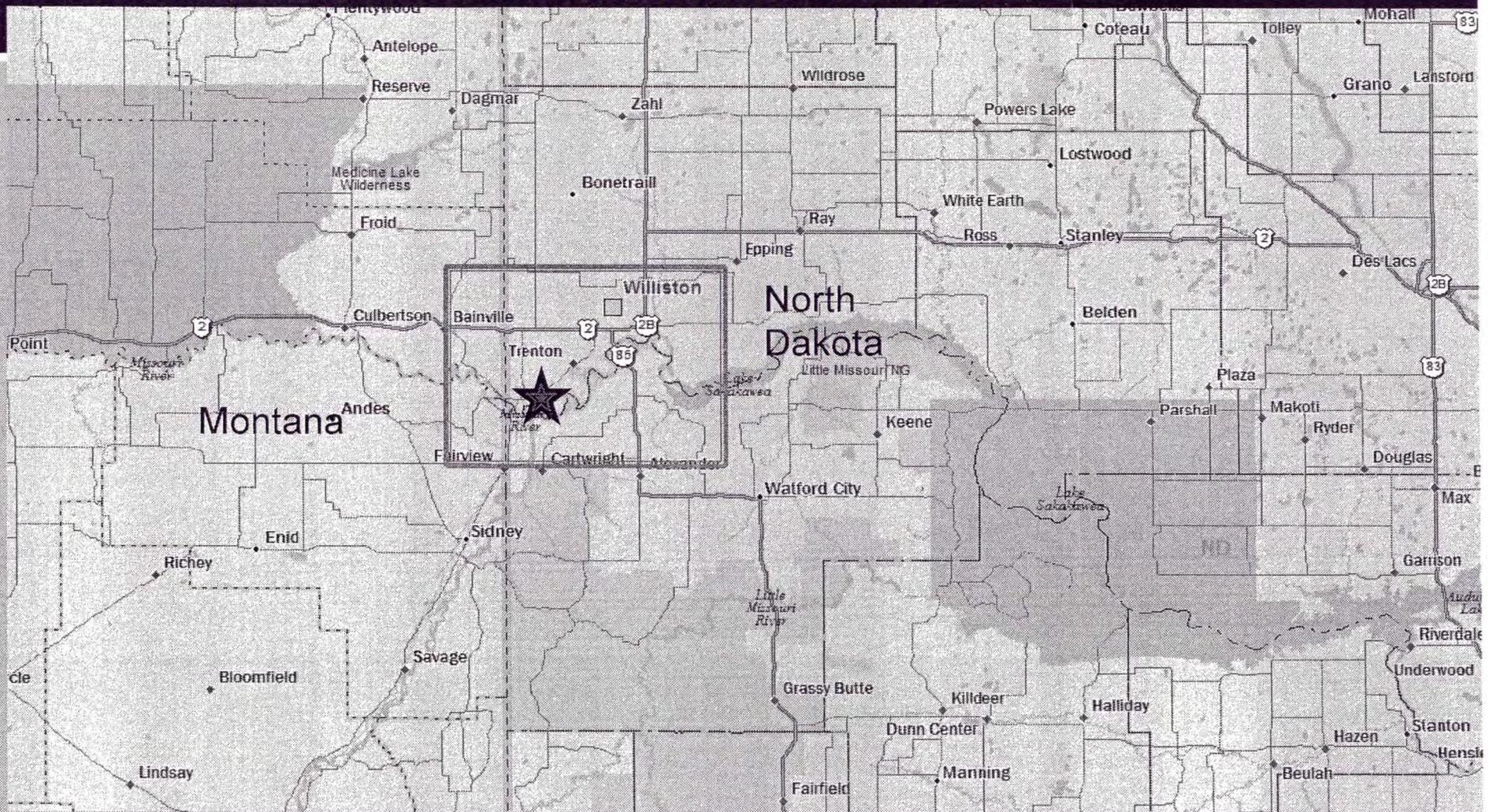
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Location

