

BAKER BOTTS LLP

1500 SAN JACINTO CENTER ABU DHABI
98 SAN JACINTO BLVD. AUSTIN
AUSTIN, TEXAS BEIJING
78701-4078 DALLAS
DUBAI
TEL +1 512.322.2500 HONG KONG
FAX +1 512.322.2501 HOUSTON
www.bakerbotts.com LONDON
MOSCOW
NEW YORK
PALO ALTO
RIYADH
WASHINGTON
TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY

December 23, 2009

064965.0124

Ms. LaDonna Castañuela
Chief Clerk (MC 105)
Texas Commission on Environmental Quality
P.O. Box 13087
Austin, Texas 78711-3087

Pamela M. GIBLIN
TEL +1 512.322.2508
FAX +1 512.322.8308
pam.giblin@bakerbotts.com

CHIEF CLERK'S OFFICE

2009 DEC 23 PM 4:10

Re: TCEQ Docket Nos. 2007-0732-MIS-U (UD 06-10270/Valero Corpus Christi Refinery - Nueces County); 2007-0733-MIS-U (UD 06-10271/Valero Corpus Christi Refinery - Nueces County); 2007-0734-MIS-U (UD 06-10281/Valero Houston Refinery - Harris County); 2007-0735-MIS-U (UD 06-10268/Valero Houston Refinery - Harris County); 2007-0736-MIS-U (UD 06-10283/Diamond Shamrock McKee Refinery - Moore County); 2007-0737-MIS-U (UD 06-10282/Diamond Shamrock McKee Refinery - Moore County); 2007-0738-MIS-U (UD 06-10280/Valero Port Arthur Refinery - Jefferson County); 2007-0739-MIS-U (UD 06-10279/Valero Port Arthur Refinery - Jefferson County); 2007-0724-MIS-U (UD 06-10285/Valero Texas City Refinery - Galveston County); 2007-0740-MIS-U (UD 06-10284/Valero Texas City Refinery - Galveston County)

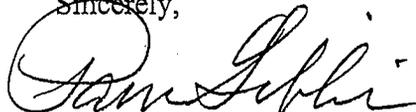
Dear Ms. Castañuela:

Enclosed for filing in the above-referenced and numbered proceeding please find an original and seven (7) copies of *Valero Refining - Texas, L.P., Diamond Shamrock Refining Company, L.P., and the Premcor Refining Group, Inc.'s Response in Reply to the Executive Director, Public Interest Counsel, and Jefferson County Appraisal District's Supplemental Response Briefs to the Appeal of the Executive Director's Negative Use Determinations.*

A copy of the above referenced document is being served on the persons identified in the Certificate of Service.

Thank you for your attention to this matter. If you have any questions concerning this filing, please do not hesitate to contact me at the number above.

Sincerely,



Pamela M. Giblin

Enclosure

cc: Attached Mailing List

TCEQ Docket Numbers

- 2007-0732-MIS-U (UD 06-10270/Valero Corpus Christi Refinery - Nueces County)
- 2007-0733-MIS-U (UD 06-10271/Valero Corpus Christi Refinery - Nueces County)
- 2007-0734-MIS-U (UD 06-10281/Valero Houston Refinery - Harris County)
- 2007-0735-MIS-U (UD 06-10268/Valero Houston Refinery - Harris County)
- 2007-0736-MIS-U (UD 06-10283/Diamond Shamrock McKee Refinery - Moore County)
- 2007-0737-MIS-U (UD 06-10282/Diamond Shamrock McKee Refinery - Moore County)
- 2007-0738-MIS-U (UD 06-10280/Valero Port Arthur Refinery - Jefferson County)
- 2007-0739-MIS-U (UD 06-10279/Valero Port Arthur Refinery - Jefferson County)
- 2007-0724-MIS-U (UD 06-10285/Valero Texas City Refinery - Galveston County)
- 2007-0740-MIS-U (UD 06-10284/Valero Texas City Refinery - Galveston County)

APPEAL OF THE EXECUTIVE DIRECTOR'S USE DETERMINATIONS ISSUED TO VALERO REFINING - TEXAS, L.P.; DIAMOND SHAMROCK REFINING COMPANY, L.P.; AND THE PREMCOR REFINING GROUP, INC. APPLICATION NUMBERS: 06-10268, 06-10270, 06-10271, 06-10279, 06-10280, 06-10281, 06-10282, 06-10283, 06-10284, and 06-10285

§
§
§
§
§
§
§
§
§
§
§

BEFORE THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

2009 DEC 23 PM 4: 10
 CHIEF CLERKS OFFICE
 TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

VALERO REFINING - TEXAS, L.P., DIAMOND SHAMROCK REFINING COMPANY, L.P., AND THE PREMCOR REFINING GROUP, INC.'S RESPONSE IN REPLY TO THE EXECUTIVE DIRECTOR, PUBLIC INTEREST COUNSEL, AND JEFFERSON COUNTY APPRAISAL DISTRICT'S SUPPLEMENTAL RESPONSE BRIEFS TO THE APPEAL OF THE EXECUTIVE DIRECTOR'S NEGATIVE USE DETERMINATIONS

Valero Refining - Texas, L.P., Diamond Shamrock Refining Company, L.P., and the Premcor Refining Group, Inc. (hereinafter collectively referred to as "Valero") files this Response in Reply to the Executive Director's, Public Interest Counsel's, and Jefferson County Appraisal District's Supplemental Response Briefs to the Appeals of the Executive Director's Use Determinations Issued to Valero.

