TCEQ Docket No. _____

In The Texas Commission on Environmental Quality

Appeal of the Executive Director's Negative Use Determination
Issued to Freestone Power Generation, LLC
f/k/a Freestone Power Generation, LP
for the Freestone Energy Center
Application No. 07-11966

NOTICE OF APPEAL

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TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
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CHIEF CLERKS OFFICE

I. INTRODUCTION

Pursuant to 30 Texas Administrative Code Section 17.25, Freestone Power Generation, LLC ("**Freestone**"), 717 Texas Ave., Suite 1000, Houston, TX, 77002, files this appeal and requests that the Texas Commission on Environmental Quality (the "**TCEQ**") reverse the negative use determination (the "**Second NUD**") issued by the Executive Director of the TCEQ by letters dated June 5, 2014 and June 17, 2014 to Freestone in connection with determination application number 07-11966. The Second NUD is attached as Exhibit 1 (App: 5-10). This appeal is timely filed within 20 days of Freestone's receipt of the Second NUD.

The current appeal is in response to the latest action by the Executive Director in his attempt to undermine the property tax exemption for heat recovery steam generators ("**HRSGs**"). The Texas Tax Code expressly declares that HRSGs are on the list of facilities, devices, or methods for controlling pollution and that the TCEQ must issue a positive use determination for such equipment. The Executive Director failed to discuss the law, and instead issued the Second NUD based on the erroneous conclusions that (i) HRSGs are not property "used, constructed, acquired, or installed wholly or partly to meet or exceed any [environmental rule] for the prevention, monitoring, control, or reduction of air, water, or land pollution," and (ii) even if there were an applicable law, the "ED does not find your methods for determining the use determination percentage to be reasonable." *Id.* The Executive Director's negative use determination is incorrect as a matter of law, contrary to the will of the Texas Legislature, and converts HRSGs from pollution control equipment to appraisal district revenue generating equipment.

HRSGs serve an important pollution control (prevention) function. Fossil fuel fired power generation facilities contribute to emissions of nitrogen oxides ("**NO_X**"), sulfur dioxide, and other contaminants in the United States. Fossil fuel-fired simple cycle combustion turbine generators, which are still installed today, lose large amounts of potential energy in the form of waste heat released into the atmosphere during operations. These types of facilities can control emissions for a given level of power output by incorporating equipment (such as Dry Low NOx combustion systems, or selective or non-selective catalytic reduction units), which directly prevent the

formation of pollution or directly reduce pollution levels once created and prior to discharge. There is, however, a different route to similar pollution control results: combined cycle technology, and specifically the use of HRSGs. HRSGs capture the waste heat created by a fossil fuel-fired combustion turbine, and use it to power a steam turbine generator set that can utilize this waste heat to produce steam and subsequently generate additional electricity. The result of this process is that HRSGs increase the electricity output per unit of fuel input, such that less fuel is burned and fewer pollutants are produced in generating the same amount of electricity. Thus, HRSGs provide an important pollution control (prevention) benefit while also generating power, both of which are important needs of the State of Texas.

Recognizing the pollution control (prevention) benefits of HRSGs, the Texas Legislature in 2007 amended section 11.31 of the Tax Code to include a new subsection (k), stating that "[t]he Texas Commission on Environmental Quality shall adopt rules establishing a nonexclusive list of facilities, devices, or methods for the control of air, water, or land pollution, which must include . . . ***heat recovery steam generators*** . . ." TEX. TAX CODE §11.31(k)(8) (emphasis added). At the same time, the Legislature added subsection (m), which requires the TCEQ to find that property listed in subsection (k) (e.g., HRSGs) are a pollution control device eligible for a tax exemption. *Id.* §11.31(m). In short, (i) the Legislature has explicitly directed the TCEQ to treat HRSGs as equipment that qualifies for the exemption, (ii) Freestone's HRSGs are a prototypical HRSG application, and (iii) therefore, Freestone's HRSGs are a type of equipment that qualifies for the exemption.

Not surprisingly given the law and the Legislature's direction, the Executive Director cannot find stable ground for his negative use determination. He has bounced from a 100% Positive Use Determination to a 61% Positive Use Determination to a 100% Negative Use Determination, all for the very same application. And in reaching his current 100% Negative Use stance, he has adjusted his position an equal number of times, making each change as he learns that his arguments cannot withstand legal scrutiny. Today, the Executive Director puts a new, but equally flawed, spin on an argument that failed in 2012. He claims that Freestone was required under the TCEQ's rules to cite a specific rule or law being met or exceeded by the HRSG (and that the Executive Director has to agree with that citation), despite the plain language of TEX. TAX CODE

§§ 11.31(k)(8) and (m), and despite the fact that the Executive Director is not making the same demands of certain other similarly situated facilities, including Freestone's sister facility, Brazos Valley. The special statutory status of HRSGs, as established by Tax Code Sections 11.31(k)(8) and (m) and as acknowledged by the Commissioners in the December 5, 2012 hearing, cannot be overridden or ignored by the Executive Director.

Compounding the error, the Commissioners' December 5, 2012 discussion of the special statutory status of HRSGs provided clear direction to the Executive Director on remand, which the Executive Director has seen fit to ignore. The Commissioners explicitly recognized the strength of the position that by creating the Subsection (k) list, the Legislature statutorily directed the TCEQ to issue positive use determinations to HRSGs, limiting the TCEQ's role to determining a reasonable percentage of exempt use. Flouting the Commissioners, the Executive Director never addressed the Commissioners' concerns regarding the duties imposed by the statutory language and legislative intent, relying instead and without explanation on an interpretation of a TCEQ administrative rule in direct conflict with the statutory language.

Despite the Executive Director's improper demands for a rule or citation, Freestone provided three significant rules being met or exceeded by use of the HRSG, which the Executive Director summarily dismissed without substantive discussion. Freestone's citations and explanations were very similar to the citations and discussions that its sister facility Brazos Valley supplied, and which the Executive Director accepted, highlighting the arbitrary nature of his decision.

Importantly, the Executive Director's attempt to reengineer the Tax Code does not end with an unsupported requirement that Freestone cite to a rule or regulation with which the Executive Director must agree. The Executive Director also forces a patently wrong partial use determination calculation in order to achieve a pre-determined result. While paying lip service to the Tier IV application process, the Executive Director insisted that Freestone use the Tier III methodology, applicable to later applications. Not stopping there, the Executive Director careened into clear error by mandating that within the Tier III calculations Freestone use incorrect inputs (such as boilers as replacement or comparable equipment), which he apparently forced to achieve his desired result.

The Executive Director's results-oriented formula creates an untenable straw man: it forces a calculation that the Executive Director knows will fail, precisely so that he can find no positive use. The Executive Director, over Freestone's objections, refused to consider any alternatives to the calculation he mandated, and rejected without analysis, the rationale demonstrating that the Executive Director's forced inputs were wrong.