Dakota Oil Processing

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Trenton Refinery Location

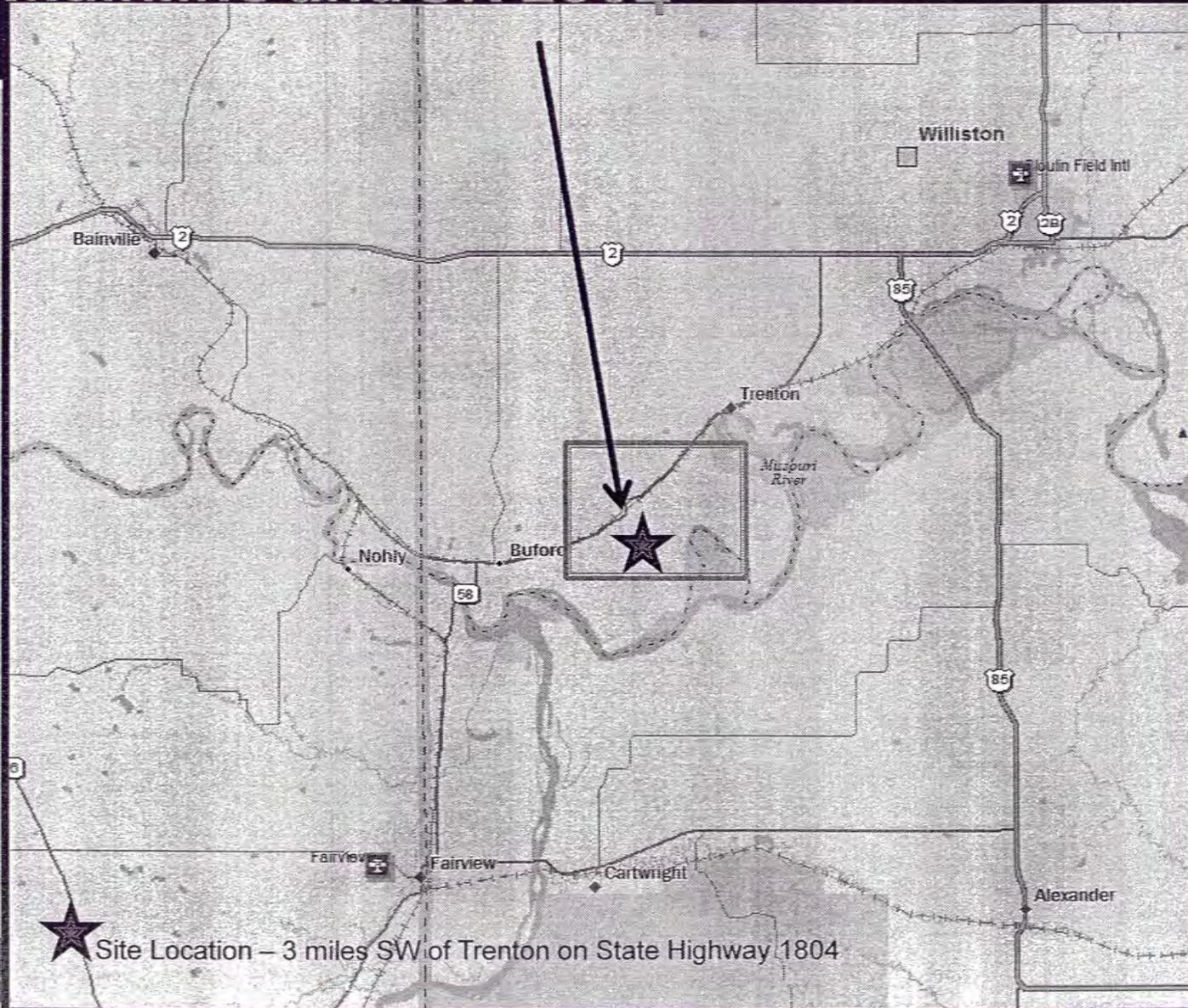


Dakota Oil Processing Site Location – 3 miles SW of Trenton on State Highway 1804

