

Bryan W. Shaw, Ph.D., *Chairman*
Carlos Rubinstein, *Commissioner*
Toby Baker, *Commissioner*
Zak Covar, *Executive Director*



TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

August 8, 2014

Bridget Bohac, Chief Clerk
Texas Commission on Environmental Quality
Office of the Chief Clerk, MC-105
P.O. Box 13087
Austin, Texas 78711-3087

Re: **2008-0830-MIS-U (UD 07-11914/Tenaska Gateway Partners, Ltd – Rusk County)**
2008-0831-MIS-U (UD 07-11966/Freestone Power Generation, L.P. – Freestone County)
2008-0832-MIS-U (UD 07-11971/Borger Energy Associates, L.P. – Hutchinson County)
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)
2008-0851-MIS-U (UD 07-11926/CER-Colorado Bend Energy LLC (f/k/a Navasota Wharton Energy Partners, L.P.) – Wharton County)
2012-1559-MIS-U (UD 12210 & 12211/Topaz Power Group, LLC – Nueces County)
2012-1562-MIS-U (UD 15506, 16410, 16411 & 16412/Cottonwood Energy Company LP – Newton County)
2012-1586-MIS-U (UD 12268/Wolf Hollow I, LP – Hood County)
2012-1587-MIS-U (UD 13534/South Texas Electric Cooperative, Inc. – Victoria County)
2012-1635-MIS-U (UD 13544/Brazos Electric Cooperative, Inc. – Johnson County)
2012-1648-MIS-U (UD 16413/Brazos Electric Cooperative, Inc. – Jack County)
2012-1650-MIS-U (UD 07-12271/Midlothian Energy Limited Partnership – Ellis County)
2012-1660-MIS-U (UD 07-12202/Wise County Power Company, LLC – Wise County)
2012-1662-MIS-U (UD 07-12203/Ennis Power Company, LLC – Ellis County)
2012-1682-MIS-U (UD 07-12272/Hays Energy Limited Partnership – Hays County)
2012-1683-MIS-U (UD 12826/EIF Channelview Cogeneration LLC – Harris County)

Dear Ms. Bohac:

Enclosed for filing, please find an original and 7 copies of “The Executive Director’s Response to Appeals of the Executive Director’s Negative Use Determinations” on the above-referenced dockets. I am also transmitting a complete copy to all persons on the attached mailing list.

Sincerely,

A handwritten signature in cursive script that reads "Don Redmond".

Don Redmond, Attorney
Environmental Law Division

TCEQ Docket

2008-0830-MIS-U (UD 07-11914/Tenaska Gateway Partners, Ltd – Rusk County)

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2012-1683-MIS-U (UD 12826/EIF Channelview Cogeneration LLC – Harris County)

THE EXECUTIVE DIRECTOR'S RESPONSE TO APPEALS OF THE EXECUTIVE DIRECTOR'S NEGATIVE USE DETERMINATIONS

The Executive Director of the Texas Commission on Environmental Quality (the Commission or TCEQ) files this response to the appeals of the Executive Director's negative use determinations issued for Heat Recovery Steam Generators (HRSGs) to the above listed Applicants. The state Constitution and TEX. TAX CODE Section 11.31 allow an exemption from ad valorem taxes for property that environmental regulations require the owner to use to control pollution. The exemption offsets some of the financial burden on companies forced, through environmental regulations, to invest in equipment that is not productive. HRSGs are production equipment, generating steam for sale or additional electricity for each gas-fired power plant and are not a burden that companies were forced to install. After considerable review of the applications, supplemental attachments and appeals, the Executive Director concludes that HRSGs are so overwhelmingly production equipment that any purported environmental control purpose is negated. The Executive Director's issuance of Negative Use Determinations should be affirmed.

Despite the number of applicants and applications under appeal, the Executive Director has decided to respond to all of the appeals in one brief. The issues raised in each of the appeals are similar to each other. And, the applicants raise many of the same arguments raised when these applications were previously considered by the commission at the

December 5, 2012 agenda meeting for the above listed dockets. For this reason, the Executive Director incorporates by reference his Response to the Appeals filed on October 4, 2012, to the extent any issues are not updated in this response.

HRSG applications background

The HRSG applicants are subject to the application requirements that were in the applicable rules in effect at the time the applications were initially received. Most of the pending applications are subject to the review standards for the “Tier IV” process as provided in 30 TEX. ADMIN. CODE (TAC) §§17.15 and 17.17.¹ Applications Nos. 15505, 16410, 16411, 16412 (Cottonwood Energy Company) and 16413 (Brazos Electric Power Cooperative Jack County Generation Facility) were filed after the commission’s December 13, 2010 rules were effective and are subject to the Tier III process.

The Executive Director’s previous brief describes the applications and process prior to the commission’s December 10, 2012 remand order. The commission’s order set aside the Executive Director’s previous negative use determinations and remanded the matters to the Executive Director for new determinations. The commission did not order that the Executive Director must issue positive use determinations. Based on the commissioners’ discussions that were not stated in the order, the Executive Director gleaned that the commission expected a more thorough evaluation of the applications and that any determination be adequately explained. Because of the conflicting interpretations of TEX. TAX CODE §11.31, the commissioners also indicated that applicants should be given another opportunity to state or explain the environmental laws that are being met or exceeded by the use of the HRSGs.

General description of HRSGs

Each applicant operates a fossil fuel fired turbine to generate electricity. Each applicant is in the business of providing energy in the form of electricity and/or steam. A HRSG significantly increases the production capability of the facility. Turbine exhaust is routed through a HRSG removing heat to generate steam that is either sold itself as a marketable product (cogeneration) or converted to electricity that is sold as a marketable product (combined cycle). Therefore, the HRSG is production equipment. HRSGs do increase fuel efficiency for the entire power plant, i.e., they allow the operator to generate more useful output per unit of fuel fired than at a facility without a HRSG. A HRSG is not a traditional air pollution control device that prevents, monitors, controls, or reduces any specific pollutants.