There can be no doubt that the Executive Director has an agenda: he wants HRSGs off of the Tax Code's list of facilities, devices, or methods for the control of pollution. But his methods are wrong. To revise how HRSGs are treated, the TCEQ has to follow the process provided by the Texas Legislature. Section 11.31(l) of the Tax Code provides a very specific process for the TCEQ to follow when it wants to update the list of equipment receiving tax benefits:

> (l) The Texas Commission on Environmental Quality by rule shall update the list adopted under Subsection (k) at least once every three years. An item may be removed from the list if the commission finds compelling evidence to support the conclusion that the item does not provide pollution control benefits.

TEX. TAX CODE §11.31(l). By issuing the Second NUD on the basis that HRSGs do not provide a pollution benefit, the Executive Director has created a policy that *de facto* precludes HRSGs from exemption. However, by statute, the sole permissible process for TCEQ to achieve that result is (i) to remove the equipment from the Expedited Review List (i.e., subsection (k)) as part of its periodic update process and (ii) to do so based on *compelling evidence* of *no* pollution control benefit.

This process is not merely academic. It involves fundamental fairness associated with the most basic premise: due process. Indeed, the Legislature wanted to ensure that TCEQ decisions were reasoned, public, and with notice.

In summary, the Second NUD is not consistent with Texas law or policy. It must be overturned.

II. APPENDIX

Citations to the exhibits used herein are identified by an Exhibit Number, followed by the Bates label number, and are contained in a separate, concurrently filed Appendix accompanying this Notice of Appeal.

III. DESCRIPTION OF FACILITY AND EQUIPMENT

The Freestone Energy Center is a nominally-rated 1038 megawatt plant that is located in Fairfield, Texas. The facility consists of four combustion turbine generators, four HRSGs, and two steam turbine generators. The equipment is configured into two largely independent power blocks, each consisting of 2 combustion turbine generators, 2 HRSGs, and 1 steam turbine generator (thus, two 2x2-1 configurations). Each combustion turbine generator exhausts into its own HRSG, which utilizes the exhaust heat to generate steam for use in the steam turbine generator. The HRSGs found at the Freestone Energy Center are therefore, in simple terms, heat exchangers that recover heat from a hot gas stream for reuse versus release into the atmosphere. Use of the otherwise wasted heat in the turbine exhaust gas results in higher plant thermal efficiency, less fuel use, and consequently less emissions compared to other power generation technologies employed in Texas.

IV. CHRONOLOGY OF FACTS AND EVENTS

Freestone's application has been pending with the TCEQ for over six years. Initially, the TCEQ found that the HRSGs were entitled to a 100% Positive Use Determination. Later, the TCEQ reduced this positive use percentage to 61%, but then changed its mind altogether to issue a 100% Negative Use Determination. That decision was set aside by the Commissioners and remanded back to the Executive Director for a new use determination. After multiple rounds of requests for information from Freestone, the TCEQ again reached the same erroneous and unsupported conclusion that the HRSGs do not qualify for a tax exemption.

Major events since the filing of the use determination application include the following:

(1) On March 25, 2008, Freestone by and through its representative Duff & Phelps filed with the TCEQ Application for Use Determination Number 07-11966 (the "**Original Application**"), attached as Exhibit 2.3 (App: 43-60), requesting a positive use determination for the HRSGs and steam turbines used at its facility.

(2) On May 1, 2008, the TCEQ issued to Freestone a final determination (the "**100% Positive Use Determination**"), attached as Exhibit 2.4 (App: 61-65), which granted a 100% positive use finding for the HRSGs and denied any positive use for the steam turbines. TCEQ processed the 100% Positive Use Determination as a "Tier IV application" pursuant to the administrative rules then in effect under Chapter 17 of title 30 of the Texas Administrative Code.

(3) On May 14, 2008, the Freestone Central Appraisal District timely filed with the TCEQ an appeal of the 100% Positive Use Determination, attached (with exhibits omitted) as Exhibit 2.5 (App: 66-67), requesting that the Commission reconsider the 100% Positive Use Determination's conclusion that the HRSGs qualified for a 100% positive use finding. The appeal asserted that the HRSGs did not qualify for any positive use determination because the HRSGs "are production equipment and not pollution equipment."

(4) On December 3, 2008, the TCEQ Executive Director filed a response brief (the "**Response Brief**"), attached (with exhibits omitted) as Exhibit 2.6 (App: 68-83), for six Appraisal District appeals of TCEQ's 100% positive use determinations for HRSGs, including an appeal of the 100% Positive Use Determination. The six appeals had been consolidated into a single appeal (the "**Consolidated Appeal**"). The Consolidated Appeal included, in addition to the 100% Positive Use Determination, the following TCEQ Docket Numbers: 2008-0830-MIS-U (UD 07-11914/Tenaska Gateway Partners, Ltd - Rusk County); 2008-0832-MIS-U (UD 07-11971/Borger Energy Associates, L.P. - Hutchinson County); 2008-0831-MIS-U (UD 07-11966/Freestone Power Generation, L.P.); 2008-0849-MIS-U (UD 07-11969/Brazos Valley Energy, L.P. - Fort Bend County); 2008-0850-MIS-U (UD 07-11994/Freeport Energy Center, L.P. - Brazoria County); and 2008-0851-

MIS-U (UD 07-11926/Navasota Wharton Energy Partners, L.P. - Wharton County). The Response Brief requested that the Commission remand the determinations for the Executive Director to issue a new use determination applying a uniform 61% positive use determination for HRSGs.

(5) On February 13, 2009, the General Counsel of TCEQ sent notice to interested parties, attached as Exhibit 2.7 (App: 84-88), that the Consolidated Appeal would be heard at the February 25, 2009 public meeting of the TCEQ. On February 23, 2009, the General Counsel sent further notice, attached as Exhibit 2.8 (App: 89-92), that the TCEQ Executive Director had filed an unopposed motion for a continuance "to allow the ED more time to evaluate its current recommendation," and that the TCEQ's Office of General Counsel had granted an "indefinite" continuance "pursuant to 30 TAC section 10.4" and "will notify the parties by subsequent letter of the future agenda and any associated filing deadlines."

(6) On June 18, 2012, the Executive Director filed a submission, attached as Exhibit 2.9 (App: 93-96), in which "[p]ursuant to 30 TAC section 17.25(d), the Executive Director of the TCEQ requests that the General Counsel remand the [six] applications for further processing."

(7) On July 10, 2012, TCEQ issued individually to each of the applicants in the Consolidated Appeal a Notice of Negative Use Determination with regard to HRSGs, attached as Exhibit 2.2 (App: 41-42). The negative determinations were characterized as the completion of the review of each applicant's original application following the June 2012 remands of such applications. The sole stated rationale for the negative use determination was that "[h]eat recovery steam generators are used solely for production and, therefore, are not eligible for a positive use determination." The TCEQ provided no technical review or analysis to Freestone or any other applicant in the Consolidated Appeal supporting the negative use determinations.

(8) On August 1, 2012, Freestone submitted its Notice of Appeal to the TCEQ with regard to the negative use determination (the "**First Notice of Appeal**"), attached as Exhibit 2 (App: 13-33), arguing, in part, that (i) the denial of a positive use determination

for the HRSGs violated the Equal and Uniform Clause of the Texas Constitution, (ii) the Executive Director's interpretation of Section 11.31 of the Tax Code was erroneous, and (iii) the HRSGS met all of the qualifications for the tax exemption.