For the reasons set out below, Valero respectfully requests that the Commission deny the Executive Director's negative use determinations and grant positive use determinations. In the alternative, Valero requests that the Commission find that the portions of the hydrotreaters and related equipment that were installed solely to meet an environmental regulation are non-productive equipment; that the equipment provides an environmental benefit at the site; that Valero is not excluded from the Proposition 2 tax exemption by the "commercial waste management" exclusion; and, that the applications be remanded to the Executive Director for new use determinations consistent with the Commission's findings. Additionally, Valero

requests that the Commission direct Staff and Valero to develop an appropriate methodology to identify the non-productive portion of the equipment.

I. Background

1. Procedural

In January 2007, Valero first submitted applications to the Texas Commission on Environmental Quality (“TCEQ”) seeking positive use determinations for sulfur-reducing hydrotreaters and associated equipment at five of its Texas refineries. TCEQ Staff denied Valero’s applications and issued negative use determinations in April 2007. In May 2007, Valero appealed the negative use determinations to the Commission. In April and May 2008, briefs were filed with the Commission by TCEQ Staff, Public Interest Counsel, the Galveston and Harris County Appraisal Districts, and Valero. Following the submission of the parties’ briefs, Valero had several meetings with Staff and submitted additional briefings and other information regarding the applications.

On January 16, 2009, Valero filed its *Supplemental Response in Reply to the Executive Director, Public Interest Counsel, Galveston Central Appraisal District, and the Harris County Appraisal District’s Response Briefs* (“Valero’s Supplemental Response”) with the Chief Clerk to ensure that the interested parties received all of the information Valero had previously shared and discussed with TCEQ Staff. In response to Valero’s Supplemental Response, on January 22, 2009, TCEQ General Counsel continued the appeals indefinitely. On November 24, 2009, General Counsel issued a new briefing schedule allowing the interested parties the opportunity to respond fully. In accordance with the revised briefing schedule, Valero files this reply to respond to the briefs filed by the Executive Director, Public Interest Counsel, and the Jefferson County Appraisal District on December 15, 2009, and to renew its request that the Commissioners deny the Executive Director’s negative use determinations and grant positive use determinations, or alternatively, remand the matters to the Executive Director for new use determinations in accordance with the Proposition 2 pollution control property requirements.

2. Background and Fundamental Purpose of Proposition 2

In 1993, Texas voters approved an amendment to the Texas Constitution allowing the Legislature to exempt property used to control pollution from ad valorem taxation. This amendment is frequently referred to as “Proposition 2.” The Texas Legislature implemented Proposition 2 in 1993 by enacting TEX. TAX CODE § 11.31. The language of the statute exempts from taxation property that is used, constructed, acquired, or installed wholly or partly to meet or exceed rules or regulations adopted by any environmental protection agency of the United States, Texas, or a political subdivision of Texas for the prevention, monitoring, control, or reduction of air, water, or land pollution.¹ This provision “was intended to give such relief to businesses compelled by law to install or acquire pollution control equipment which generates no revenue

¹ TEX. TAX CODE § 11.31(a) and (b).

for such businesses.”² In order to receive a pollution control property tax exemption, a positive use determination must first be received from the TCEQ Executive Director.³

In 2001, the Legislature provided additional direction as to the implementation of the Proposition 2 program. The most critical of these additions was an instruction that TCEQ adopt rules to ensure that determinations are made in a manner that is “equal and uniform.”⁴ In response to this direction, TCEQ adopted additional rules and included a Decision Flow Chart referencing “environmental benefit at the site.”⁵

The long-standing purpose behind the Proposition 2 program is one of fundamental fairness.⁶ Businesses that are required by the government to acquire, install, and operate pollution control property should not be further penalized by the government by then being taxed on that same property that has been installed under mandate.⁷ It should be noted that the authorizing statute of the Proposition 2 program, TEXAS TAX CODE § 11.31, creates a clear and unambiguous *exemption* from ad valorem taxation for Pollution Control Property. This exemption is neither a tax deduction nor a subsidy.

The statute sets out only two basic criteria that must be satisfied in order to qualify for the pollution control exemption. First, the property must be used, constructed, acquired, or installed to meet or exceed a rule or regulation of an environmental agency after January 1, 1994. Second, the property must prevent, control, or reduce air, water, or land pollution.⁸ The hydrotreaters and associated equipment at issue in this appeal meet both of these requirements.

² *Op. Tex. Att’y Gen. No. 96-128* (1996).

³ TEX. TAX CODE § 11.31(c) and (d).

⁴ TEX. TAX CODE § 11.31(g).

⁵ 30 TEX. ADMIN. CODE § 17.15(a).

⁶ House Research Organization, Floor Report for HB 1920 at 3. (April 19, 1993) “It would be unfair to tax businesses on property they are required by law to purchase.”