Process after 2012 remand

After the remand, the Executive Director’s staff conducted further review of the HRSG applications. On February 21, 2013, each of the applicants was sent a Notice of Technical Deficiency letter. These letters were tailored to each specific application

¹ Because of subsequent statutory and rule changes, each application is reviewed under the rules in effect at the time of the application. The Tier IV process was removed from the commission’s rules in 2010.

asking the applicant to review its application to determine whether information was still current, seeking clarification from the applicant about submitted citations to environmental laws, and seeking clarification and correction of errors in use determination percentage calculations. The letter also requested that the applicant submit a use determination percentage calculation using the Cost Analysis Procedure (CAP) provided in 30 TAC § 17.17. In response to this letter, every applicant requested an extra 90 days to respond. After the request for additional time was granted by the Executive Director, each applicant submitted supplemental application materials. The Executive Director's staff reviewed the supplemental materials and responses. Applicants' responses continued to raise arguments and objections presented in their appeal rather than providing the information requested by the Executive Director. Applicants also incorporated into their responses and applications the same legal memo with a discussion of the citations to various environmental laws purportedly being met or exceeded by the HRSGs. Because of various applicability requirements for the cited rules, no one applicant could be subject to all of the rules cited in the legal memo that was incorporated in each application.

Because of the applicants' failure to provide the requested CAP information and because they continued to provide citations to inapplicable environmental laws, the Executive Director's staff sent applicants another Notice of Technical Deficiency letter. These letters were issued in November and December of 2013. The second Notice of Technical Deficiency letter asked applicants to explain the applicability of cited environmental laws. The second Notice of Technical Deficiency letter again asked for the correction to variables in submitted calculations and to provide a calculation using the CAP as requested by the ED in the first NOD letter. Applicants were again granted an extension of time to comply with the submissions from the second NOD letter. The responses were received by the end of March 2013.

The Executive Director thoroughly reviewed each application and the various use determination percentages calculated or requested for the HRSGs. The Executive Director concluded that because the HRSGs' production value so-overwhelmingly outweighs any purported pollution control value, none of the submitted calculations requesting a positive use determination was reasonable. Consequently, the Executive Director issued Negative Use Determinations on June 5, 2014. Due to a mailing error, some applicants did not receive their letter promptly. For those applicants, the Executive Director re-issued new Negative Use Determinations dated June 17, 2013 to allow all applicants sufficient time to file an appeal. All of the appeals were timely filed.

As explained below, the Executive Director appropriately issued a Negative Use Determination for all HRSG applicants and recommends that the appeals be denied and that the Executive Director's Negative Use Determinations be affirmed.

HRSGs are not entitled to an automatic positive use determination

HRSGs appear on the list of property in TEX. TAX CODE § 11.31(k) ("the (k)-list"). Applicants argue that by enacting TEX. TAX CODE § 11.31(k) and (m), the Texas Legislature: 1) determined that property appearing on the § 11.31(k) list is entitled to a positive use determination; 2) exempted property appearing on the § 11.31(k) list from

the TCEQ's review standards at 30 TEX. ADMIN. CODE (TAC) Chapter 17; and 3) limited the Executive Director's review of property on the § 11.31(k) list to the single task of assigning an appropriate positive use determination percentage. For their use determination applications, applicants claim that they do not need to provide any citation to an environmental law that is being met or exceeded by their HRSGs.

The applicants' interpretation of TEX. TAX CODE § 11.31 is not consistent with the state constitution creating the Tax Relief for Pollution Control Property Program (Prop 2); applicants' interpretation is not consistent with the applicable commission rules; applicants' interpretation is not consistent with prior commission statements in rulemaking; and applicants' interpretation is not consistent with the commission's affirmation of another negative use determination for property on the (k)- list.

To be eligible for a positive use determination, the property must be used, constructed, acquired or installed wholly or partly to meet or exceed environmental rules or regulations. In Prop 2, the people of Texas approved a constitutional amendment in Article VIII, Section 1-l that authorizes the legislature to exempt from taxation only certain property used, constructed, acquired or installed wholly or partly to meet or exceed environmental rules or regulations. Property that is not used, constructed, acquired or installed wholly or partly to meet or exceed an environmental rule or regulation would not be authorized under the tax exemption approved by the people. The Executive Director interprets TEX. TAX CODE § 11.31 and commission rules, consistent with the authority conferred by the Constitution, to allow positive use determinations only for property that is used, constructed, acquired or installed wholly or partly to meet or exceed an environmental rule, even for property listed in Section 11.31(k). The applicant asks for an interpretation of Section 11.31 that disregards the constitution by allowing a positive use determination for property that is not used, constructed, acquired or installed to meet or exceed an environmental rule.

Consistent with TCEQ rules, the Executive Director interprets TEX. TAX CODE § 11.31(k) and (m) as exempting certain applicants from providing specified application information and requiring an expedited review of applications containing the 18 categories of equipment listed. When initially implementing HB 3732 (the legislation creating the (k)-list), the Commission created a flow chart in Figure 30 TAC §17.15(b), requiring applicants to show that the proposed equipment was installed in order to meet or exceed an adopted environmental rule or regulation. Later, the property on the (k)-list was reorganized in commission rules as the "expedited review list" in current Figure 30 TAC § 17.17(b). From the time of the implementation of HB 3732 to the present, commission rules have continually required all applicants to submit a citation to the specific law, rule or regulation that is being met or exceeded by the use, installation, construction, or acquisition of the proposed pollution control property. Likewise, commission rules have always stated that to obtain a positive use determination, the pollution control property must be, used, constructed, acquired, or installed wholly or partly to meet or exceed an environmental law. There is no exception in the commission's rules from providing the environmental law citation for property included on the (k)-list.