(9) On October 4, 2012, the TCEQ and the Public Interest Council filed their briefs in reply to Freestone's First Notice of Appeal, attached as Exhibit 3 (App: 224-292). Freestone filed its reply to these briefs on October 30, 2012 (the "**Reply Brief**"), attached as Exhibit 4 (App: 293-333).

(10) On December 5, 2012, in its public meeting, the Commissioners set aside the original Second NUD and remanded the matter back to the Executive Director for a new use determination, attached as Exhibit 5 (App: 344).

(11) On February 21, 2013, the TCEQ issued a Notice of Technical Deficiency with regard to Freestone's Original Application (the "**First Notice of Technical Deficiency**"), attached as Exhibit 6 (App: 393-396). Freestone provided a response to this notice on June 21, 2013 (the "**Response to First Notice of Technical Deficiency**"), attached as Exhibit 7 (App: 397-462), that supplemented the Original Application and set forth in detail how the HRSGS met or exceeded the requirements of an environmental rule designed to reduce pollution, and the appropriate calculation for determining the percentage use to be assigned to the HRSGs. On January 8, 2014, the TCEQ issued a second Notice of Technical Deficiency (the "**Second Notice of Technical Deficiency**"), attached as Exhibit 8 (App: 463-466). Freestone provided its response on April 10, 2014 (the "**Response to Second Notice of Technical Deficiency**"), attached as Exhibit 9 (App: 467-497), that further supplemented the Original Application and reemphasized why the HRSGs were entitled to a positive use determination. The Original Application, as supplemented by the Response to First Notice of Technical Deficiency and the Response to Second Notice of Technical Deficiency, shall be referred to hereinafter as the "**Supplemented Application.**"

(12) On June 5, 2014, TCEQ issued a Second NUD, but never mailed it to Freestone. Instead the Second NUD was mailed to the Appraisal District and to a different party, Tenaska. Freestone received the Second NUD on June 11, 2014 from the Appraisal

District. Recognizing that it had not properly provided notice, on June 17, 2014, the TCEQ issued to Freestone the Second NUD, which it mailed that same day. The two NUDs are identical except for the dates. The stated rationale for the Second NUD was that:

- the ED cannot find that the property is used, constructed, acquired, or installed wholly or partly to meet or exceed any cited laws, rules, or regulations adopted by any environmental protection agency of the United States, or a political subdivision of Texas for the prevention, monitoring, control, or reduction of air, water, or land pollution; and

- even if there were an applicable law cited in the application for the subject property, the ED does not find your methods for determining the use percentage reasonable.

The Second NUD is contrary to Texas law and public policy.

V. ARGUMENTS AND AUTHORITIES

A. *The Executive Director's Reliance on a TCEQ Rule Over the Texas Statute Voids the Rule, and in Any Event, Freestone Properly Cited Rules and Regulations that are Met or Exceeded Through the Use of the HRSGs.*

The Executive Director's first stated basis for the Second NUD is that he "cannot find that the property is used, constructed, acquired, or installed wholly or partly to meet or exceed any cited laws, rules, or regulations adopted by any environmental protection agency of the United States, or a political subdivision of Texas for the prevention, monitoring, control, or reduction of air, water, or land pollution." Exhibit 1 (App: 5). The Executive Director's conclusion is wrong on the law and the facts. First, Freestone was not required to identify such laws, rules or regulations. But even so, Freestone provided proper citations and the Executive Director had no authority to reject them.

1. *The Executive Director's Interpretation of 30 TAC §17.10(d) Conflicts with the Plain Language of Section 11.31, Rendering the Rule Void.*

The Executive Director ignores Section 11.31(m) of the Tax Code in favor of his own rule, 30 TAC §17.10(d), which conflicts with the plain language of the Tax Code. As a consequence, 30 TAC §17.10(d) is void with regard to HRSGs. Notably, the Executive Director never even examines the actual language of the applicable statue. A look at Section 11.31(m) tells the story:

> (m) **Notwithstanding the other provisions of this section, if the** facility, **device,** or method for the control of air, water, or land pollution described in an application for an exemption under this section **is a** facility, **device,** or method **included on the list adopted under Subsection (k), the executive director** of the Texas Commission on Environmental Quality, not later than the 30th day after the date of receipt of the information required by Subsections (c)(2) and (3) and without regard to whether the information required by Subsection (c)(1) has been submitted, **shall determine that the** facility, **device,** or method described in the application **is used wholly or partly as a** facility, **device,** or method **for the control of** air, water, or land **pollution** and shall take the actions that are required by Subsection (d) in the event such a determination is made.

TEX. TAX CODE § 11.31(m) (emphasis added). This legislative directive is definitive and unambiguous: the Legislature has determined that the equipment listed on subsection (k) has conclusively met all criteria to constitute pollution control equipment. Thus, because HRSGs are included on the list adopted by the TCEQ under Subsection (k), the statute mandates that HRSGs are *per se* considered used, constructed, acquired, or installed wholly or partly to meet or exceed rules or regulations adopted by an environmental agency, and presumptively qualify as devices for the control of pollution.[1]

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[1] The Executive Director has in the past suggested that the TCEQ could issue a determination finding that the "part" used for pollution control is 0%. This is not correct. First, typical dictionary definitions of "partly" do not include "none." For example, Oxford defines "partly" as "to some extent; not completely." Second, the Executive Director's reading makes the statute internally inconsistent. The Subsection (k) list by definition includes only property that is "for the control of air, water, or land pollution," but the Executive Director's interpretation is that Subsection (m) allows the TCEQ to find that the same property is not for pollution control. *See Williams v. Adams*, 74 S.W.3d 437, 441 (Tex. App.–Corpus Christi 2002)(stating that statutes should be construed to be internally consistent).

The Second NUD ignores the statute and instead focuses exclusively on a TCEQ rule, asserting:

> Commission rule at 30 TAC §17.10(d) requires an applicant to cite to a specific law, rule, or regulation that is being met or exceeded by the use, construction, acquisition, or installation of the pollution control property. . . . Commission rules do not allow an applicant to omit the requirement to cite a specific environmental law even for property that is specified on the list of property in Texas Tax Code §11.31(k).

Exhibit 1 (App: 5-6). The Executive Director's focus on the rule rather than the statute is fatally flawed because **an administrative rule that is contrary to the relevant governing statute is void.** *See Office of Pub. Util. Counsel v. Pub. Util. Comm'n*, 104 S.W.3d 225, 232 (Tex. App.—Austin 2003, no pet.); *see also Lee v. Tex. Workers' Compensation Comm'n*, 272 S.W.3d 806, 813 (Tex. App.—Austin 2008, pet. denied) ("If a promulgated rule has no supporting statutory authority, the rule is void."); *Employees Retirement Sys. of Tex. v. Jones*, 58 S.W.3d 148, 154 (Tex. App.—Austin 2001, no pet.) ("A rule of an administrative agency is void if it conflicts with the statute, regardless of how long-standing such rule may be.").