⁷ *Id.*

⁸ (a) A person is entitled to an exemption from taxation of all or part of real and personal property that the person owns and that is used wholly or partly as a facility, device, or method for the control of air, water, or land pollution. A person is not entitled to an exemption from taxation under this section solely on the basis that the person manufactures or produces a product or provides a service that prevents, monitors, controls, or reduces air, water, or land pollution. Property used for residential purposes, or for recreational, park, or scenic uses as defined by Section 23.81, is ineligible for an exemption under this section. (b) In this section, “facility, device, or method for the control of air, water, or land pollution” means land that is acquired after January 1, 1994, or any structure, building, installation, excavation, machinery, equipment, or device, and any attachment or addition to or reconstruction, replacement, or improvement of that property, that is used, constructed, acquired, or installed wholly or partly to meet or exceed rules or regulations adopted by any environmental protection agency of the United States, this state, or a political subdivision of this state for the prevention, monitoring, control, or reduction of air, water, or land pollution. This section does not apply to a motor vehicle. TEXAS TAX CODE § 11.31.

3. Valero's Hydrotreaters

In 2006 Valero installed "Tier 2"⁹ hydrotreaters and associated equipment at five of its refineries in response to United States Environmental Protection Agency's ("EPA") low-sulfur pollution control requirements for gasoline and diesel fuels.¹⁰ As noted in the *Executive Director's Supplemental Response Brief to Valero Refining - Texas, L.P., Diamond Shamrock Refining Company, L.P., and the Premcor Refining Group, Inc.'s Appeal of the Executive Director's Negative Use Determinations* (the "Executive Director's Supplemental Response"), the EPA Tier 2 regulations require that sulfur levels in gasoline and diesel fuels be reduced in order to combat ozone and particulate matter pollution.¹¹ In the Preamble to the adoption of the low-sulfur gasoline regulations, EPA stated that:

Today's program will bring about major reductions in annual emissions of these pollutants and also reduce the emissions of sulfur compounds resulting from the sulfur in gasoline. For example, we project a reduction in oxides of nitrogen emissions of at least 856,000 tons per year by 2007 and 1,236,000 by 2010, the time frame when many states will have to demonstrate compliance with air quality standards. Emission reductions will continue increasing for many years, reaching at least 2,220,000 tons per year in 2020 and continuing to rise further in future years. In addition, the program will reduce the contribution of vehicles to other serious public health and environmental problems, including VOC, PM, and regional visibility problems, toxic air pollutants, acid rain, and nitrogen loading of estuaries.¹²

The additional reduction in gasoline and diesel sulfur content required by EPA provides very significant reductions in air pollutants. This reduction was not required by market demand and provides no benefits to petroleum refiners who must comply with these environmental regulations. The Executive Director does not dispute and, in fact, has agreed that Valero only installed the Tier 2 hydrotreaters in order to meet EPA's Tier 2 sulfur requirements. Because the Tier 2 hydrotreaters and associated equipment were "installed wholly or partly to meet or exceed rules or regulations adopted by [an] environmental protection agency of the United States" after

⁹ The term "Tier 2" hydrotreater is used throughout this brief to distinguish the hydrotreating equipment included in Valero's Proposition 2 applications from other hydrotreating equipment in service at Valero's refineries. Tier 2 refers to the second phase of EPA's low sulfur regulations (40 CFR § 80.195 *et seq.* and 40 CFR § 80.500 *et seq.*) which required the installation of this hydrotreating equipment. The EPA's "Tier 2" sulfur regulations should not be confused with TCEQ's "Tier II" category of applications for a pollution control property use determination.

The Tier 2 hydrotreaters include both newly installed and modified equipment. At some of Valero's refineries, due to the particular configurations in place prior to the implementation of the EPA Tier 2 regulations, the most efficient option for complying with the EPA requirements involved combining the additional hydrotreating capacity required by the EPA rules with capacity previously in place and required for production. At other refineries, entire new hydrotreating units were installed to comply with the regulations. In the instances where previously existing hydrotreaters were modified or replaced with units that meet the EPA requirements, the additional hydrotreating equipment required by the regulations qualifies for a use determination under the long-standing agency practice of recognizing exemptions for the portion of equipment modified to comply with an environmental regulation.

¹⁰ See 40 CFR § 80.195 *et seq.* and 40 CFR § 80.500 *et seq.*

¹¹ See Executive Director's Response p. 2 and 65 Fed. Reg. 6698 (February 10, 2000).

¹² See 65 Fed. Reg. 6698 (Feb. 10, 2000).

January 1, 1994, and because the Tier 2 hydrotreating equipment prevents air pollution, the hydrotreaters clearly satisfy the statutory requirements necessary to qualify for the Proposition 2 exemption.

II. Issues

The following issues have been identified in the Executive Director's Supplemental Response as outstanding and central to the resolution of Valero's appeals: (i) the classification of the Tier 2 hydrotreating equipment as production or pollution control equipment; (ii) the environmental benefit provided at the site by the Tier 2 hydrotreaters; and, (iii) the "commercial waste management exclusion."¹³ Valero respectfully disagrees with Staff that any of these factors necessitates that the negative use determinations for Valero's Tier 2 hydrotreaters be upheld. As discussed below, the Tier 2 hydrotreaters meet all applicable requirements for a Proposition 2 pollution control property tax exemption.