When establishing the rules that implement TEX. TAX CODE § 11.31, the commission has repeatedly stated that property on the (k)-list is not entitled to an automatic positive use

determination. In the adoption preamble for the rulemaking implementing HB 3732, the Commission stated, “[s]imply because a piece of equipment is on the [ECL] or purports to fall under a category set forth on the list, does not mean it will receive a positive use determination.”² In the adoption preamble to the 2010 rule implementing HB 3206 and HB 3544, the Commission reiterated, “inclusion of a piece of equipment on the Tier I Table or on the table in §17.17(b) or the assertion that a piece of equipment falls under a category set forth on either list does not mean that the equipment would receive a positive use determination in all circumstances.”³

Subsequent to the remand order for these HRSG applications, the commission has considered another appeal of a negative use determination. Air Products LLC (Application No. 16632) applied for a use determination for its carbon capture and sequestration (CCS) systems including carbon dioxide capture, separation, purification, transportation, monitoring, and verification equipment. The applicant cited several rules which the Executive Director found were not appropriate or applicable. The Executive Director issued a negative use determination because the application did not cite an environmental law that was being met by the subject property. On appeal, Air Products claimed that its CCS System is entitled to a positive use determination because the property is included on the (k)-list (Tex. Tax Code 11.31(k)(16)). As in the present case for HRSGs, the Executive Director argued that the applicant is not entitled to an automatic positive use determination simply because its equipment is on the (k)-list. After considering the matter at its September 24, 2013 agenda meeting, (TCEQ Docket No. 2013-1252-MIS-U), the commission denied Air Products’ appeal and affirmed the Executive Director’s negative use determination, having concluded that the Executive Director’s Determination regarding Application No. 16632 was in accordance with applicable statutes and rules.⁴

Applicants ask the Executive Director and the commission to ignore the rules establishing the eligibility requirements for use determinations (30 TAC § 17.4(a)) and requirements that applicants cite an applicable environmental law for the proposed pollution control property (30 TAC § 17.10(d)(4)). The commission’s rules were properly adopted as required under TEX. GOV’T CODE Chapter 2001, and the commission must follow its own rules as adopted until it changes them in accordance with TEX.

² 33 TexReg 932 at 933. In response to comment regarding “green products” made to meet an environmental rule, the commission stated: “The commission does not agree that a piece of equipment is automatically eligible for tax exemption under TTC, §11.31 simply because it was installed to meet an environmental initiative. A piece of equipment installed to meet an environmental initiative must also satisfy all statutory and regulatory requirements to qualify for a positive use determination including that it provide a pollution control benefit at the site.” 33 TexReg 932 at 936. Also, in response to a comment that HB 3732 allows production equipment using new or advanced technologies to also have a pollution control benefit, the commission responded: “The commission appreciates this comment and agrees that certain production equipment using advanced technologies may also have pollution control benefits. However, each category of equipment listed in TTC, §11.31(k) will be considered on an application-specific basis to determine whether the equipment is installed to wholly or partly control air, water, or land pollution. Under the adopted rules, the categories of equipment listed in HB 3732 are incorporated into rule in Part B of the ECL.” 33 TexReg 932 at 939. Repealed November 18, 2010, 35 TexReg 10964.

³ 35 TexReg 10964.

⁴ *TCEQ Order concerning the appeal filed by Air Products, LLC, with regard to the Executive Director’s Negative Use Determination for Application No. 16632; TCEQ Docket No. 2013-1252-MIS-U*, issued September 26, 2013.

GOV'T CODE Chapter 2001.⁵ The Executive Director has appropriately and consistently required all applicants to cite a specific law, rule, or regulation that is being met or exceeded by the use, installation, construction, or acquisition of the proposed pollution control property.

ED's review of cited environmental laws

The Executive Director's staff reviewed each law cited by the applicant to determine if the HRSG is used, constructed, acquired, or installed wholly or partly to meet or exceed that cited law. In addition, staff reviewed individual permit and permit application files to examine specific requirements or application representations regarding HRSGs. Because HRSGs are production equipment and not traditional control equipment, they are regulated as sources of pollution and are not used to meet or exceed the cited environmental laws.

However, because HRSGs do allow the entire plant to be more efficient, the Executive Director does acknowledge that HRSGs could be used to meet an output based emission limit. The New Source Performance Standards (NSPS) Standards for Performance for Stationary Combustion Turbines, 40 CFR Chapter 60, Subpart KKKK, establish emission standards for certain stationary combustion turbines that commenced construction, modification or reconstruction after February 18, 2005. Subpart KKKK limits emissions of SO₂ and NO_x. The KKKK rules allow owners or operators of regulated turbines to meet NO_x limits that are based either on concentration of NO_x emitted (NO_x ppm) or mass of NO_x emitted per unit electricity produced (lbs. NO_x/megawatt hour). Because the NSPS KKKK emission limit is based on emitted pounds of NO_x per unit of electricity, the Executive Director accepted NSPS KKKK as an environmental law that was being met by the use of the HRSGs.

The Executive Director accepted the cites provided by Navasota Wharton Bend (Application No. 11926), Brazos Valley Energy (Application No. 11969), Topaz Power Group Barney Davis Power Plant (Application No. 12210), Topaz Power Group Nueces Bay Power Plant (Application No. 12211), Wolf Hollow Power Plant (Application No. 12268), Midlothian Energy Project (Application No 12271), and South Texas Electric Cooperative Sam Rayburn Power Plant (Application No. 13534). The Negative Use Determination letter issued to Freeport (Application No. 11994) and Brazos Electric Jack County Facility (Application No. 16413) should not have indicated that those applicants did not cite an environmental law. In addition, Brazos Electric Power Cooperative Johnson County Generation Facility (Application No. 13544) has a special condition in Air Permit No. 25384 which discusses HRSGs within the Emissions Limitations and Operating Specifications.

The Executive Director reviewed each applicant's citation to an environmental law for which the applicant claimed that their HRSG was used to meet or exceed. A brief explanation of the Executive Director's consideration of the environmental laws that were not appropriately cited is included in Attachment 1.

⁵ See TEX. WATER CODE § 5.103(c).

The Executive Director determined that none of the submitted Tier IV positive use calculations was reasonable under 30 TAC §17.17(d).

All applicants, including the Tier III applicants, submitted a variety of methodologies for deriving a positive use percentage for the HRSGs. The requested percentages ranged from 21% to 100%. All of the applicants eventually submitted a CAP calculation, as described in 30 TAC Chapter 17, that resulted in a negative number.