Texas courts have repeatedly held that administrative rules are void where, as here, they contradict an underlying statute or impose burdens beyond those required by law.[2] In fact, Texas courts have rejected the application of administrative rules imposing additional eligibility criteria (as the Executive Director is attempting to do here) precisely because those rules conflicted with the underlying statutory schemes. For instance, in *Employees Retirement System of Texas v. Jones*, the court considered the validity of an administrative rule promulgated by the Employee Retirement System that barred certain insurance coverage for disabled dependent children over twenty-five years of age, despite the governing statute's definition of a dependent as "any such child, *regardless of age,* who lives with or whose care is provided by an employee or annuitant on a regular basis if such child is mentally retarded or physically incapacitated . . . ." 58 S.W.3d at

[2] *See, e.g., Tex. Dep't of Ins. v. Ins. Council of Tex.*, 2008 WL 744681 (Tex. App.—Austin, Mar. 21, 2008, no pet.) (unpublished disposition) (holding that an administrative rule promulgated by the Texas Department of Insurance and providing alternative dispute resolution procedures for resolving medical necessity disputes conflicted with the governing statute allowing for judicial review of disputes and was therefore invalid); *Polasek v. State*, 16 S.W.3d 83, 88 (Tex. App.—Houston [1st dist.] 2000, pet. ref'd) (holding that a rule requiring court reporters to make a full record of proceedings unless excused by agreement of parties was void because it conflicted with a statute requiring the court reporter to appear and make record only if requested).

152 (emphasis supplied). The court noted that the legislature had placed an absolute prohibition on applying an age-based criterion for disabled children, and that because "the Rule bars coverage for a person eligible under the Act, we conclude that the Rule is invalid as applied." *Id.* at 153.

Here, the TCEQ is charged with carrying out a statute that by its plain and unambiguous language requires the Executive Director to determine that all equipment on the Subsection (k) list is used wholly or partly for pollution control "without regard to whether the information required by Subsection (c)(1) [which includes citation of an environmental law or rule] has been submitted." TEX. TAX CODE § 11.31(m). According to the Executive Director, however, "Commission rules do not allow an applicant to omit the requirement to cite a specific environmental law even for property" on the subsection (k) list. Exhibit 1 (App: 6). In short, the Executive Director is relying on an administrative rule that, as interpreted by the Executive Director, imposes an eligibility requirement that directly contradicts the governing statute. Because 30 TAC § 17.10(d) conflicts with Subsection (m) of the statute, it is analogous to the rules held to be invalid in the *Jones* case. The TCEQ rule is void and unenforceable as interpreted by the Executive Director.

2. *Freestone's HRSGs Meet or Exceed Environmental Rules.*

Even though Freestone was not required to cite to rules or laws given HRSGs' special statutory status, Freestone, subject to its objections, followed the Executive Director's mandate and cited three rules that it meets or exceeds through its HRSGs. The Executive Director summarily rejected the rules Freestone cited. Yet, these rules are very similar to the rules that Freestone's sister facility, Brazos Valley, cited, and which the Executive Director did not contest.

The only basis provided by the Executive Director for rejecting the citations was that none of the rules cited "were to rules that the HRSGs were required to meet." Exhibit 1 (App: 6). However, both the Tax Code and the TCEQ's rules provide that the pollution equipment is only required to "meet or exceed" an environmental rule. TEX. TAX CODE §11.31(b) (Section 11.31 of the Tax Code requires the pollution control property be "used, constructed, acquired, or installed wholly or partly to *meet or exceed* rules or regulations adopted by any environmental protection agency."); 30 TAC §17.4(a) (the pollution control property must be used, constructed, acquired, or installed wholly or partly to *meet or exceed* laws, rules or regulations adopted by any environmental

protection agency). The Executive Director's veiled assertion that the pollution control equipment be specifically required in order to meet a rule (as opposed, e.g., to causing pollution reduction in excess of a rule standard) is contrary to the statute and the TCEQ's own rules.[3]

Specifically, Freestone offered the following to the Executive Director, but the Executive Director could not be bothered with a specific response. HRSGs allow the facility to meet or exceed the following environmental rules: (i) the Clean Air Interstate Rule ("**CAIR**"), (ii) Best Available Control Technology ("**BACT**"), and (iii) Greenhouse Gas ("**GHG**") BACT requirements.[4] All of these rules are for the prevention and/or control of pollution, and Freestone uses the HRSGs to meet or exceed the pollution control standards established by each of these regulations.

(1) CAIR

HRSGs are an important component in lowering the facility's NOx emissions in order to comply with CAIR.[5] TCEQ implemented CAIR in Texas by requiring electric generating facilities to have a sufficient number of "allowances" to cover the amount of NOx being emitted. *See* 30 TAC §101.506(c). Allowances are calculated based, in part, upon the amount of fuel being combusted (identified in the rules as "heat input"). *Id.* Because a HRSG captures the waste heat generated by the gas turbine and utilizes this heat to power a steam turbine, less fuel (and a corresponding lower heat input) is needed to produce the same amount of electricity. The increased fuel efficiency resulting from the use of the HRSGs meets or exceeds the CAIR rules by helping the facility to comply with its NOx allowance allocation. *See* Declaration of Patrick Blanchard, ¶¶ 8-

[3] The Executive Director's contention that HRSGs must be "required to meet" an environmental rule in order to qualify for a positive use determination effectively amends and narrows the administrative rule's broader concept that pollution control equipment need only be "used, constructed, acquired, or installed wholly or partly *to meet or exceed*" a rule. 30 TAC §17.4(a) (emphasis added). The Executive Director has violated the Administrative Procedures Act by attempting to amend the administrative rule via a change in agency policy rather than formal rulemaking, and his interpretation accordingly is impermissible and invalid. *See* TEX. GOV'T CODE Ch. 2001.

[4] At this time, the Freestone facility is not subject to the most stringent New Source Performance Standard ("NSPS") applicable to stationary combustion turbines, located at 40 C.F.R. pt. 60, subpt. KKKK. NSPS KKKK directly correlates pollution prevention with the amount of electricity produced by the facility. Nevertheless, the Freestone facility is already compliant with this standard and providing a pollution reduction benefit above and beyond its current applicable requirements.

[5] CAIR was promulgated by EPA to reduce the interstate transport of pollutants, especially NOx and sulfur dioxide. 70 Fed. Reg. 25162 (May 12, 2005).

9, Exhibit 4 (App: 332). The Executive Director offered no direct response to Freestone's citation to CAIR.

(2) BACT

TCEQ's BACT requirements are also met or exceeded by the use of HRSGs at the Freestone facility. BACT is defined as the reduction in total emissions that can be achieved through the use of either: (i) add-on pollution control equipment; or (ii) production processes, systems, methods, or work practices. 30 TAC §116.10(1). As defined by the TCEQ's rules, BACT can be an add-on pollution control device OR a "production process". The facility's BACT requirement is a specification for the rate of NOx emitted into the atmosphere and can be expressed in equivalent of pounds per megawatt hour of electricity produced. A HRSG reduces the amount of fuel used to produce a given amount of electricity. Reduced fuel use corresponds to fewer total pollutants, including NOx, being emitted. This increased fuel efficiency goes above and beyond TCEQ's BACT requirements. *See* Declaration of Patrick Blanchard, ¶ 10, Exhibit 4 (App: 332-333). The use of the HRSGs as an additional pollution prevention device "exceeds" TCEQ's BACT requirements, which is all that is required to satisfy the Tax Code. *See* 19 Tex. Reg. 7793, 7793 (the tax exemption also applies to voluntary projects which go beyond minimum requirements). The Executive Director was silent in response to Freestone's BACT argument.