1. Valero is Seeking a Tax Exemption Only for Its Non-Productive, Tier 2 Hydrotreating Equipment

Valero is seeking Proposition 2 tax exemptions only for the non-productive, Tier 2 hydrotreating equipment that it installed, as Staff has acknowledged, to meet the EPA requirements. Staff argues that Valero's Tier 2 hydrotreaters and associated equipment are not eligible for a Tier II 100% positive use determination because "hydrotreating is a necessary component of Valero's production process."¹⁴ This assertion is based on the flawed premise that all "hydrotreating" has a productive purpose. Hydrotreating certainly can be productive. For example, removing some sulfur may be necessary to protect production equipment from corrosion. The use of hydrotreaters, however, is not limited to productive uses. The Tier 2 hydrotreating equipment used by Valero to meet the EPA low-sulfur requirements does not provide a benefit to Valero's production process. Instead, as Staff acknowledges, "additional hydrotreating at Valero's refineries is now necessary" because of the EPA pollution control standards.¹⁵ This additional hydrotreating is not "a necessary component of Valero's production process."¹⁶

The Equipment and Categories List ("ECL") contains several examples of property that can be either pollution control property or production equipment depending on its specific use. For example, piping is often used for production purposes including transporting feed stock and refined product. Piping used as production equipment would not be eligible for a pollution control exemption. Piping dedicated to pollution control projects, such as when used as part of vapor recovery equipment, however, is not denied a positive use determination based on its potential for use as production equipment in other instances. Similarly, the fact that hydrotreaters can be and are in use as production equipment in the refining process should not control the use determinations for the specific Tier 2 hydrotreating equipment installed only to meet pollution control requirements.

¹³ See Executive Director's Response p. 2.

¹⁴ *Id.* at p. 3.

¹⁵ *Id.*

¹⁶ *Id.*

Although the Executive Director's Supplemental Response states that "Valero has never acknowledged the production aspect of its hydrotreating equipment," Valero believes that the previously filed Valero's Supplemental Response and the associated Process Flow Diagrams and Equipment List Exhibits have acknowledged and discussed the productive uses of hydrotreating equipment at its refineries.¹⁷ Additionally, the Proposition 2 tax exemption is not limited to only that pollution control property that serves no productive purpose; productive equipment that also serves as pollution control property may qualify for the exemption. TEX. TAX CODE § 11.31 provides that TCEQ must adopt rules that "allow for determinations that distinguish the proportion of property that is used to control, monitor, prevent, or reduce pollution from the proportion of property that is used to produce goods or services."¹⁸

Valero once again stresses that it is seeking an exemption only for that non-productive hydrotreating equipment and other associated equipment that was installed and is used solely to comply with the EPA pollution control sulfur standards. Valero strongly believes that it has made every effort to include only the non-productive, pollution controlling Tier 2 hydrotreating equipment in its Tier II applications. However, if Staff believes that the methods used by Valero to distinguish the non-productive, pollution control equipment from the production equipment at its refineries is flawed, Valero would welcome the opportunity to work with Staff to refine the equipment covered in the applications.

2. The Tier 2 Hydrotreaters Provide an Environmental Benefit at the Site

A. The Executive Director Apparently Agrees that the Tier 2 Hydrotreaters Provide an Environmental Benefit at the Site

The Decision Flow Chart included in the TCEQ regulations indicates that, in order to qualify for a Proposition 2 exemption, pollution control property must provide "an environmental benefit at the site."¹⁹ This requirement is not found in the statute and is not discussed in the narrative portion of the rules.²⁰

Although apparently unsatisfied with the sufficiency or type of the benefit, the Executive Director appears to agree that the Tier 2 hydrotreaters provide environmental benefits at the site.²¹ These benefits include the following: reductions in sulfur dioxide ("SO₂"), nitrogen oxide ("NO_x") and fine particulate matter (PM) emissions in the immediate air shed; reductions in flaring events associated with unit shutdowns; reductions in emissions from associated equipment such as heaters, boilers and electrical production equipment; reductions of emissions from sample collection stations; reductions in hydrogen sulfide ("H₂S") emissions from fugitive components; reductions in H₂S emissions from product tanks and loading and unloading facilities; and reductions in the firing and flaring events of refinery fuel gas.²²

¹⁷ See Valero's Supplemental Response p. 3-4; Exhibit D, Valero's Supplemental Response; Exhibit E, Valero's Supplemental Response.

¹⁸ TEX. TAX CODE § 11.31(g).

¹⁹ See 30 TEX. ADMIN. CODE § 17.15(a).

²⁰ See TEX. TAX CODE § 11.31 and 30 TEX. ADMIN. CODE § 17.15(a).

²¹ See Executive Director's Supplemental Response, p. 5-6.

²² See *Id.*

B. The Executive Director's Brief Would Impose Ad-Hoc Requirements

The Decision Flow Chart expresses the environmental benefit at the site requirement as a box to be checked by the applicant.²³ The rules and guidance provide no elaboration as to how "environmental benefit at the site" is to be interpreted and contain no additional requirements for quantification or specification. The agency has provided no illumination beyond the examples contained in the ECL. The Executive Director apparently agrees that the Tier 2 hydrotreaters provide some environmental benefits at the sites, which is all that is required by the statutes, rules and agency guidance.