Under 30 TAC § 17.17(d) applicable to the Tier IV applications, it is the responsibility of the Tier IV applicant to propose a reasonable method for determining the use determination percentage. It is the responsibility of the Executive Director to review the proposed method and make a final determination. Under 30 TAC § 17.17(e), if the method accepted by the Executive Director produces a negative number, the property is not eligible for a positive use determination. As discussed below, the Executive Director found only one methodology that properly took into account the purported pollution control aspect as well as the production aspect of the HRSG—the CAP. That method resulted in a negative number for all applicants, reflecting the overwhelming production aspect of the HRSG. None of the other methodologies proposed by the applicants were proper in that they ignored the production aspect or the pollution control aspect, or both.

100% Positive Use Determination not lawful for production equipment.

Some applicants still request that they be issued a 100% positive use determination for their HRSGs. HRSGs generate steam for generation of electricity or for sale. Therefore, HRSGs are production equipment. Property cannot qualify as 100% pollution-control property if any portion of its value is attributable to its capacity to produce goods and services.⁶

The Executive Director did previously issue 100% positive use determinations for some HRSG applications. These previous 100% positive use determinations were issued in error. A 100% positive use determination can only be issued when the equipment is wholly used for pollution control. The Executive Director is not bound by a previous erroneous determination and is not required to perpetuate the error in applications that are still pending for the sake of consistency.

61% fuel substitute approach not a reasonable method and not supported by ED.

In November 2008, the Executive Director considered a method for determining a use determination percentage for HRSGs that tried to equate and quantify *fuel efficiency* as the proportion of the property providing *pollution control*. This method was based on the idea that the HRSG acts as a fuel substitute in a combined cycle facility. This method led to the Executive Director's recommendation stated in the Executive Director's Response Brief to the appraisal districts' appeals of the previous positive use determinations for the HRSGs in the document dated December 3, 2008.

However, after further consideration and review of this method, the Executive Director no longer agrees with this approach. The pollution control percentage was determined by subtracting the derived fuel efficiency percentage from 100%. The method does not

⁶ *Mont Belvieu Caverns, LLC v. Tex. Comm'n. on Envtl. Quality*, 382 SW3d 472 at 489 (Tex. App.-Austin) Aug. 3, 2012.

present a reasonable and logical calculation for the pollution control proportion of the property because decreases in efficiency result in an increasing percentage that reflects pollution control. The Executive Director cannot support a use determination based on this method.

The “avoided emissions” calculation is not reasonable.

Applicants submitted an “avoided emissions” calculation where the thermal output of a combined cycle plant (using a HRSG) is compared to the thermal output of a simple cycle facility that does not use a HRSG. The calculations varied using the avoided emissions approach, ranging from 21% to 91% positive use determinations.

The Negative Use Determination letter issued to EIF Channelview (Application No. 12826) did not address the applicant’s proposed avoided emissions calculation. The proposed method was reviewed, but the letter omitted to address the results of the review. The Executive Director did not find the proposed avoided emission approach in Application No. 12826 to be reasonable because it does not distinguish the proportion of property used to control or prevent pollution from the portion used to produce a product. The proposed avoided emission approach does not attribute any value to production. By attributing the entire avoided emissions to the HRSGs, the approach ignores nitrogen oxides (NO_x) reductions related to other property, i.e., selective catalytic reduction systems, flue gas recirculation systems, and low NO_x burners, for which a positive use determination has been issued. The Executive Director regrets that this information was not put in EIF Channelview’s negative use determination letter and expects that the applicant can consider this additional information when providing a reply brief to this response.

The problem with all of the avoided emission submittals is that the pollution control portion of one piece of equipment cannot be derived simply by comparing potential emissions reductions from one type of power generating plant to an alternative type of power generating plant. This sort of hypothetical comparison leads to absurd results. Any situation can be created to claim whatever pollution control benefit is desired. Applicants could claim a 100% positive use for their entire combined cycle plant by comparing it to a pulverized coal plant and citing the avoided SO₂ emissions. Alternatively, owners of nuclear power plants, wind farms, or solar arrays could claim 100% positive use determinations by comparing emissions from their facilities to emissions from a combined cycle power plant. No applicant has provided sufficient information as to why these hypothetical comparisons should be done, nor have they provided why the hypothetical single-cycle plant or boiler are appropriate comparisons.

The amount of pollution “avoided” by the use of a particular piece of property is not relevant in trying to determine the portion of the property that is attributable to pollution control. For example, a large spill control container would not be assigned a higher use determination percentage than a smaller container because it can contain and control a larger amount of pollution than the smaller one. The proposed method must distinguish the portion of the property that is used for pollution control and the portion that is used for production.⁷

⁷ TEX. TAX CODE § 11.31(g)(3). The Texas Court of Appeals, Third District, stated that “subsection (g)(3) means that TCEQ must distinguish the proportion of the property’s value that is attributable to a pollution-control feature

The avoided emissions approach also attributes the avoided emissions to the HRSG without addressing any pollution reduction contribution from other pollution control equipment, including pollution control equipment that may be subject to another positive use determination. Attribution of the pollution control function of the HRSG should not be based on the contribution from other pollution control equipment.

The “Modified” or “Clarified” CAP is not reasonable.

Applicants submitted modifications to the CAP formula used for Tier III applications required in 30 TAC § 17.17 as a proposed Tier IV calculation or when objecting to provide a CAP calculation as requested by the Executive Director.

Applicants argue that Capital Cost Old (CCO) should be \$0 as applied in the formula because there is no property that is being replaced. Applicants cite to the first sentence of the *current* definition of Capital Cost Old in 30 TAC §17.2(2): “The cost of the equipment that is being or has been replaced by the equipment covered in an application.” The rest of the definition states that the value for the variable is determined by using one of the four hierarchal methods in the figure in §17.17(b)(1). The current definition was adopted in the 2010 rulemaking effective December 13, 2010. Upon adoption, the commission stated in the preamble that “when a piece of equipment is not replacing previous equipment, instead of zero, capital cost old is the cost of a comparable piece of equipment without the pollution control feature.”⁸ This is also reflected in the first hierarchal step in the figure in §17.17(b)(1). The prior rule definition that is applicable to the applications filed prior to that date is “capital cost old—this is the cost of comparable equipment or process without the pollution control feature.” As applied to the formula in figure 30 TAC § 17.17(b), CCO should be the cost of comparable equipment without the pollution control feature. The Executive Director does not believe it is reasonable to assign CCO as \$0. Using \$0 for CCO results in a higher determination for the applicants because there is no reduction for the capital cost of the production value of the equipment. TCEQ rules do not support using \$0 for CCO.