(3) GHG BACT

Additionally, Freestone expects to be subject to GHG emission limitations, which meets the Tax Code's plain language that the device be "installed wholly or partly to meet or ***exceed*** rules or regulations." TEX. TAX. CODE §11.31(b) (emphasis added). Freestone fully expects that it will be subject to GHG emission restrictions under Section 111(d) of the Clean Air Act in the future as EPA has indicated an intent to do so. *See* www2.epa.gov/carbon-pollution-standards/what-epa-doing. Complying with the GHG limitation now demonstrates that the facility is exceeding regulatory requirements. Quite simply, the HRSGs are eligible for a positive use determination because their use results in early compliance with GHG requirements, and voluntarily goes beyond the current requirements of the GHG rules. *See* 19 Tex. Reg. at 7793 (the tax exemption

applies to voluntary projects which go beyond minimum requirements). The Executive Director did not address GHG BACT in his Second NUD.

Freestone's HRSGs meet or exceed each of these environmental rules. The Executive Director's summary dismissal of these rules is baseless.

B. *Freestone's Tier IV Analysis is the Appropriate Method for Calculating a Use Determination Percentage, and the Executive Director Should Not Be Permitted to Impose a Tier III Calculation on Freestone.*

1. *TCEQ Must Apply the Pre-2010 "Tier IV" Criteria to the HRSGs.*

The Executive Director has repeatedly tried to force the TCEQ's current Tier III process onto Freestone's HRSGs, despite the fact that Freestone timely filed a Tier IV application. The Second NUD purports to recognize that Freestone is subject to Tier IV standards, but then summarily rejects as unreasonable Freestone's Tier IV positive use computations, insisting that the only proper approach is the Tier III-mandated Cost Analysis Procedure ("**Tier III CAP**") in effect today. As a result, irrespective of the Executive Director's lip service that Freestone's application authorizes it to use a Tier IV approach, the Executive Director has in fact required a Tier III computation utilizing a methodology not in effect at the time of the filing of Freestone's application.

There can be no dispute that Freestone's application is a Tier IV application. While in 2010 the TCEQ amended its rules to eliminate the Tier IV application, the rule change explicitly does not apply to use determination applications filed before January 1, 2009. *See* 35 Tex. Reg. 10965 (Dec. 10, 2010). Freestone's Original Application was filed on March 25, 2008.

Retroactive application of the formulas added to the TCEQ rules in 2010 violates the constitutional prohibition on retroactive laws and contravenes the express language of the legislation pursuant to which the amended rules were adopted. Therefore, in making use determinations with regard to Freestone's HRSGs, the TCEQ must apply the Tier IV rules that

were in effect in 2008 when the applications were filed and that led to the issuance of the 100% Positive Use Determination.

2. *Freestone's Tier IV Avoided Emissions Approach is Appropriate and Reasonable.*

The Executive Director had no legal basis to reject Freestone's "avoided emissions" approach. When a HRSG and its dedicated ancillary equipment are not part of the electric generation process, the facility is classified as a simple-cycle facility, which emits more pollutants for the same amount of electricity produced because of a decrease in fuel efficiency. Use of a HRSG and its dedicated ancillary equipment in a combined-cycle facility increases fuel efficiency and avoids the generation of NOx and other emissions that otherwise would occur. Quite simply, the HRSG's installation causes the combined-cycle facility to avoid emissions.[6]

The avoided emissions approach is authorized under the Texas Tax Code, which provides that equipment qualifies for the exemption if it is used in whole or in part for pollution control, pollution prevention, pollution monitoring, or the reduction of pollution. *See* TEX. TAX CODE §11.31(b). During the December 5, 2012 hearing, the Commissioners recognized that energy efficiency resulted in emission avoidance, and directed staff to consider energy efficiency in calculating the appropriate use percentage.[7]

Additionally, avoided emissions are the preferred pollution control/prevention strategy under federal and state law. The Pollution Prevention Act states that it is the policy of the United States that "pollution should be prevented or reduced at the source whenever feasible." 42 U.S.C. § 13101(b). Pollution prevention is the preferred method for dealing with pollution, followed by recycling, treated in an environmentally safe manner, and finally disposal or release into the environment. *See Id.* This same preference is found in the federal Clean Air Act, which provides

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[6] "*Output-Based Regulations: A Handbook for Air Regulators*", U.S. Environmental Protection Agency, Office of Atmospheric Programs – Climate Protection Partnerships Division, August, 2004, p.22.

[7] Commissioner Rubinstein stated that it was not appropriate to "discount the fact that efficiency ends up in emission avoidance." Exhibit 5 (App: 378). And in his direction to staff, Chairman Shaw stated that TCEQ needs to take into account "some percentage reduction . . . in the emissions that are occurring." *Id.* at 386.

that pollution prevention is of primary importance in reducing emissions. *See* 42 U.S.C. § 7401(c). Federal law strongly identifies pollution prevention as being more effective in controlling pollution then add-on controls.

Texas law is no different. The Texas Emissions Reduction Plan is specifically designed to reduce emissions from polluting vehicles and equipment. *See* TEX. HEALTH & SAFETY CODE ch. 386. This statute targets older, higher polluting vehicles and equipment to reduce contaminants released into the air. HRSGs also reduce the amount of pollution produced at the source.

Emission avoidance is an important pollution control/prevention strategy and one that is favored under the law. The avoided emissions approach is a widely accepted view of pollution control/prevention. Even the Executive Director relies on avoided emissions. For example, on or about May 1, 2008, the Executive Director awarded 100% Positive Use Determinations for HRSGs belonging to approximately 20 different applicants that used the avoided emissions approach. Those 100% Positive Use Determinations were never appealed and are now part of this framework.

The Executive Director's rejection of avoided emissions is wrong as a matter of law and fact.

a. Freestone Was Not Required to Distinguish Between that Portion of the Property Used To Control or Prevent Pollution From the Portion Used to Produce a Product, But In Any Event It did Do So.

The Executive Director incorrectly asserts in the Second NUD that Freestone's avoided emissions approach to calculating the use determination percentage under the Tier IV analysis "is not reasonable because it does not distinguish the proportion of property used to control or prevent pollution from the proportion used to produce a product." Exhibit 1 (App: 6). The Executive Director's argument fails on two grounds. First, nothing in the Tier IV application process (which governs Freestone's application) required Freestone to distinguish between pollution prevention and production value. In other words, the Executive Director is attempting an after-the-fact rewrite of the Tier IV application (notably to make it look like a Tier III application) to deny a positive use because he claims that Freestone did not provide an analysis that by law it was not

required to provide. This is improper. Quite simply, determining the percentage for production was not required of Freestone and the Executive Director cannot impose it on Freestone now.