Nonetheless, the Executive Director's Supplemental Response still concludes that the Tier 2 hydrotreaters fail to meet the environmental benefit at the site regulatory requirement.²⁴ In various filings, the Executive Director has developed a variety of extra-regulatory requirements that purport to mandate a denial of Valero's applications.²⁵ For example, in his latest filing, the Executive Director argues that Valero fails to meet the requirement because its identified reductions are not sufficiently "significant," because the reductions are not those that were identified by the environmental regulation, and because it would be impossible to generate reliable data regarding SO₂, NO_x and fine PM emissions that could be attributed solely to the utilization of Valero's low sulfur fuel.²⁶ None of these requirements can be found in TEX. TAX CODE § 11.31, TCEQ rules, or Commission guidance. The introduction of these interpretations is, in fact, impermissible ad hoc rulemaking, and the individual requirements are inconsistent with the Commission guidance.

Staff argues, after acknowledging that the environmental benefit at the site regulation does not include a quantitative requirement, that the environmental benefits provided at the site in the form of reductions in SO₂, NO_x and fine PM emissions are not a significant enough percentage in comparison to the total fuel processed by the hydrotreaters.²⁷ Staff does not provide any definition of what would be a significant percentage or any indication of how to determine this percentage, nor does the agency's application forms or guidance indicate a need to quantify the benefit or evaluate its "significance." While Staff may not find the reduction in emissions "significant," the EPA, in its adoption of the low-sulfur regulations, stated: "the Tier 2/gasoline sulfur rule will achieve environmental benefits in the local areas where refineries are located, due to reductions in tail pipe emissions from vehicles driven in those areas."²⁸ This area includes the refinery sites themselves, and, as Staff has said, the environmental benefit at the site requirement "does not mean that pollution control equipment cannot provide an additional environmental benefit off-site."²⁹

²³ 30 TEX. ADMIN. CODE § 17.15(a).

²⁴ See Executive Director's Supplemental Response, p. 5-6.

²⁵ See *Id.* at p. 5-6 and *Executive Director's Response Brief to Valero Refining - Texas, L.P., Diamond Shamrock Refining Company, L.P., and The Premcor Refining Group, Inc.'s Appeal of the Executive Director's Negative Use Determinations*, p. 23.

²⁶ See Executive Director's Supplemental Response, at p. 5.

²⁷ See *Id.* at p. 5-6.

²⁸ 65 Fed. Reg. 6774 (Feb. 10, 2000).

²⁹ See Executive Director's Supplemental Response, p. 4.

Staff also objects to several specific, significant environmental benefits at the site including a reduction in flaring events; a reduction in emissions from associated equipment; a reduction of emissions from sample collection stations; a reduction in H₂S emissions from fugitive components, product tanks, and loading and unloading facilities; and a reduction in the firing and flaring events of refinery fuel gas. The Executive Director's Supplemental Response states that these specific environmental benefits occurring at the Valero sites are not sufficient to meet the environmental benefit at the site requirement as the benefits are "not consistent" with the environmental rules cited in Valero's applications.³⁰ Again, neither the language of the environmental benefit at the site item, nor the statutory language of TEX. TAX CODE § 11.31 provides any support for this proposed requirement.

The objections made by the Executive Director to the very real environmental benefits provided by the Tier 2 hydrotreaters at the site are not anchored in the Commission's rules. The language in the environmental benefit at the site item in the Decision Flow Chart is limited to *only* "an environmental benefit at the site."³¹ The rule language does not include any of these newly-announced additional limitations, such as an ability to generate data regarding the specific emissions reduction, or the requirement that an environmental benefit comprises a "significant" enough percentage of the pollution control property, that the Executive Director is now trying to impose in its analysis of Valero's applications.

The Executive Director's Supplemental Response continues to fail to provide an explanation of what environmental benefit at the site *is*. Rather, Staff has only supplied additional ad hoc factors as to what an environmental benefit at the site is *not*. Although Staff may believe that it "knows an environmental benefit at the site when it sees it," it is fundamentally unreasonable to leave the regulated community without a clear standard that includes the factors that must be met in order to show an environmental benefit at the site. Moreover, this failure to articulate a standard has resulted in non-compliance with the statute's directive that all rulings must be "be sufficiently specific to ensure that determinations are equal and uniform."³²

Given the language of the environmental benefit at the site requirement, and the information provided by Valero showing several environmental benefits occurring at the sites as a result of the Tier 2 hydrotreaters and associated equipment, the only reasonable conclusion is that the Tier 2 hydrotreaters meet the environmental benefit at the site requirement.

C. Equipment and Categories List

The Executive Director's Supplemental Response continues to maintain that the environmental benefit at the site requirement can only be satisfied by a showing of a benefit within the fence line of the site.³³ Based on several items included on the ECL, Valero has suggested that the environmental benefit at the site requirement may be met either by a showing of an environmental benefit within the fence line of the site, within the area of the site, or created

³⁰ See *Id.* at p. 6.

³¹ 30 TEX. ADMIN. CODE § 17.15.

³² See TEX. TAX CODE § 11.31(g).