Some applicants present similar reasons for why CCO should be the cost of a spool piece or ductwork that would vent the exhaust heat to a stack, control device, or to the atmosphere. A spool or duct is not comparable equipment to the HRSG because the spool or duct does not reflect comparable production capability as the HRSG. The spool or duct does not generate steam available for sale or production of electricity. Using such a spool or ductwork for CCO yields a higher percentage for the applicants because there is not an appropriate reduction for the capital cost of the production value of the equipment.

Applicants also urge that Capital Cost New (CCN) should include the cost of the steam turbines and ancillary water equipment, arguing that without such equipment the steam produced from the HRSG would be worthless. The Executive Director does not agree that the costs of steam turbines or ancillary water equipment should be included in the

from that attributable to its capacity to produce goods and services, thereby reflecting legislative intent to limit the pollution-control property exemption solely to capital investment made to comply with state or federal environmental regulations that does not yield productive benefits and would thus otherwise be irrational economically.” *Mont Belvieu Caverns, LLC v. Tex. Comm’n. on Env’tl. Quality*, 382 SW3d 472 at 489 (Tex. App.-Austin) Aug. 3, 2012.

⁸ 35 TexReg 10966.

capital cost of the HRSG. The steam turbines and associated water equipment are purely production components and offer no pollution control. Inflating the CCN to include the cost of steam turbines and water equipment, results in a higher use determination percentage because it increases the purported pollution control value of the equipment. CCN should reflect the cost of the HRSG.

The CAP is only reasonable method to establish use determination percentage.

The Cost Analysis Procedure (CAP) is the only method that the Executive Director has found to properly assess the pollution control and production function of equipment or property. Although the use of the CAP is not required of the Tier IV applicants, the Executive Director requested that the applicant provide a calculation using this method.⁹ Applications Nos. 15505, 16410, 16411, 16412 (Cottonwood Energy Company) and 16413 (Brazos Electric Power COOP Jack County Generation Facility) are Tier III applications and must use the CAP.

TEX. TAX CODE § 11.31(g)(2) requires TCEQ rules and implementation to provide use determinations that are equal and uniform. Applying the CAP to all applicants allows the Executive Director to consider the determinations uniformly. The CAP has also been recognized as an appropriate method to account for both the pollution control and economic benefit of the property.¹⁰

When requesting the applicants to submit the CAP calculation, the Executive Director required the applicants to use the cost of a boiler generating the equivalent amount of steam as the HRSG for CCO. As discussed above, applicants preferred using a much smaller number in the CAP equation for CCO. CCO should be the cost of comparable piece of equipment without the pollution control. A boiler is the appropriate comparable equipment to a HRSG because they both generate steam that is either sold or converted to electricity as a marketable product.¹¹ As used in the CAP equation, CCO captures the production value of the equipment. The Executive Director's requirement to use the cost of the boiler conforms to the definition of CCO and reasonably reflects the production value of the HRSG.

When requesting the applicants to submit the CAP calculation, the Executive Director required the applicants to not include fuel costs for operating the gas-fired turbines as part of the Production Costs for the HRSGs. Fuel costs for any associated duct burners were allowed as part of the Production Costs. Production Costs should be the costs directly attributable to the operation of the HRSGs. The fuel costs for the gas-fired turbines are production costs for generating electricity from the gas turbines and are not directly attributable to the HRSGs. Including the fuel costs for the gas-fired turbines,

⁹ Under 30 TAC §17.10(d)(7) a use determination must include any information the executive director deems reasonably necessary to determine the eligibility of the application.

¹⁰ Legislative Budget Board (LBB) Government Effectiveness and Efficiency Report Submitted to the 81st Texas Legislature, *Revise the Property Tax Exemption for Pollution Control Equipment*, January 2009, pp. 109-114.

¹¹ Supporting the Executive Director's position that boilers are comparable equipment to HRSGs is the fact that many cogeneration and combined cycle and power plants actually install auxiliary boilers to provide redundancy and reliability of steam supplies, to keep HRSGs and steam turbines warm during intermittent combustion operations, or for power augmentation.

improperly inflates the Production Cost of the HRSGs yielding a higher use determination percentage.

Once the applicants submitted calculations in accordance with the method for the CAP proscribed in 30 TAC Chapter 17, the calculations resulted in a negative number. Therefore, the Executive Director determined that the HRSGs are not eligible for a positive use determination and issued negative use determinations. Applicants complain upon appeal, that a negative result somehow shows that the CAP is flawed or illogical. The Executive Director disagrees. The CAP and the rules specifically contemplate a negative result.¹² The negative result indicates to the Executive Director that the HRSGs' function as production equipment negates any pollution control function.

The Executive Director finds that the CAP is the only reasonable method presented for making a use determination on the HRSG applications. The Executive Director reviewed the CAP calculation and agrees that it generates a negative number. Accordingly, the Executive Director issued negative use determinations.

Conclusion

In the legislative discussions on the origins of the Prop 2 program, one legislator succinctly described the tax exemption's purpose.

[I]f this capital expense is going to be imposed by government, why should they have the double whammy of having to pay an additional amount of money for the ad valorems. . . . If they are going to be forced to buy stuff because the government is insisting that they do it, don't hit them another time by paying the ad valorems on something they don't really want anyway.¹³

That described "double whammy" effect is simply not the case for a HRSG at a cogeneration or combined-cycle power plant. The HRSGs were not required by regulation and the HRSGs are something the power plant wants to have because they significantly increase production.

After considerable review of the HRSG applications and the issues raised on appeal, the Executive Director respectfully recommends that the commission deny the appeals and affirm the Executive Director's Negative Use Determination.

If the commission decides to remand these applications again to the Executive Director, the Executive Director would appreciate specific guidance and instruction on the consideration of the applications and the method to be used for deriving a reasonable use determination percentage. The Executive Director would also appreciate direction on whether rulemaking may be required to consider a new approach for partial use determinations on efficiency-type equipment.