Nevertheless, the percentage attributable to pollution control versus production was readily available to the Executive Director.[8] Indeed, Freestone calculated a percentage use determination of 43.5%. As a consequence, Freestone's avoided emissions approach did in fact assign 56.5% of the HRSGs' value (including dedicated ancillary equipment) as being attributable to the production of a product and subject to taxation. The Tier IV approach (which Freestone used) therefore distinguishes between the pollution prevention benefits of the HRSGs and their production benefits, and for this additional reason, the Executive Director's complaint should fall on deaf ears.

b. The Executive Director's Characterization of the Avoided Emissions Approach as Not Accounting for Other Pollution Control Equipment is Incorrect.

The Executive Director also incorrectly asserts that Freestone's avoided emission approach attributes all of the emissions avoided to the HRSGs and ignores emission reductions related to other property for which a positive use determination has been issued. The Executive Director apparently has not reviewed how Freestone calculated its avoided emissions. Freestone compared the emissions resulting from a combined-cycle facility and a simple-cycle facility. The only factor that changed in this comparison was that the combined-cycle facility utilized a HRSG and the necessary dedicated ancillary equipment. The other emission reduction equipment was treated similarly for the two types of facilities. In other words, each facility was treated as if it had similar pollution control equipment for NOx emissions, except that the combined-cycle facility included a HRSG. In this manner, the HRSGs are not given credit for reducing emissions associated with other pollution control equipment.

[8] Except when implementing a Tier III analysis (not applicable to Freestone), the Tax Code and the TCEQ's rules only require that the pollution control/prevention portion of the eligible equipment be determined. *See* TEX. TAX CODE §§ 11.31(d), (m); 30 TAC §17.12(4).

3. *The Tier III Approach Mandated by the TCEQ is Wrong for Freestone, but in Any Event, is Unreasonably Restrictive and Demanded to Force the Executive Director's Desired Result.*

In both the First Notice of Technical Deficiency and the Second Notice of Technical Deficiency, the Executive Director requested that Freestone calculate the appropriate use percentage for the HRSGs based upon utilizing the Tier III approach in use currently, despite the fact that Freestone has a timely-filed Tier IV application. Freestone, over its objections, provided information to the Executive Director utilizing the forced Tier III approach. In addition to mandating the Tier III formula, the Executive Director directed the inputs, which were also wrong, and which were evidently imposed to lead to a negative use determination. In fact, when Freestone used the Tier III methodology and the Executive Director's mandated inputs, the calculation led to a negative use percentage of -1543.6%. Exhibit 9 (App: 483). This enormous negative number simply confirms that the Executive Director's position is manipulative and flawed. Notably, the Tier III methodology is intended to determine what portion of equipment usage is pollution control. For equipment that serves no pollution control function, a correctly designed and applied formula should yield a result of zero. The Executive Director's massive negative percentage for the HRSGs makes no sense--seeming to imply that HRSGs actually increase pollution--and establishes that his purported Tier III computation parameters are illogical and invalid. Adopting the flawed negative use percentage is in clear contradiction with the legislative pronouncement that HRSGs are a device for the control of air, water, or land pollution. TEX. TAX CODE §11.31(k)(8). The Executive Director cannot be permitted to devise a formula (and force the inputs) in contravention of Texas law.

Although Freestone strenuously objected to providing a Tier III calculation, Freestone offered a modified Tier III analysis (also over objection), which provided a more appropriate estimation of the pollution prevention benefit as compared to the generation of a product. The Executive Director rejected the modified Tier III approach, raising two objections in the Second NUD. Set forth below is Freestone's response to each objection.

a. Inclusion of the Costs Associated with the Steam Turbines and the Water System in the Tier III Analysis is Reasonable and Appropriate.

The Executive Director argues that the capital costs[9] associated with the HRSGs should not include (i) the steam turbines because these turbines received a negative use determination and are not part of the HRSG application, and (ii) the water system because it is production equipment. The Executive Director is wrong because both the steam turbines and the water system are part of the same operating system that enable HRSGs to function. Isolating HRSGs from the operative components makes no sense, except in a world designed to yield a negative use percentage for HRSGs.

The basic underpinning of the environmental rules met by a combined-cycle plant is the fuel and emissions efficiency obtained by operating both a gas and steam turbine in the combined-cycle configuration. The contribution of the steam turbine through its electric generation process provides significant environmental benefit directly attributable to installing a HRSG. The steam turbine equipment – along with various other plant systems – works in combination with the HRSG for maximum environmental and operational efficiency.

Without the steam turbine equipment, the steam produced by the HRSG is essentially worthless and ultimately vented to the atmosphere. However, TCEQ staff has requested in the past that the marketable product value portion of the Tier III analysis include the revenue derived from electricity produced from the steam output of the HRSG unit. Exhibit 6 (App: 395). It is not appropriate to exclude the steam turbine from the capital cost component of the Tier III analysis while at the same time attempting to attribute the steam turbine's economic benefit to the HRSG unit.[10]

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[9] These capital costs are identified in the TCEQ's rules as "capital cost new" or "CCN." 30 TAC §17.17(c).

[10] The Executive Director has complained that Freestone did not appeal the rejection of the steam turbine's positive use determination. Because the TCEQ granted a 100% Positive Use Determination for the HRSGs, Freestone did not appeal the Executive Director's decision with regard to the steam turbines. Now, however, the Executive Director has reversed his position, first issuing a Negative Use Determination that was set aside by the Commissioners in December 2012 and now the Second NUD. The lack of appeal does not change the analysis of how the system functions or undermine Freestone's claim

The same analysis is applicable to the water systems. Steam will not be produced to generate electricity without the use of water. The economic value of the HRSGs cannot be considered in isolation without consideration of the necessary ancillary equipment needed to produce electricity in the Tier III CAP model. To remove the water systems and the steam turbines from the capital costs associated with operating a HRSG results in an inaccurate representation of capital costs.

To calculate a marketable product percentage, the costs of the HRSGs must be considered in association with all of its ancillary component parts, which includes the steam turbines and the water system.

b. A Boiler is Not Comparable Equipment to a HRSG under the Tier III Analysis.

Rejecting summarily Freestone's use of $0 in calculating the capital costs associated with a comparable system, the Executive Director incorrectly declared that the comparable equipment that produces steam without a pollution control is a boiler. The Executive Director's results-oriented approach is wrong.

A boiler is not the appropriate replacement and/or comparable equipment for calculating the capital costs associated with this portion of the Tier III analysis (and of course, Freestone objects to being required to engage in a Tier III calculation at all). A boiler would not be installed in a combined cycle facility as a replacement for a HRSG because it produces steam in a simple cycle configuration, as compared to the function of the HRSG, which is to capture the exhaust heat from the gas turbine generator and utilize it to produce steam/electricity in a combined cycle system. A boiler cannot perform the function of the HRSG and the HRSG cannot perform the function of a boiler. The Executive Director's position with regard to developing a comparable capital cost value is not appropriate.

