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TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

October 4, 2012

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: BRAZOS ELECTRIC POWER COOPERATIVE, INC.
TCEQ DOCKET NO. 2012-1648-MIS-U**

Dear Ms. Bohac:

Enclosed for filing is the Office of Public Interest Counsel's Response to Appeal of Negative Use Determination in the above-entitled matter.

Sincerely,

A handwritten signature in cursive script that reads "Amy Swanholm".

Amy Swanholm, Attorney
Assistant Public Interest Counsel

cc: Mailing List

Enclosure

TCEQ DOCKET NO. 2012-1648-MIS-U

IN THE MATTER OF THE APPEAL	§	
BY BRAZOS ELECTRIC POWER	§	BEFORE THE
COOPERATIVE, INC. OF NEGATIVE	§	TEXAS COMMISSION ON
USE DETERMINATION	§	ENVIRONMENTAL QUALITY
NO. 16413	§	

**OFFICE OF PUBLIC INTEREST COUNSEL'S
RESPONSE TO APPEAL OF NEGATIVE USE DETERMINATION**

**TO THE HONORABLE MEMBERS OF THE TEXAS COMMISSION ON
ENVIRONMENTAL QUALITY:**

The Office of the Public Interest Counsel (OPIC) files this response to Brazos Electric Power Cooperative, Inc.'s (BEPC or Appellant) appeal of the negative use determination issued by the Executive Director (ED).

I. INTRODUCTION

In February 2012, BEPC submitted a Tier III use determination application to the Texas Commission on Environmental Quality (TCEQ). BEPC sought use determinations for two thermally efficient heat recovery steam generators (HRSG) associated with electric power generation at the Jack County Generation Facility in Bridgeport, Jack County, Texas. The application describes the property as using combined-cycle technology to power combustion turbines. These turbines are routed to two heat recovery steam generators and dedicated ancillary systems, where the exhaust heat is converted to steam used to power a steam turbine and generate additional electricity. The application states that by utilizing both the gas and steam turbines to generate

electricity, thermal efficiency is improved 14–19% and less fuel is required in the production process, thereby reducing the emission of exhaust gases. As required with a Tier III application, BEPC calculated the pollution control percentage of the two HRSGs to form the basis of its request for a 74.66% tax exemption.

On July 10, 2012, the ED issued a negative use determination for BEPC's facility. The ED stated that HRSGs and associated dedicated ancillary equipment are used solely for production and are not considered pollution control equipment.

On July 31, 2012, BEPC appealed the ED's negative use determination for the two HRSG units. BEPC argues that the TCEQ did not have authority to issue a negative use determination, as this would be contrary to the legislature's intent as expressed in the Texas Tax Code. BEPC also argues that such a conclusion violates the Texas Administrative Procedure Act in addition to TCEQ's own regulations and procedures as related to rulemaking. BEPC requests that the appeal be granted and the ED directed to issue a positive use determination.

II. APPLICABLE LAW

A. Legislative History

On November 2, 1993, Texas voters approved a constitutional amendment exempting certain pollution control property/equipment from property taxation. This amendment added Section (§) 1-1 to Article 8 of the Texas Constitution. Legislation to implement the amendment was approved in House Bill (HB) 1920, 73rd Texas Legislature, 1993. This legislation added the new section 11.31 to the Texas Tax Code.

The intent of the constitutional amendment was to ensure that capital expenditures undertaken to comply with environmental rules did not increase a facility's property taxes.

The 77th Texas Legislature, 2001, amended §11.31 to require the TCEQ to adopt specific standards for evaluating applications and create a formal procedure to allow applicants or appraisal districts to appeal a final determination.

The 80th Legislature, 2007, amended §11.31 by adding three new subsections. The first change required the TCEQ to adopt a nonexclusive list of property/equipment that included a list of 18 different categories, i.e., the Expedited Review List that is specified in §17.17(b) of the Texas Administrative Code. The second change required that the list be reviewed at least once every three years and established a standard for removing property/equipment from the list. The third change established a 30-day review period for applications that contain only property/equipment listed on the Expedited Review List.

The 81st Texas Legislature, Regular Session, 2009, passed House Bills 3206 and 3544, amending §11.31 by adding two new sections. New section (g-1) requires that applications containing property/equipment adopted under §11.31(k) be reviewed using the methods and standards adopted under §11.31(g). New section (n) requires the establishment of a permanent advisory committee that is charged with advising the commission on the implementation of §11.31. In addition, the legislation corrected the agency's name in the statute and allowed for electronic appraisal district notifications as required by §11.31(d).

