

SunCoke Testimony
IRS Public Hearing on Proposed MLP Qualifying Regulations
Fay West, Senior Vice President and Chief Financial Officer
John Quanci, Vice President of Engineering and Technology
October 27, 2015

I am Fay West, Chief Financial Officer of SunCoke Energy. I am joined by my colleague, Dr. John Quanci, SunCoke's Vice President of Engineering and Technology. Thank you for the opportunity to provide comments on the proposed regulations addressing qualifying income of publicly traded partnerships.

SunCoke is a publicly traded partnership. We are engaged primarily in the processing or refining of coal into coke. As Dr. Quanci will describe in more detail, our cokemaking process eliminates impurities from coal by heating it in the absence of oxygen. This process produces qualifying income from the refining of a natural resource.

SunCoke strongly believes that the cokemaking process satisfies the definition of "refining" under the proposed regulations. The proposed regulations state that activities that separate or eliminate impurities from partially processed ores and minerals, which is what cokemaking does, is refining. The coking process eliminates impurities in crushed coal, a partially processed mineral, by heating it in the absence of oxygen. This separates and expels impurities from the coal.

SunCoke has a "will" level opinion from our counsel that the coking of coal constitutes the refining of coal and, therefore, generates qualifying income under section 7704. However, the definition of "processing or refining" in the proposed regulations creates an unresolved ambiguity.

The proposed regulations define the "processing" of ores and minerals as "mining processes," and thus, by implication, have excluded the "non-mining processes" as defined in the regulations under section 613. Those "non-mining processes" include a number of purification processes such as roasting, calcining, thermal smelting, and thermal action, which by example includes the coking of coal.

The market has effectively ignored our "will" level opinion and has instead focused on the reference in the proposed regulations to "mining processes" which as currently written exclude "non-mining processes," such as the coking of coal. As a result, SunCoke and its investors have suffered staggering losses totaling hundreds of millions of dollars. This omission has also effectively eliminated our ability to access public markets to fund future growth initiatives.

This omission could not have been intentional. If these nonmining processes were not qualifying activities, there would be a gap, or a "doughnut hole," in the spectrum of qualifying activities. For example, a publicly traded partnership could mine copper ore and refine blister copper, but the partnership could not smelt the mined copper ore to produce blister copper. The final regulations should clarify that "processing or refining" includes those nonmining processes that eliminate impurities from ores and minerals.

Additionally, the proposed regulations appear to limit “processing or refining” in general to activities that do not result in a “substantial physical or chemical change.” However, as Dr. Quanci will explain, eliminating impurities from ores and minerals inherently involves physical and chemical changes. We believe that under the proposed regulations as written, this limitation does not apply to the processing or refining of ores and minerals. However, more clarity is needed.

Dr. Quanci: I will address the cokemaking process and the physical and chemical changes that occur in the processing and refining of ores and minerals. As background, I have over 25 years’ experience in process research and development, plant optimization, and plant production for SunCoke, Sunoco, and other petroleum industry participants. I hold a Ph.D. in Chemical Engineering from Princeton University.

Coke is simply a purer form of coal. Specifically, it is the solid fuel that remains after coal is heated in the absence of oxygen. Nothing is added to the coal in the coking process. In fact, coke itself is a natural resource. Natural coke is formed when magma seeps into coal beds, exposing the coal to intense heat in the absence of oxygen. Natural coke has been commercially mined from coal seams in the United States.

The technical term for the coking process is *pyrolysis*, which is the high-temperature thermal distillation in the absence of oxygen. Coal is valuable for its carbon content. In the coking process, coal is heated in excess of 2000 degrees Fahrenheit in a coke oven, and impurities, called volatile matter, are separated and expelled from the coal in gaseous form by means of physical and chemical changes.

Volatile matter includes hydrogen and hydrocarbons such as methane, ethane, propane, olefins, naphtha, and heavier hydrocarbons. Before coking, coal can have in excess of 20% volatile matter. After coking, the remaining coal, now called *coke*, has minimal volatile matter. This is refining of an ore or mineral.

Under the proposed regulations, refining of ores and minerals is any activity that eliminates impurities or foreign matter from smelted or partially processed metallic and nonmetallic ores and minerals. Eliminating impurities from ores and minerals inherently involves physical and chemical changes. A physical change involves the change of a substance from one state—gas, liquid, or solid—to another state, without alteration of the chemical composition of the substance. For example, freezing or evaporating water is a physical change.

A chemical change involves a rearrangement of the atoms, ions, or radicals of one or more substances. Chemical changes include the destruction of chemical bonds as well as the creation of new chemical bonds. For example, refining coal into coke involves both melting the coal, which is a physical change, and breaking bonds that attach volatile matter to the coal, which is a chemical change. These processes are similar to distillation and cracking processes that occur in a crude oil refinery.

The proposed regulations provide as an example “the refining of blister copper” as a qualifying refining activity. In fact, eliminating impurities from copper ore requires several steps, including mining processes, nonmining processes, and refining. These steps involve physical and chemical changes to the copper ore that was originally mined.

For example, beneficiation of copper ore, which is a mining process, involves chemical and physical changes to increase its copper content. Likewise, copper concentrate with a copper content of 20-35% is

refined into copper matte, which has a 50-70% copper content, through roasting and smelting. The copper matte, which is largely composed of copper sulfide, is then processed into blister copper, which contains 98-99% copper. Both processes involve melting, which is a physical change, and chemical changes in which iron and sulfur atoms are extracted. The blister copper is then fire-refined and electro-refined into 99.99% pure copper. These refining processes also involve physical and chemical changes where atoms, ions, or radicals are removed or rearranged.

Refining coal into coke, like the production of refined copper from copper ore, involves physical and chemical changes. However, as just discussed, production of copper is a much more complex process, requiring several nonmining processes, each of which involves physical and chemical changes. Cokemaking requires only a single step.

Fay West: In summary, the coking process simply refines a natural resource by eliminating impurities from crushed coal. As such, we strongly believe that cokemaking is refining, and thus is a qualifying activity under the proposed regulations. We are certain that it was not the intent of the proposed regulations to exclude purification processes such as ours from the definition of “qualifying activities.” However, the proposed regulations are unclear, and our depressed share price reflects that lack of clarity. The changes we have proposed—first, clarifying that nonmining processes that purify ores and minerals are qualifying activities, and, second, eliminating the physical or chemical change limitation—would bring needed clarity to the definition of “processing.”

Thank you very much for your time. We would be happy to answer any questions you may have.