In fact, none of the four methods provided by TCEQ's rules for calculating comparable capital costs is applicable to Freestone's application (even assuming a Tier III CAP applies, which it does not). *See* 30 TAC §17.2(2), 17.17(c)(1) n.3. Method 1 involves estimating the cost of comparable

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regarding a positive use determination for the HRSG.

equipment without the pollution control feature. This method is not applicable here. The pollution control benefits of the HRSG are part of its design (i.e., reduced fuel use). Methods 2 and 3 are also not applicable because they involve the replacement of an existing piece of equipment. The HRSGs are not a replacement for other equipment (for example, a HRSG is not a replacement for a boiler). And finally, Method 4 is not applicable because it requires the calculation of the cost of manufacturing the equipment without the pollution control feature. The pollution control benefit provided by the HRSG is reduced fuel use, which cannot be separated from its original design.

Because the Executive Director required a Tier III CAP analysis (over Freestone's protest) and because none of the methods identified in the TCEQ's rules for calculating the comparable costs applies, Freestone established the comparable cost value for the HRSGs logically: HRSGs are not replacement equipment but rather new equipment that provide both a production benefit and a pollution prevention benefit. As a consequence, the comparable costs would be $0, which is consistent with the TCEQ's definition because no equipment is being replaced. *See* 30 TAC §17.2(2).

The Executive Director complains that allowing the comparable costs to be $0 ignores the fact that HRSGs perform a production function. To the contrary, using $0 is a logical accounting conclusion, given that no equipment is being replaced by the HRSGs. And there should be no concern (contrary to the Executive Director's suggestion) that $0 could be misleading on the production benefits. The production benefits of the HRSGs are accounted for elsewhere in the Tier III analysis because the marketable product of the electricity being produced is subtracted from the capital cost of the HRSGs.

For these reasons, under the Tier III CAP analysis (although Tier III does not apply), the appropriate method to calculate the use determination percentage is as proposed by Freestone in its Response to First Notice of Technical Deficiency (calculated as 52%). Exhibit 7 (App: 406).

C. *A Rulemaking Is Necessary to Implement the Change in the Executive Director's Treatment of HRSGs.*

By issuing negative use determinations, the Executive Director has effectively removed HRSGs from the list of pollution control equipment (the Section 11.31(k) list) and therefore updated the list without following the rulemaking process, in violation of Section 11.31(l).[11] The Executive Director's reliance on 30 TAC §17.10(d) (rather than Section 11.31) and his back-calculated, forced in-put Tier III approach combine to mean that HRSGs can never achieve positive use status. In other words, the Executive Director's actions *de facto* remove HRSGs from the list of pollution control items. The Executive Director cannot remove HRSGs from the list of pollution control equipment in this manner.

Section 11.31(l) provides a specific process that the Executive Director must follow in order to remove pollution control equipment from the list of pollution control items. The statute provides:

> The Texas Commission on Environmental Quality **by rule** shall update the list adopted under Subsection (k) at least once every three years. An item may be removed from the list if the commission finds compelling evidence to support the conclusion that the item does not provide pollution control benefits.

TEX. TAX CODE § 11.31(l) (emphasis added). Moreover, the statute directs that only "the commission" has the authority "by rule" and based on "compelling evidence" to override the list; here, the Executive Director seeks to accomplish this result by informal, unilateral action.

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[11] During the December 12, 2013 TCEQ Commissioner's hearing, the Executive Director suggested that hypothetically there might be some limited circumstances or facts under which the Executive Director would issue a positive use determination to HRSGs. This speculation does not negate Freestone's contention that the Executive Director's current action is a *de facto* removal of HRSGs from 11.31(k) list without following the procedures specified by 11.31(l). First, contemporaneous with the issuance of the Second NUD, the Executive Director issued negative use determinations to numerous other HRSGs encompassing all current factual usages of HRSGs in Texas. The Executive Director's speculation that somehow, somewhere there might arise a HRSG that qualifies for positive use cannot overcome the reality of his blanket denial of positive use for all HRSGs. Second, for all the HRSGs, the Executive Director has taken a uniform legal position that a positive use determination is unavailable because installation of HRSGs is not required to meet an environmental rule. Thus, the Executive Director has taken the position that as a matter of law HRSGs cannot qualify for exemption.

The Executive Director's elimination of positive use determinations for HRSGs, implemented without a formal rulemaking, violates both the Administrative Procedure Act and Section 11.31 of the Tax Code. The Legislature intentionally created a high threshold that the TCEQ must cross before it is authorized to supersede the Legislature's decision to include HRSGs on the list of exempt equipment, and the TCEQ is now trying to sidestep this threshold through the use determination process. The TCEQ is without authority to take this action.

D. *The Executive Director's Negative Use Determination Violates the Texas Constitution's Equal and Uniform Taxation Requirement.*

The Executive Director's Second NUD is unconstitutional because it violates Article VIII, Section 1(a) of the Texas Constitution, which requires that "taxation shall be equal and uniform." In his Second NUD, the Executive Director ignored the Texas Constitution and the twenty virtually identical HRSGs for which TCEQ issued 100% Positive Use Determinations that have become final and have created tax exemptions. This the Executive Director cannot do.

Equality and uniformity are the cornerstones of Texas taxation, particularly property taxation. A taxing scheme must be both equal and uniform to survive constitutional scrutiny. It has long been held that the "standard of uniformity" required by the Equal and Uniform Taxation Clause is the taxable value of property, a standard that necessarily includes whether an exemption is applied to the property.[12]

These constitutional principles of equality and uniformity apply to the TCEQ in its use determinations. Although the TCEQ's primary mission is to administer the environmental laws of the State of Texas, the sole reason the TCEQ performs use determinations for pollution-control property is to determine whether such property qualifies for exemption from property tax under Texas Tax Code section 11.31. Because the TCEQ is performing a tax administration function in

[12] *Lively v. Mo., K&T Ry. Co. of Tex.*, 120 S.W. 852, 856 (Tex. 1909) ("[t]he standard of uniformity prescribed by the Constitution being the value of the property, taxation cannot be in the same proportion to the value of the property unless the value of all property is ascertained by the same standard"); *see also Enron Corp. v. Spring Indep. School Dist.*, 922 S.W.2d 931, 935 (Tex. 1996) (in discussing statutory taxation distinctions among classes of property, stating "the Legislature could not constitutionally classify inventory separately from other property for at least some purposes. For example, inventory cannot be taxed at a rate different from other property, nor could it be exempted from taxation altogether.").

issuing use determinations, in doing so it is subject to the Texas Constitution's requirement that its decisions and processes result in equal and uniform taxation. The Tax Code itself recognizes that the TCEQ is subject to these constitutional constraints, requiring that the TCEQ's administrative rules regarding pollution-control equipment determinations "must . . . be sufficiently specific to ensure that determinations are equal and uniform." TEX. TAX CODE §11.31(g). Texas courts have made clear that the Equal and Uniform Taxation Clause requires that similarly situated taxpayers must be taxed in the same fashion.[13]

This requirement of uniform treatment carries over to the administration of property tax exemptions. The Texas Constitution authorizes, and the Texas Legislature has enacted, certain enumerated exemptions from taxation, including the pollution control exemption. For taxation to be "uniform and equal" as required by the Texas Constitution, exemptions must be applied in a consistent manner. Under these principles, TCEQ's decision to overturn a 100% positive use determination for Freestone's HRSGs violates the Texas Constitution's equal and uniform taxation guarantee, because multiple other HRSGs that are factually and legally indistinguishable from Freestone's HRSGs have been granted positive use determinations and have been exempted from property taxation.