On November 18, 2010, the TCEQ adopted changes to 30 Tex. Admin. Code Chapter 17 to establish procedures and mechanisms for obtaining a use determination

required to implement the amendments to §11.31 by House Bills 3206 and 3544, 81st Texas Legislature, Regular Session, 2009.

B. 30 Texas Administrative Code Chapter 17

The rules state 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 laws, rules, or regulations adopted by any environmental protection agency of the United States, Texas, or a political subdivision of Texas, for the prevention, monitoring, control, or reduction of air, water, or land pollution.” 30 TAC § 17.4(a). Chapter 17 contains a list of items (the Tier I Table), predetermined as used wholly for pollution control purposes. 30 TAC § 17.14. In addition, there are three different types of use determination applications;

Tier I- An application which contains property that is in Part A of the figure in §17.14(a) or that is necessary for the installation or operation of property located on the Tier I table; 30 TAC § 17.2(8)

Tier II- An application for property that is used wholly for the control of air, water, and/or land pollution, but is not located on the Tier I Table in §17.14(a); 30 TAC § 17.2(9)

Tier III- An application for property used partially for the control of air, water, and/or land pollution and that does not correspond exactly to an item on the Tier I Table in §17.14(a); 30 TAC § 17.2(10)

In addition, a Tier III partial use determination “submitted for all property that is either not on the Tier I Table located in §17.14(a) of this title (relating to Tier I Pollution Control Property), or does not fully satisfy the requirements for a 100% positive use determination.” 30 TAC § 17.17(a). To calculate partial use for Tier III applications, the cost analysis procedure (CAP) in 30 TAC § 17.17(c) must be used. *Id.* If the cost analysis

procedure produces a negative number or a zero, the property is not eligible for a positive use determination. 30 TAC § 17.17(d).

Under § 17.25, an appellant has 20 days to appeal a use determination issued by the ED. 30 TAC § 17.25(a)(2)(A) and (B); 30 TAC § 17.25(b). Upon a timely appeal, the Commission may either “deny the appeal and affirm the ED’s use determination” or “remand the matter to the ED for a new determination.” 30 TAC § 17.25(d)(2). The general counsel may remand a matter from the commission's agenda to the executive director if the executive director or the public interest counsel requests a remand. 30 TAC § 17.25(d).

Should the Commission remand the use determination, the ED shall conduct a new technical review and issue a new use determination. 30 TAC § 17.25(f)(A) and (B).¹ This determination may be appealed. 30 TAC § 17.25(f)(2). If the Commission denies the appeal and affirms the use determination, this decision is final and appealable. 30 TAC § 17.25(e)(3).

III. TIMELINESS

¹ OPIC finds that the rules and statutes in effect when the Appellant submitted its application should be applied. The Code Construction Act states that “a statute is presumed to be prospective unless expressly made retrospective.”¹ TEX. GOV'T CODE § 311.022. And the Texas Attorney General has clarified that “the same general principles [in TEX. GOV'T CODE § 311.022] also apply to agency rules.”¹ Op. Tex. Att’y Gen. No. GA-0655 (2008) (citing *R.R. Comm’n v. Lone Star Gas Co.*, 656 S.W.2d 412, 425 (Tex. 1983)). Further, House Bills 3206 and 3544 “specifically [do] not apply to applications filed prior to January 1, 2009, or to applications filed after January 1, 2009, that received final determinations prior to September 1, 2009.”¹ 35 Tex. Reg. 10965. See also Tex. H.B. 3206, 81st Leg., R.S. (2009).

Appellant submitted its application in February 2012, therefore HB 3206 and HB 3544 as well as the 2010 amendments to Chapter 17 abolishing Tier IV would apply to this application. If appeal of the 2012 negative use determination is granted and this matter is remanded to the ED for a new use determination, the ED should process this application as a Tier III application.

Under § 17.25, an appellant has 20 days to appeal a use determination issued by the ED.² The Appellant submitted its appeal of the ED's July 10, 2012 use determination and its request for reversal within the 20 day deadline. Therefore these appeals are timely and may be considered by the Commission.