³³ See Executive Director's Supplemental Response, p. 5.

by equipment at the site.³⁴ Staff has rejected Valero's analysis because "the Executive Director only grants positive use determinations for equipment that provides an 'environmental benefit at the site.'"³⁵ The Executive Director's Supplemental Response expands on this interpretation by describing the possible environmental benefit within the fence line for a selected portion of the ECL items Valero used as examples of items that do not provide an environmental benefit within the fence line of site.³⁶ For example, the Executive Director's Supplemental Response indicates that slurry and barrier walls provide an environmental benefit at the site by preventing pollution migration on the affected property, and that injection wells provide an environmental benefit by providing an authorized method of waste disposal at the site.³⁷

These explanations are, at best, unnecessarily tortured, and, at worst, are inconsistent with the customary use and purpose of slurry walls and injection wells, whose general goal may be described as preventing migration off-site by containing contaminants on-site and therefore creating an ongoing environmental burden at the site. Staff's explanations regarding a subset of the equipment on the ECL also fails to show that each of the items on the ECL is capable of providing an environmental benefit within the fence line of the site.³⁸ An interpretation of the requirement that allows for an environmental benefit in the area of the site or an environmental benefit which is created at the site better explains several of the items on the ECL. Regardless of any disagreement as to whether or not the environmental benefit at the site requirement should be limited to the fence line of the site, the environmental benefits from Valero's Tier 2 hydrotreating equipment meet all possible interpretations of "environmental benefit at the site."

Valero has provided information showing that the Tier 2 hydrotreaters provide environmental benefits at its refinery sites. The Executive Director's Supplemental Response does not dispute the existence of such benefits. As such, Valero respectfully requests that the Commission find that the Tier 2 hydrotreating equipment provides an environmental benefit at the site in satisfaction of the Decision Flow Chart requirement.

3. Valero is Not a Manufacturer of Pollution Control Property Subject to the Commercial Waste Management Exclusion

Valero is not a manufacturer of pollution control property. Valero has been required by law to install pollution control property, which it did not manufacture, in the form of the Tier 2 hydrotreaters. These hydrotreaters qualify for the Proposition 2 exemption. To hold otherwise would unfairly require Valero to pay taxes on property that it was required to install pursuant to EPA regulations.

³⁴ See Exhibit A, Valero's Supplemental Response, p. 2-5.

³⁵ See Executive Director's Supplemental Response, p. 4.

³⁶ See Executive Director's Supplemental Response, p. 4. Valero notes that the Executive Director's Supplemental Response did not provide any explanation as to the possible environmental benefits at the site of a double-hulled barge, off-site ambient air monitors, and non-commercial injection wells that accept waste generated off-site.

³⁷ See *Id.*

³⁸ See *Id.*

A. The Commercial Waste Management Exclusion is Intended to Address Those in the Business of Pollution Control

TEX. TAX CODE § 11.31 includes a provision excluding manufacturers of pollution control property from qualifying for a Proposition 2 tax exemption,³⁹ which Staff has aptly described as the “commercial waste management exclusion.”⁴⁰ This exclusion was included in the statute to clarify that the Proposition 2 exemption is “not intended as tax relief for persons engaged for profit in the pollution control business.”⁴¹ Instead, Proposition 2 was intended to avoid the unfair result, or “double whammy,” that would occur by requiring a company to make significant expenditures for pollution control property and then forcing the company to annually pay taxes on the same equipment.⁴²

The original text of the statute did not exclude businesses whose purpose is to manufacture pollution control property.⁴³ Concerns were raised during hearings on the bill that the exemption may be used to exempt all taxable property of companies in the business of pollution control, specifically businesses such as automobile inspection stations or landfill operators.⁴⁴ The original bill’s sponsor, Representative Mark Stiles, stated that he did not think such businesses that were in the business of providing pollution control services were covered by the Proposition 2 exemption and that he “would be glad to accept an amendment that [if] somebody’s in the business to make money with a service like that, that would not be applicable under this law.”⁴⁵ To address these concerns, an exclusion from Proposition 2 was added to preclude businesses that make pollution control property (such as wet gas scrubbers, flares, selective catalyst reduction, etc.) as their stock in trade from claiming an exemption. The exclusion, as drafted and as confirmed by the Texas Attorney General, was intended to, and does make clear that “[t]he statute was not intended to provide a tax exemption to businesses which are engaged for profit in the commercial trade of pollution control or abatement.”⁴⁶

B. Valero is Not in the Business of Pollution Control or Abatement

Valero is not engaged for profit in the commercial trade of pollution control or abatement. Valero’s business is the production of petroleum-derived fuels such as gasoline and diesel whose purpose is the production of energy. EPA regulations have required Valero to install additional pollution control equipment to remove sulfur from its fuels products. These EPA regulations, however, have not transformed Valero into a business that is engaged in the commercial trade of pollution control.

In an attempt to show that Valero is a manufacturer of pollution control property, Staff draws an inaccurate comparison between Valero’s fuel products and actual pollution control

³⁹ TEX. TAX CODE § 11.31(a).

⁴⁰ See Executive Director’s Supplemental Response, p.6.

⁴¹ *Op. Tex. Att’y Gen. No. 96-128* at 3 (1996).

⁴² Quoting Representative Steven Wolens, Deliberations of the House Ways and Means Committee on H.J.R. 86 and H.B. 1920, March 24, 1993. Transcript prepared by the Office of Attorney General, Natural Resources Division.

⁴³ *Op. Tex. Att’y Gen. No. 96-128* at 2.

⁴⁴ *Id.* at 2-3.

⁴⁵ *Id.* at 2 citing Hearings on H.B. 1920 & H.J.R. 86 Before the House Ways and Means Comm., 73d Leg (March 24, 1993).