¹² Current rule 30 TAC §17.17(d) and prior rule 30 TAC §17.17(e) both anticipate that the CAP can produce a negative number. In such a case, the property is not eligible for a positive use determination.

¹³ Hearing on Tex. H.J.R. 86 and H.B. 1920 before the House Comm. On Ways and Means, 73rd Leg. R.S. (March 24, 1993), statements of Rep. Steven Wolens.

Respectfully submitted,

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REPRESENTING THE
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CERTIFICATE OF SERVICE

I certify that on August 8, 2014, an original and seven copies of the “Executive Director’s Response to Appeals of the Executive Director’s Negative Use Determination” was filed with the Texas Commission on Environmental Quality’s Office of the Chief Clerk, and a complete copy was transmitted by mail, facsimile, electronic mail or hand-delivery to all persons on the attached mailing list.

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Attachment 1

The various HRSG applications cited a number of air pollution control laws.

New Source Performance Standards (NSPS), Part 60 Subparts Da, Db, and GG

Generally, the NSPS requirements of Part 60, Subparts Da, Db and GG are emissions standards established by EPA for certain sources of pollution. These standards must be met before constructing or modifying a facility and the standards can be placed in a federal or state New Source Review permit, Prevention of Significant Deterioration permit or Title V operating permit. The applicability of the various NSPS subparts may depend on the type or purpose of the source of pollution and the date of proposed construction or modification of the source.

40 CFR § 60.44Da(d) NSPS Standards of Performance for Electric Utility Steam Generating Units

Subpart Da establishes emission standards for certain electric utility steam generating units capable of combusting more than 73 megawatts heat input of fossil fuel for which construction, modification, or reconstruction is commenced after February 28, 2005. Section 60.44Da(d) requires facilities that commenced construction, reconstruction, or modification after July 9, 1997 and before March 1, 2005 to prohibit the discharge into atmosphere any gases that contain NO_x in excess of the limits established in (d)(1) or (d)(2). The limitations are based on mass of NO_x emitted per gross electricity generated (lb/MWh). Under § 60.40Da(e), HRSGs used with duct burners associated with stationary combustion turbines capable of combusting more than 73 MW heat input of fossil fuel are subject to Subpart Da; for HRSGs used with duct burners subject to Subpart Da, only emissions resulting from the combustion of fuels in the duct burners are subject to the standards in Da.

The fact that HRSGs and associated duct burners are regulated under the Subpart Da performance standards shows that HRSGs are part of the production equipment that are regulated as sources of pollution, not pollution control devices. The HRSGs are part of the affected electric utility steam generating unit that are subject to an environmental rule or regulation that must be met. The HRSGs are not pollution control equipment used to assist the electric utility steam generating unit in meeting a rule.

40 CFR 60.44 Db NSPS Standards of Performance for Industrial-Commercial-Institutional Steam Generating Units

Subpart Db establishes emission standards for affected facilities constructed, reconstructed or modified after June 19, 1984, with heat input capacity from fuels combusted in the steam generating unit of greater than 29 megawatts. Subpart Db establishes emission standards for SO₂, NO_x, and particulate matter. The various emission limits in Section 60.44b vary based on the type of fuel and are expressed in mass of NO₂ emitted per heat input. Duct burners used in a combined cycle system have emission limits under 60.44b(a)(4).

The HRSG is not a pollution control device that reduces the concentration of NO_x emitted from a gas turbine. The HRSG neither prevents NO_x from entering a combustion turbine nor prevents NO_x from exiting the combustion turbine. The HRSG

may help make an entire plant more efficient, but plant efficiency is not a standard an owner or operator is required to meet under 40 CFR § 60.44b. HRSGs are not required to be used under Subpart Db and are not used to meet or exceed Subpart Db.

40 CFR § 60.332, Subpart GG, NO_x Standard of Performance for Stationary Gas Turbines

Subpart GG establishes performance standards for certain stationary gas turbines. And, § 60.332 establishes NO_x emission limits for stationary gas turbines. Subpart GG applies to affected facilities with stationary gas turbines constructed or modified after October 3, 1977, with a heat input at peak load equal to or greater than 10 million Btu. Section 60.332 limits the discharge into the atmosphere of any gases which contain nitrogen oxides in excess of various concentration limits (NO_x percent by volume). The applicable NO_x concentration limit may depend on the type and use of the gas turbine or on the nitrogen content of the fuel.

The HRSG is not a pollution control device that reduces the concentration of NO_x emitted from a gas turbine. The HRSG neither prevents NO_x from entering a combustion turbine nor prevents NO_x from exiting the combustion turbine. The HRSG may help make an entire plant more efficient, but plant efficiency is not a standard an owner or operator is required to meet under 40 CFR § 60.332. HRSGs are not required to be used under Subpart GG and are not used to meet or exceed Subpart GG.

Cap and Trade Programs

30 TAC § 101.506(c) and 40 CFR Part 96 Clean Air Interstate Rule (CAIR)

EPA issued CAIR to address power plant pollution that drifts from one state to another. Specifically, EPA promulgated CAIR to assist nonattainment areas in downwind states in achieving compliance with NAAQs for PM_{2.5} and eight-hour ozone. Under CAIR, EPA established state emission budgets for NO_x and SO₂ reduction requirements. EPA provides states with two compliance options for meeting reduction requirements under CAIR: 1) meet the state emission budget by requiring electric generating units to participate in an EPA-administered cap and trade program; or 2) meet the state budget through measures of the state's choosing. The commission's rules in 30 TAC Chapter 101, Subchapter H, Division 7 reflect the state's implementation of the cap and trade program provided under CAIR. Section 101.506 specifies the methodology for distributing the CAIR NO_x allowance for each stationary, fossil fuel-fired boiler or stationary, fossil fuel-fired combustion turbine meeting the requirements of 40 CFR Part 96, Subpart AA or Subpart AAA. The annual cap is established in tons of NO_x emitted.

A HRSG captures waste heat and converts it to steam. A HRSG does not help the owner or operator of a boiler or turbine subject to CAIR meet an emission cap. The HRSG is not a pollution control device that reduces the NO_x or SO₂ output. Section 101.506 does not require the use of HRSGs to meet or exceed an emission limit. Therefore, HRSGs are not equipment used to meet or exceed 30 TAC § 101.506 and 40 CFR Part 96.