IV. ARGUMENT

A. Whether the ED's determination that HRSGs are "Production Equipment" was proper.

Appellant argues the ED's negative use determination is incorrect because it disregards statutory authority and is arbitrary and capricious insofar as it is inconsistent with prior use determinations on HRSGs and that any change in position should have been addressed through rulemaking. OPIC disagrees and defers to the ED's technical determination that HRSGS are solely used for production.

1. The statutory framework charges the ED with determining pollution vs. production capacity.

Property used solely for production purposes is not eligible for tax exemption under Tax Code § 11.31.³ The ED determined that the Appellant's HRSG equipment is used solely for production, and has issued a negative use determination. The ED has authority, subject to an appeal, to determine if a facility, device, or method is used wholly or partly as a facility, device, or method for the control of air, water, or land

² *Id.* at § 17.25(a)(2)(A), (b).

³ TEX. TAX CODE § 11.31(a), (b). The legislation enacting 11.31 provided that this tax exemption applies only to pollution control property that is constructed, acquired, or installed after January 1, 1994. *See* Act of May 10, 1993, 73d Leg., R.S., ch. 285, § 5(b), 1993 Tex. Gen. Laws 1322, 1325. Op. Tex. Att'y Gen. No. JC-0372 at 2 (2001).

pollution.⁴ TCEQ's rules implementing § 11.31 must allow for determinations that distinguish between pollution control property (which is eligible for a tax exemption) and equipment, or the portion of equipment, that is attributed to production.⁵

The legislative intent of TTC § 11.31, as stated in the recently-issued *Mont Belvieu* case, is "to limit the pollution-control property exemption solely to capital investment made to comply with state or federal environmental regulation that does not yield productive benefits and would thus otherwise be irrational economically."⁶

2. Statutory and regulatory classification of the equipment.

Appellant asserts that because HRSGs are listed in TTC § 11.31(k), they are automatically entitled to a positive or partial use determination. OPIC disagrees. The ED clearly has authority to issue a negative use determination where it has determined that equipment is used solely for production, as opposed to pollution control.

In situations where the equipment is listed in § 11.31(k), it is not a foregone conclusion that the equipment will receive a positive use determination.⁷ The preamble to TCEQ's most recent rulemaking discusses the legislative changes to TTC § 11.31.

Previously,

"[TTC] § 11.31(k) did not provide the pollution control percentage for each of the 18 categories of equipment. Staff reviewed these items and determined that the pollution control percentage varies depending upon many different factors, including type of facility where the property is located and the function of the property...The inclusion of a piece of equipment in the Tier I Table or the table in § 17.17(b)⁸ or the assertion that a piece of equipment falls under a category set

⁴ TEX. TAX CODE § 11.31(d).

⁵ *Id.* at § 11.31(g)(3).

⁶ *Mont Belvieu Caverns LLC v. Texas Comm'n on Env'tl. Quality*, No. 03-11-00442-CV, 2012 WL 3155763, at *19 (Tex. App.-Austin, Aug. 3, 2012).

⁷ 35 Tex.Reg. 10964 (Dec. 10, 2010).

⁸ These lists include the 18 items listed in TTC § 11.31(k).

forth on either list does not mean that the equipment would receive a positive use determination in all circumstances.”⁹

Whether the equipment at issue is used partially for pollution control or solely production is, ultimately, an inquiry conducted by the ED’s technical staff with specific expertise in this area. The ED has concluded that “[HRSGs] are used solely for production; therefore, [they] are not eligible for a positive use determination.”¹⁰ OPIC also anticipates that the ED’s response brief will provide further explanation of this conclusion. At this time, without contrary compelling information showing that the ED was incorrect, OPIC defers to the ED’s conclusion.

3. TCEQ’s previous decisions on HRSGs.

Appellant argues that the TCEQ would be contradicting itself if it were to approve the ED’s negative use determination, because the TCEQ has issued positive use determinations for HRSGs in the past. This, Appellant argues, would amount to an arbitrary use of agency authority.

The issue of whether an administrative agency has acted arbitrarily and capriciously is a standard reserved generally for an appellate court’s review of an agency action. The Commission is not limited in its review of a use determination.¹¹ Therefore any discussion of the “arbitrary and capricious” nature of the ED’s use determination is premature. OPIC provides a brief discussion of this issue, though, as it may provide guidance for the Commission when determining whether to approve or deny the appeal

⁹ 35 Tex.Reg. 10964 (Dec. 10, 2010) (emphasis added).