⁴⁶ *Op. Tex. Att’y Gen. No. 96-128* at 3.

property using low NO_x burners as an example. The Executive Director's Supplemental Response states that "[a] low NO_x burner is manufactured so that the end user can meet emission limitations," and that this is "just like Valero's low sulfur fuels," because "the sulfur reduction in the fuels allows the consumers' vehicles to meet emission limitations."⁴⁷ The *consumers* of low sulfur fuels, however, are not required by the EPA regulations to control their emissions of SO₂, NO_x and fine PM in the same way that an industrial purchaser of a low NO_x burner is required to comply with NO_x limitations. Rather EPA has tasked fuel refiners, like Valero, with controlling SO₂, NO_x and fine PM emissions from the consumers' fuel through the use of pollution control equipment like the Tier 2 hydrotreaters.⁴⁸ Unlike manufacturers who sell Valero its low NO_x burners and hydrotreaters so that Valero can comply with all air quality requirements, Valero is not selling low sulfur fuel products to allow the consumers to meet emission regulations. Valero instead has purchased Tier 2 hydrotreating equipment to remove sulfur from its gasoline and diesel in order to meet EPA fuel emission regulations, just as it has done with low NO_x burners to meet air regulations.

4. XTO Energy Use Determination is Not Controlling in Valero's Appeal

OPIC's Supplemental Response argues that the *XTO Energy Use Determination* is controlling in Valero's present appeal and creates a basis upon which Valero's applications should be denied.⁴⁹

In *XTO Energy*, the Commission determined that a natural gas manufacturer could not qualify for a Proposition 2 tax exemption on sulfur removal equipment unless such sulfur removal was required by an environmental regulation.⁵⁰ The Commissioners found that absent such an environmental regulation requiring the sulfur removal, XTO Energy was voluntarily removing sulfur from its natural gas to meet market standards.⁵¹ Because the removal was intended to meet market standards and not any environmental regulation, the equipment was considered production equipment with no pollution control purpose and therefore not eligible for a Proposition 2 exemption.

In contrast, Valero did not install the Tier 2 hydrotreaters to meet market standards. Valero is required by EPA regulations, not market standards, to reduce the sulfur in its products to Tier 2 levels for air quality purposes.⁵² The level of sulfur reduction required by these EPA rules does not increase Valero sales or otherwise provide a benefit in the production process.

III. Conclusion

Valero's Tier 2 hydrotreaters are non-productive, pollution control property that remove sulfur from gasoline and diesel solely for environmental purposes. The Tier 2 hydrotreaters meet all stated statutory and regulatory requirements. The Tier 2 hydrotreating equipment was

⁴⁷ See Executive Director's Supplemental Response, p. 7.

⁴⁸ See 40 CFR § 80.195 *et seq.* and 40 CFR § 80.500 *et seq.*

⁴⁹ The Executive Director's Supplemental Response, perhaps recognizing the significant factual and legal differences between *XTO Energy* and Valero's appeal, did not make a similar argument.

⁵⁰ See Exhibit C, Valero's Supplemental Response, p. 2.

⁵¹ See *Id.*

⁵² See 40 CFR § 80.195 *et seq.* and 40 CFR § 80.500 *et seq.*

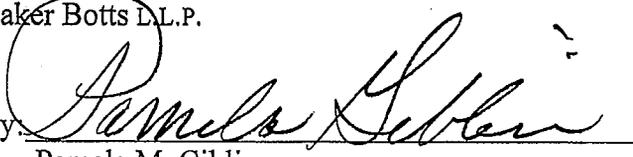
installed after January 1, 1994 and is operated by Valero solely to comply with the EPA low sulfur regulations. The equipment prevents air pollution by removing sulfur from gasoline and diesel. As Staff has acknowledged, the Tier 2 hydrotreating equipment provides multiple environmental benefits at the site, and thus meets the "environmental benefit at the site" requirement found in the regulatory Decision Flow Chart. Furthermore, as a producer of petroleum-derived diesel and gasoline fuels, Valero is not excluded from the Proposition 2 tax program by the "commercial waste management exclusion."

Granting a positive use determination for the Tier 2 hydrotreating equipment is consistent with Proposition 2's long-standing purpose of fundamental fairness. It would be unfair to penalize the company by taxing the non-productive equipment installed by Valero pursuant to the EPA's Tier 2 requirements. Valero is not seeking a Proposition 2 tax exemption for any equipment other than that which it installed solely to meet the EPA regulations. Valero seeks to work cooperatively with Staff to resolve the applications and will submit any additional information required by Staff to ensure that the exemption granted covers only the non-productive, pollution control property which was installed to comply with the Tier 2 regulations.

For these reasons, Valero respectfully requests that the Commission deny the Executive Director's negative use determinations and grant positive use determinations. In the alternative, Valero requests that the Commission find that the portions of the hydrotreaters and related equipment that were installed solely to meet an environmental regulation are non-productive equipment; that the equipment provides an environmental benefit at the site; that Valero is not excluded from the Proposition 2 tax exemption by the "commercial waste management" exclusion; and, that the applications be remanded to the Executive Director for new use determinations consistent with the Commission's findings. Additionally, Valero requests that the Commission direct Staff and Valero to develop an appropriate methodology to identify the non-productive portion of the equipment.

Respectfully submitted,

Baker Botts L.L.P.