30 TAC § 101.352(b) Mass Emissions Cap and Trade Program

The Mass Emissions Cap and Trade Program applies only to certain sites in the Houston-Galveston-Brazoria ozone nonattainment area. TCEQ rule in § 101.352(b)

requires each site subject to the program to establish a quantity of allowances, or cap, in its compliance account for each upcoming year that is equal to or greater than the total emissions of nitrogen oxides emitted during the previous year. The Mass Emissions Cap and Trade Program is not a “command and control” method for reducing or controlling air pollution. It does not require the use of HRSGs.

A HRSG captures waste heat and converts it to steam. A HRSG does not help the owner or operator of a site meet an emission cap. The HRSG is not a pollution control device that prevents or reduces the amount of NO_x that is emitted. It may help make an entire plant be more efficient, but plant efficiency is not a standard a site is required to meet under 30 TAC § 101.352(b). Section 101.352(b) does not require the use or installation of HRSGs to meet or exceed an emission limit. Therefore, HRSGs are not equipment used to meet or exceed 30 TAC § 101.352(b).

Best Available Control Technology

30 TAC § 116.111(a)(2)(C) and 40 CFR § 52.21(b)(12) BACT

TCEQ rule in Section 116.111(a)(2)(C) requires an application for a New Source Review permit to include an evaluation and application of best available control technology (BACT). Section 116.10(1) defines BACT as air pollution control method for a new or modified facility that through experience and research, has proven to be operational, obtainable, and capable of reducing or eliminating emissions from the facility, and is considered technically practical and economically reasonable for the facility. Certain facilities in nonattainment areas must evaluate and apply BACT as defined in Section 116.160(c)(1)(A), which incorporate by reference EPA rules in 40 CFR § 52.21(b)(12)-(15). EPA rule 40 CFR 40 CFR § 52.21(b)(12) is a definition of “best available control technology” which means an emissions limitations based on the maximum degree of reduction for each pollutant subject to regulation under the Clean Air Act which the Administrator determines is achievable for such source or modification through application of production processes or available methods, systems, and techniques including fuel cleaning or treatment or innovative fuel combustion techniques for the control of such pollutant.

The regulations cited are for definitions and requirements for BACT. Neither TCEQ nor EPA has determined that HRSGs satisfy the requirements for BACT. HRSGs are not a pollution control technology; they are production equipment. The cited definitions and requirements for BACT do not require HRSGs to meet or exceed an emission limit. The cited definitions and requirements for BACT do not require the use or installation of a HRSG. Therefore, HRSGs are not equipment used to meet or exceed 30 TAC § 116.111(a)(2)(C) and 40 CFR § 52.21(b)(12).

HB 788 and 40 CFR § 52.21(b)(49)(iv)-(v)—GHG Regulation

EPA promulgated the PSD and Title V Greenhouse Gas (GHG) Tailoring Rule on June 3, 2010. Beginning January 2, 2011, GHG were subject to regulation for: a new major source of a regulated NSR pollutant, other than GHG, that will have the potential to emit at least 75,000 tons per years (tpy) carbon dioxide equivalent (CO_{2e}), or an existing major source of a regulated NSR pollutant, other than GHG, that will have an emission increase of a regulated pollutant, and an emissions increase of at least 75,000 tpy. Beginning July 1, 2011, GHG were subject to regulation at a new stationary source that

will emit or have the potential to emit at least 100,000 tpy CO₂ or at an existing source that emits or has the potential to emit 100,000 tpy CO₂ when such stationary source undertakes a physical change or change in the method of operation that will result in an emissions increase of at least 75,000 tpy CO₂. EPA is currently the GHG permitting authority in Texas under a Federal Implementation Plan (FIP) effective December 30, 2010.

On June 23, 2014, the United States Supreme Court ruled that EPA's regulation of GHG sources under the PSD and Title V programs invalid to the extent that these sources triggered regulation based solely on their GHG emissions (*Utility Air Regulatory Group v. Environmental Protection Agency et al.*, No. 12-1146, slip op. (June 23, 2014)). The Court upheld EPA's ability to require a BACT review of GHG emissions at sources that trigger PSD based on emissions of other regulated pollutants (so-called 'anyway sources'). EPA issued interim guidance establishing a de minimis GHG threshold for BACT review for major sources and modifications at the 75,000 tons per years (tpy) carbon dioxide equivalent (CO₂e) level. EPA must establish the de minimis BACT threshold in rule, however, it is not certain whether EPA's regulation of GHGs will be vacated upon remand to the D.C. Circuit until such time as the de minimis rule is promulgated.

HB 788 was enacted by the Texas Legislature in 2013. HB 788 authorizes TCEQ to issue permits for the emission of greenhouse gases (GHG) to the extent required under federal law and authorizes TCEQ to submit a state implementation plan revision to EPA for the control of GHG under federal laws. If approved by EPA into the Texas State Implementation Plan (SIP), HB 788 will allow 'anyway sources' in Texas to receive permits for their GHG emissions over an established de minimis amount from TCEQ rather than EPA. TCEQ adopted rules implementing HB 788, effective April 17, 2014. EPA has not approved a SIP revision or rescinded the GHG FIP that would allow state permitting of GHG emissions. No HRSG applicant has demonstrated that they are subject to TCEQ's GHG rules and that the HRSGs are used to meet the requirements.

No applicant for a use determination has shown that their GHG emissions are subject to regulation by EPA. Because of the 2011 applicability dates of the EPA Tailoring Rule, the facilities with HRSGs in the pending applications did not trigger PSD permitting under the EPA FIP. An applicant cannot receive a positive use determination by citing a regulation that it is not required to meet. HB 788 does not impose any emission limits on entities in Texas or require the installation of any pollution control equipment. An existing HRSG cannot have been used to meet or exceed HB 788 because the legislation did not exist when the device was installed.