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Marley Crossing

BNSF Mainline and SR 1804



★ Site Location – 3 miles SW of Trenton on State Highway 1804

Dakot

ENTIAL

Dakota Oil Processing

JULY SITE PLAN - 2011 024-102.DWG 12/31/2011

SECTION 5 TOWNSHIP 152
RANGE 103 - BUFFORD TOWNSHIP
NORTH DAKOTA



TRENTON DIESEL REFINERY
20,000 BBL/DAY

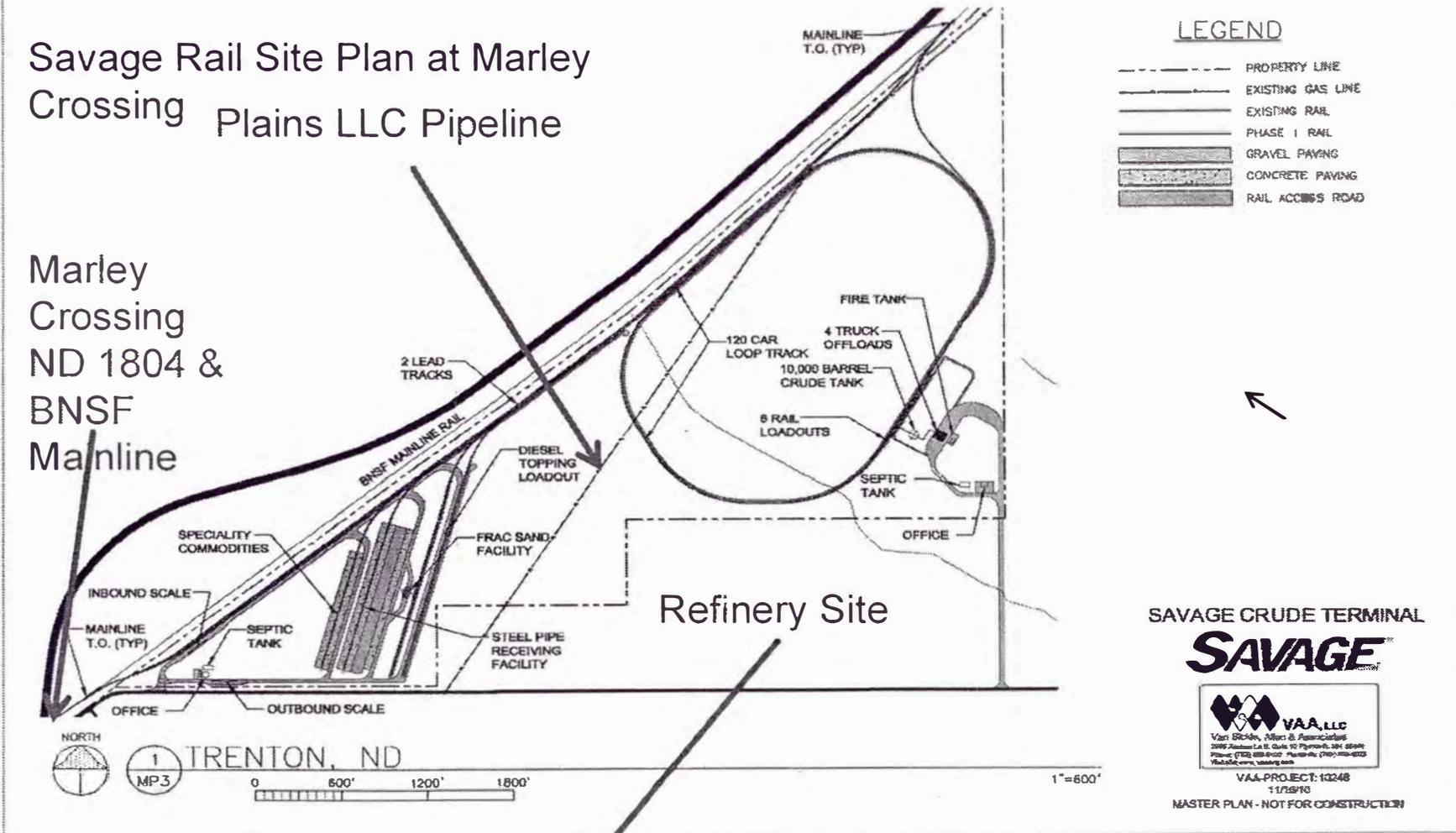
Dakota Oil Processing
310 Airport Road
Williston, North Dakota 58801