By: 

Pamela M. Giblin
State Bar No. 07858000
Amber G. Weigl
State Bar No. 24055531
1500 San Jacinto Center
98 San Jacinto Center
Austin, Texas 78701-4039
Tel: 512.322.2500
Fax: 512.322.8308

CERTIFICATE OF SERVICE

I certify that on December 23, 2009 copies of the "Valero Refining - Texas, L.P., Diamond Shamrock Refining Company, L.P., and the Premcor Refining Group, Inc.'s Response in Reply to the Executive Director, Public Interest Counsel, and Jefferson County Appraisal District's Supplemental Response Briefs to the Appeal of the Executive Director's Negative Use Determinations" was filed with the Office of the Chief Clerk, Texas Commission on Environmental Quality, and was served by first-class mail, email or facsimile to all persons on the attached mailing list.

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY
DEC 23 PM 4:10
CHIEF CLERK'S OFFICE

Guy Henry
Timothy Reidy
Robert Martinez
Texas Commission on Environmental
Quality
Environmental Law Division
P.O. Box 13087, MC-173
Austin, Texas 78711-3087
Tel: (512) 239-5487 / Fax: (512) 239-0606
Email: ghenry@tceq.state.tx.us
Email: treidy@tceq.state.tx.us
Email: rmartine@tceq.state.tx.us
Via Email and U.S. Mail

Ron Hatlett
Texas Commission on Environmental
Quality
Small Business & Environmental Assistance
Division
P.O. Box 13087, MC-110
Austin, Texas 78711-3087
Tel: (512) 239-3100 / Fax: (512) 239-5678
Email: rhatlett@tceq.state.tx.us
Via Email and U.S. Mail

Blas Coy
Garrett Arthur
Texas Commission on Environmental
Quality
Office of Public Interest Counsel
P.O. Box 13087, MC-103
Austin, Texas 78711-3087
Tel: (512) 239- 6363 / Fax: (512) 239-6377
Email: bcoy@tceq.state.tx.us
Email: garthur@tceq.state.tx.us
Via Email and U.S. Mail

Bridget Bohac
Texas Commission on Environmental
Quality
Office of Public Assistance
P.O. Box 13087, MC-108
Austin, Texas 78711-3087
Tel: (512) 239-4000 / Fax: (512) 239-4007
Email: bbohac@tceq.state.tx.us
Via Email and U.S. Mail

Dr. Emmanuel Wada
Texas Commission on Environmental
Quality
Engineers Office
P.O. Box 13087, MC-168
Austin, Texas 78711-3087
Tel: (512) 239-1917 / Fax: (512) 239-6188
Email: ewada@tceq.state.tx.us
Via Email and U.S. Mail

Kyle Lucas
Texas Commission on Environmental
Quality
Alternative Dispute Resolution Program
P.O. Box 13087, MC-222
Austin, Texas 78711-3087
Tel: (512) 239-0687 / Fax: (512) 239*4015
Email: klucas@tceq.state.tx.us
Via Email and U.S. Mail

Les Trobman
General Counsel
Texas Commission on Environmental
Quality
Office of General Counsel
P.O. Box 13087, MC-101
Austin, Texas 78711-3087
Tel: (512) 239-5500 / Fax: (512) 239-5533
Email: ltrobman@tceq.state.tx.us
Via Email and U.S. Mail

Ollie Grant
Chief Appraiser
Nueces County Appraisal District
210 N. Chaparral
Corpus Christi, Texas 78401-2563
Tel: (361) 881-9978 / Fax: (361) 887-6138
Email: ogrant@nuecescad.net
Via Email and U.S. Mail

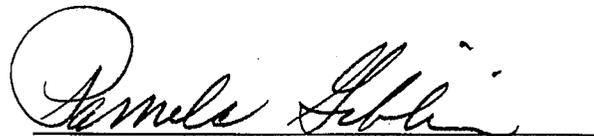
Diane Ball
Chief Appraiser
Moore Central Appraisal District
P.O. Box 717
Dumas, Texas 79029-0717
Tel: (806) 935-4193 / Fax: (806) 935-2792
Via Facsimile and U.S. Mail

Roland R. Bieber
Chief Appraiser
Jefferson County Appraisal District
P.O. Box 21337
Beaumont, Texas 77705-4547
Tel: (409) 840-9944 / Fax: (409) 727-5621
Email: info@jcad.org
Via Email and U.S. Mail

Jim Robinson
Chief Appraiser
John M. Renfrow
Assistant General Counsel
Harris County Appraisal District
P.O. Box 920975
Houston, Texas 77292-0975
Tel: (713) 812-5800 / Fax: (713) 957-5210
Email: jrobinson@hcad.org
Via Email and U.S. Mail

Ken Wright
Chief Appraiser
Galveston County Appraisal District
600 Gulf Freeway
Texas City, Texas 77591-2815
Tel: (409) 935-1980 / Fax: (409) 935-4319
Email: gcad@galvestoncad.org
Via Email and U.S. Mail

Anthony P. Brown
McLeod, Alexander, Powel & Apffel
802 Rosenberg
P.O. Box 629
Galveston, Texas 77533
Tel: (409) 763-2481 / Fax: (409) 762-1155
Email: apbrown@mapalaw.com
Via Email and U.S. Mail



Pamela M. Giblin