42 USC 7401(c) Clean Air Act Congressional Findings and Declaration of Purpose

Section 101(c) of the federal Clean Air Act (41 USC §7401(c)) states that "a primary goal of this chapter is to encourage or otherwise promote reasonable Federal, State, and local governmental actions, consistent with the provisions of this chapter, for pollution prevention." This provision in law encourages or directs federal, state, and local government action. It does not direct a specific facility to limit or reduce emissions and does not require a facility to use HRSGs. Therefore, HRSGs are not equipment used to meet or exceed Section 101(c) of the federal Clean Air Act.

National Ambient Air Quality Standards (NAAQS)

40 CFR §§ 50.6, 50.8, and 50.11 NAAQS

NAAQS for PM₁₀

Section 50.6 of Part 40 establishes the level of national primary and secondary 24-hour ambient air quality standards for particulate matter and establishes the method for measuring attainment. The establishment of a NAAQS for a particular region triggers a requirement for the state to adopt an implementation plan to enforce and maintain the standard in that region. The NAAQS is not an emission limit for a particular facility or source of pollution and does not direct a specific facility to use HRSGs. Therefore, HRSGs are not equipment used to meet or exceed 40 CFR Section 50.6.

NAAQS for CO

Section 50.8 of Part 40 establishes the level of national primary 8-hour and 1-hour ambient air quality standards for carbon monoxide and establishes the method for measuring attainment. The establishment of a NAAQS for a particular region triggers a requirement for the state to adopt an implementation plan to enforce and maintain the standard in that region. The NAAQS is not an emission limit for a particular facility or source of pollution and does not direct a specific facility to use HRSGs. Therefore, HRSGs are not equipment used to meet or exceed 40 CFR Section 50.8.

NAAQS for NO_x

Section 50.11 of Part 40 establishes the level of national primary and secondary ambient air quality standards for oxides of nitrogen and establishes the method for measuring attainment. The establishment of a NAAQS for a particular region triggers a requirement for the state to adopt an implementation plan to enforce and maintain the standard in that region. The NAAQS is not an emission limit for a particular facility or source of pollution and does not direct a specific facility to use HRSGs. Therefore, HRSGs are not equipment used to meet or exceed 40 CFR Section 50.11.

Combustion Control in Ozone Nonattainment Areas

30 TAC § 117.1310 Emission Specifications for Eight-Hour Attainment Demonstration; Dallas-Fort Worth Eight-Hour Ozone Nonattainment Area Utility Electric Generation Sources

Section 117.1310 requires the owner or operator of certain utility boilers, auxiliary steam boilers, or gas turbines within the Dallas-Fort Worth eight-hour ozone nonattainment area to meet certain NO_x (as well as CO and ammonia) limitations from each utility boiler, auxiliary steam boiler, and stationary gas turbines based on pounds of NO_x emitted per heat input into the boiler or gas turbine. The HRSG captures waste heat and converts it to steam. A HRSG does not help the owner or operator of the boiler or turbine meet the emission limit. The HRSG is not a pollution control device that reduces the NO_x output or increase heat input for a boiler or gas turbine. It may help make an entire plant more efficient, but plant efficiency is not a standard an owner or operator is required to meet under 30 TAC § 117.1310. Section 117.1310 does not require the use of HRSGs to meet or exceed an emission limit. Therefore, HRSGs are not equipment used to meet or exceed 30 TAC § 117.1310.

30 TAC § 117.1205(f) Emission Specifications for Reasonably Available Control Technology (RACT)

Section 117.1200 applies the requirements of Division 3 of Subchapter C of Chapter 117 to certain utility boilers, auxiliary steam boilers, stationary gas turbines, and duct burners in turbine exhaust ducts used in certain electric power generating systems within the Houston-Galveston-Brazoria ozone nonattainment area. Section 117.1205(f) prohibits the discharge into the atmosphere from certain stationary gas turbines of NO_x emissions in excess of a block one-hour average of: 42 ppm by volume at 15% oxygen, dry basis, while firing natural gas; and 65 ppm while firing fuel oil.

A HRSG captures waste heat and converts it to steam. A HRSG does not help prevent or reduce the discharge of NO_x into the atmosphere from a gas turbine. The HRSG may help make an entire plant be more efficient, but plant efficiency is not a standard a facility is required to meet under 30 TAC § 117.1205(f). Section § 117.1205(f) does not require the use or installation of HRSGs to meet or exceed an emission limit. Therefore, HRSGs are not equipment used to meet or exceed 30 TAC § 117.1205(f).

30 TAC §§ 117.450, 117.454, 117.456, 117.9030, and 117.9130 Dallas Fort Worth Eight Hour Ozone Nonattainment Area Final Control Plans

Section 117.410(b)(5) establishes emission limits for stationary gas turbines in mass of NO_x emitted per unit of heat energy produced (lb/MMBtu), depending on the rating of the turbine. Section 117.410(b)(6) also establishes a NO_x emission limit on duct burners corresponding to the emission limit for the gas turbine. Section 117.450 requires the owner or operator of a unit at a major source of NO_x in the Dallas-Fort Worth eight-hour ozone nonattainment area to submit an initial control plan. Section 117.454 requires owners or operators of any unit subject to 117.410 to submit a final control report to show compliance with the requirements of 117.410. Section 117.456 addresses provisions for submitting a revised control plan. Section 117.9030 establishes the schedule for submission of an initial control plan. Section 117.9130 establishes the schedule for submission of a final control plan regarding emissions.

A HRSG captures waste heat and converts it to steam. A HRSG does not help prevent or reduce the discharge of NO_x into the atmosphere from a gas turbine. A HRSG does not increase the energy produced from the gas turbine. The HRSG is not used for the submission of a control plan for the emission of NO_x in the Dallas-Fort Worth eight hour ozone nonattainment area. Sections 117.450, 117.454, 117.456, 117.9030, and 117.9130 do not require the use or installation of a HRSG, and HRSGs are not equipment used to meet an emission limit under these rules.

Required by permit

Applicants have stated that HRSGs are required by the permit. Except for the Brazos Electric Johnson County Facility (Application No. 13544), none of the cited permits require the use or installation of a HRSG as a pollution control device to meet or exceed an environmental rule. Air permits may incorporate or require certain NSPS standards and HRSGs may be subject to emission limits as a source of pollution. The fact that a piece of equipment may be subject to a rule or permit does not mean that the property is used to meet or exceed a requirement of an environmental rule.