Savage Services Rail Facility

Markey Crossing, ND

Savage Rail Site Plan at Marley Crossing
Plains LLC Pipeline

Marley Crossing
ND 1804 &
BNSF
Mainline



SAVAGE CRUDE TERMINAL

SAVAGE



VAA-PROJECT: 10248

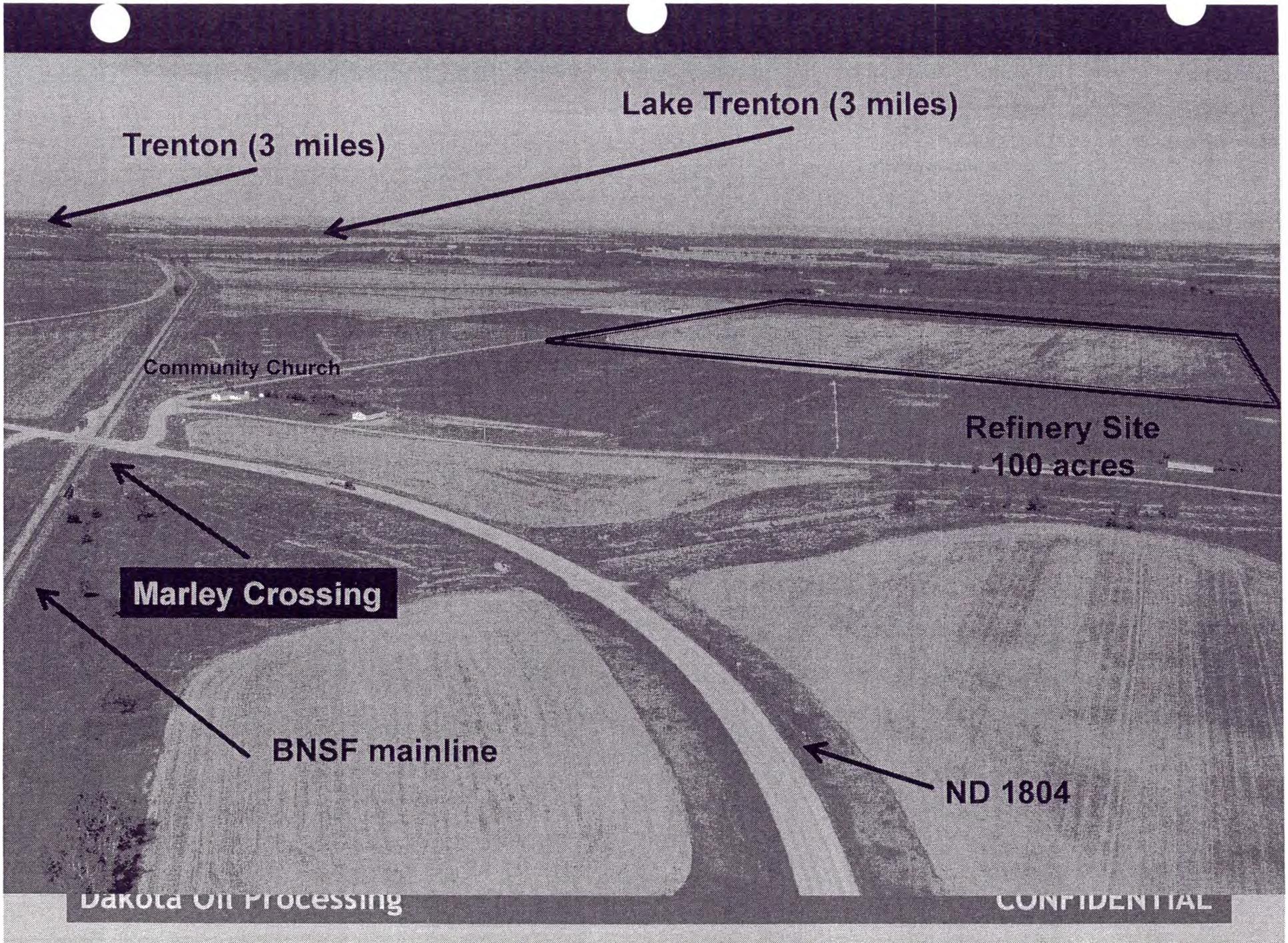
1/17/2010

MASTER PLAN - NOT FOR CONSTRUCTION

SAVAGE



Refinery Site Location – 3 miles SW of Trenton on State Highway



Dakota Oil Processing

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General Plan

Dakota Oil Processing

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Plan

- Land purchased
- Refinery AQ Permit issued
- Upon Financing
 - Fast track site engineering
 - Agreements on utilities
 - Begin OSBL / Site Engineering
 - Issue order for battery (ISBL Engineering/Fabrication)

SB 2309

**Extraction Tax Abatement
Crack Spread Calculation**

Date goes here

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Crack Spread

- The difference in the Price of Crude and the Price of the Petroleum products that can be refined from it: the gross profit margin.

Sample based on pricing 2/4/2013

Crack Spread Calculation Illustration

Weighted cost of #1 and #2 diesel, Mandan, Minot and Glendive, MT, 2/4/2013 (average prices)

\$3.1781 / gal

\$133.48 Diesel / bbl

Overall Crack Spread

| | % Product | \$/bbl | Weighted Value |
|----------------------------------|-----------|----------|----------------|
| Diesel (Average No. 1 and No. 2) | 36.33% | \$133.48 | \$48.49 |
| Bottoms (Average all) | 34.04% | 96.00 | 32.68 |
| Naphtha | 29.63% | 96.00 | 28.44 |
| Weighted Product Value/bbl | 100.00% | | \$109.62 |
| Cost of Crude = WTI-7 | | | 89.00 |
| Crack Spread | | | \$ 20.62 |

Questions - Discussion

Dakota Oil Processing

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