The TCEQ's own record and statements establish its unconstitutional course of conduct. The TCEQ Executive Director issued the Second NUD for Freestone's HRSGs, which will have the direct effect of imposing property taxes on, by denying exemption for, the HRSGs. However, the TCEQ Executive Director's Response Brief in the Consolidated Appeal admitted that twenty other, indistinguishable property owners have received the benefit of positive use determinations and exemptions from tax. Exhibit 2.6 (App: 73-74); *see also* Exhibit 2.10 (App: 97-208)

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[13] *Bullock v. Sage Energy Co.*, 728 S.W.2d 465, 468 (Tex. App.—Austin 1987, writ ref'd n.r.e.) (invalidating administrative rule that did not result in equal and uniform imposition of the franchise tax upon similarly situated taxpayers). Moreover, the tax treatment of a group of taxpayers or properties is considered to be both equal and uniform only "when the tax classification is not unreasonable or arbitrary and operates equally within the class." *Tarrant Appraisal Dist. v. Colonial Country Club*, 767 S.W.2d 230, 234 (Tex.App.—Fort Worth 1989, writ denied); *see also* Op. Tex. Att'y Gen. No. GA-0653 (2008) (addressing the equal and uniform nature of local sales and use tax rates); *TGS-NOPEC Geophysical Co. v. Combs*, 268 S.W.3d 637, 646 (Tex. App.—Austin 2008), *rev'd on other grounds*, 340 S.W.3d 432 (Tex. 2011) ("[t]he requirements for equal protection under the United States Constitution and equal and uniform taxation under the Texas Constitution are substantially the same").

(Appraisal District records substantiating that the facilities which Freestone understands received the nonappealed HRSG positive use determinations have been granted property tax pollution control exemptions).[14]

The twenty HRSGs for which TCEQ issued use determinations that created exemptions include HRSGs that are used in the same fashion at the same type of facilities as Freestone's HRSGs. Notably, the TCEQ processed the use determination applications for the twenty HRSGs under the same standard that must be applied to Freestone's HRSG, i.e., as "Tier IV" applications under the TCEQ's pollution control exemption administrative rules as amended effective January 16, 2008 to implement H.B. 3732. The TCEQ acted well within its authority to issue these 100% positive use determinations and was acting well within its reasonable administrative powers to do so.

As a result, the TCEQ by administrative action has already granted a property tax exemption to a class of property owners and property that is factually indistinguishable from Freestone, and the TCEQ has done so pursuant to the legal standard that must be applied to Freestone's HRSGs. The TCEQ therefore lacks constitutional authority to now create, through a change in administrative policy, a second class of HRSG owners (including Freestone) that is treated wholly differently and denied exemption.[15]

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[14] The TCEQ Executive Director's Response Brief in the Consolidated Appeal indicates that twenty HRSG exemptions are final and nonappealable, while the appraisal district records suggest there are nineteen. Whether the correct number is nineteen or twenty is not material to the principles discussed in the text.

[15] The Executive Director has attempted to justify his unequal and non-uniform treatment by characterizing his prior positive use determination as having been issued "in error" and asserting that he is now simply correcting a "misapplication of a tax exemption." Exhibit 8 (App: 463-464). To support its position, the Executive Director has primarily relied upon *Grocers Supply Co. v. Sharp*, 978 S.W.2d 638 (Tex. App.—Austin 1998, pet. denied). See Exhibit 3 (App: 238). However, *Grocers Supply* considered a Comptroller tax policy change in direct response to a Texas Supreme Court decision mandating the new policy. *See* 978 S.W.2d at 640, 645. The court characterized the Comptroller's prior, changed policy as an "erroneous interpretation in clear contravention of the legislature's purpose" and in direct conflict with Texas Supreme Court precedent. By contrast, the inclusion of the HRSGs on the Section 11.31(k) equipment list establishes that TCEQ had ample authority to adopt its longstanding administrative interpretation that the HRSGs qualify for positive use, and no case law establishes that HRSGs cannot qualify as pollution control equipment. Thus, the prior HRSG policy that the Executive Director now seeks to change is *not* "erroneous" or "in direct contravention" of the statute and case law, but instead is a valid administrative agency interpretation. This distinction negates the primary basis on which *Grocers Supply* justified the unequal treatment of taxpayers as being constitutional.

E. *Additional Arguments Incorporated by Reference*

Since the Original Application was filed in 2008, the TCEQ has provided several alternative bases for issuing a negative use determination for the HRSGs. As a consequence, and in order to prepare as a complete a record as possible, Freestone incorporates by reference the arguments set forth in all of the following documents: (i) The First Notice of Appeal, (ii) the Reply Brief, (iii) Response to the First Notice of Technical Deficiency, and (iv) Response to the Second Notice of Technical Deficiency.

VI. CONCLUSION

In his quest to convert HRSGs from pollution control (prevention) equipment to revenue-generating equipment, the Executive Director committed numerous errors. His results-oriented approach began when he ignored Section 11.31(m) of the Tax Code, which mandates that equipment on the (k) list receive positive use treatment without the need to cross any other threshold. Bypassing the statute, the Executive Director relied on his own rule, which required citations to laws that Freestone was meeting or exceeding by using the HRSGs. Not to be deterred, Freestone complied with the Executive Director's rule (despite the fact that the rule, by law, cannot trump the statute), and when it did so, the Executive Director summarily dismissed, without explanation, Freestone's citations. Incredibly, he did so while accepting similar citations from Freestone's sister facility, Brazos Valley.

As if these efforts to trip Freestone were not enough, the Executive Director then forced Freestone into a Tier III CAP calculation, despite the fact that Freestone's application was clearly a Tier IV application (which the Executive Director does not deny). To dictate the end result, the Executive Director improperly rejected as unreasonable Freestone's Tier IV calculation methodology, even though the Executive Director has accepted the very same calculation methodology for equipment other than HRSGs. After rejecting the Tier IV calculations, the Executive Director then corralled Freestone into a Tier III CAP calculation, but incredibly demanded that Freestone include certain inputs that are simply incorrect or not applicable to the facility. Those inputs embedded in the inapplicable Tier III CAP calculation gave the Executive Director the desired result—a negative

use number that is so extreme it highlights the manipulation. There can be no denying that this was a pre-determined result, where nothing but a negative use number would satisfy the Executive Director. This is a clear violation of Texas law and public policy.

For the reasons discussed in this Notice of Appeal and pursuant to 30 Texas Administrative Code section 17.25(d)(2), Freestone requests that the Commissioners set aside the Second NUD and (i) reinstate the 100% Positive Use Determination; (ii) accept as the appropriate percentage use for the HRSGs (and dedicated ancillary equipment) of 43.5%, as calculated by Freestone utilizing the Tier IV avoided emissions approach (*see* Exhibit 9 (App: 481)); or (iii) accept as the appropriate percentage use for the HRSGs (and dedicated ancillary equipment) of 52%, as calculated by Freestone utilizing a modified Tier III analysis (*see* Exhibit 7 (App: 406)).

Respectfully submitted,

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