¹⁰ Letter from Chance Goodin, Team Leader, Air Quality Division, TCEQ, to Greg Maxim, Director, Duff and Phelps, LLC (July 10, 2012).

¹¹ Chapter 17 provides no standard by which the Commission may review the ED’s use determination. It provides actions that the Commission may take upon evaluating a use determination appeal, but requires no deference to the ED’s use determination, as would be necessary were the Commission evaluating the ED’s use determination under an “arbitrary and capricious” standard of review.

of the ED's use determination, and because any appeal arising from the Commission's final action may be evaluated by reviewing courts as to whether the decision is arbitrary and capricious.

An administrative agency has acted arbitrarily and capriciously where it does not follow the clear, unambiguous language of its own regulation.¹² It also acts arbitrarily and capriciously if it fails to consider a factor that the Legislature has directed it to consider, considers an irrelevant factor, considers relevant factors but still reaches a completely unreasonable result, makes a decision without regard to facts, relies on findings not supported by evidence, or with rational connection between the facts and the decision.¹³

In addition, to determine an agency's proper exercise of its authority, "[s]tatutory exemptions from taxation," like the pollution-control exemption, "are subject to strict construction because they undermine equality and uniformity by placing a greater burden on some taxpaying businesses and individuals rather than placing the burden on all taxpayers equally."¹⁴ All doubts are resolved against granting an exemption.¹⁵

Although the Executive Director has changed its position on the issue of whether HRSGs offer pollution control, this does not necessarily mean that the Commission would be acting arbitrarily and capriciously by affirming the negative use determination. And the record on which a reviewing court would evaluate the arbitrary and capricious nature of TCEQ's action is not complete at this time.

¹²*Mont Belvieu*, 2012 WL 3155763, at *11 (quoting *Rodriguez v. Service Lloyds Ins. Co.*, 997 S.W.2d, 248, 245-55 (Tex. 1999)).

¹³*City of Waco v. Texas Comm'n on Env'tl. Quality*, 346 S.W.3d 781, 819 (Tex. App.—Austin 2011, pet. denied) (citing *City of El Paso v. Pub. Util. Comm'n*, 883 S.W.2d 179, 184 (Tex. 1994)).

¹⁴*Mont Belvieu*, 2012 WL 3155763, at *11 (quoting *N. Alamo Water Supply Corp. v. Willacy County Appraisal Dist*, 804 S.W.2d 894, 899 (Tex. 1991)).

¹⁵*Id.*

First, the ED's position on HRSGs has evolved over time. Initially the ED issued 100% positive use determinations for HRSGs filing Tier IV applications.^{16 17} However, in responding to several appraisal districts' appeals of these use determinations, the ED stated that it initially issued 100% use determinations for the first set of applications it adjudicated under the (then) new Tier IV application.¹⁸ Subsequently, the ED established through a workgroup that 61% would be more appropriate for HRSGs, to account for the production gain and increased efficiency associated with the installation of HRSGs at a combined cycle power plant.¹⁹

Before the Commission could consider the ED's position on this matter at the February 25, 2009 Agenda, the ED requested, in an uncontested brief, additional time to evaluate its recommendation. While the matter was on hold, the TCEQ promulgated rules abolishing the Tier IV application and establishing that items on the TTC § 11.31(k) list must use a new Tier III application, requiring the use of Cost Analysis Procedure (CAP) in § 17.17(c), instead of requiring the applicant to submit its own formula for determining the percentage of any equipment eligible for tax exemption.

Appellant applied for a use determination after these changes went into effect, though, using a Tier III application and proposing its own formula.²⁰ On July 10, 2012, the ED issued a negative use determination for the Appellant's HRSGs. The ED stated

¹⁶ See *Executive Director's Response Brief to Rusk County, Freestone, Central, Hutchinson County, Fort Bend Central, Brazoria County, and Wharton County Appraisal Districts' Appeals of the Executive Director's Use Determinations*, 2008-0830-MIS-U; 2008-0831-MIS-U; 2008-0832-MIS-U; 2008-0849-MIS-U; 2008-0850-MIS-U; 2008-0851-MIS-U, December 3, 2008 (hereinafter *ED's 2008 Consolidated Appeals Brief*).

¹⁷ These applications were filed under TCEQ rules implementing HB 3732, effective February 7, 2009. The Tier IV application process was later abolished by TCEQ's rulemaking implementing HB3206 and HB 3544. See 33 Tex.Reg 932 (Feb. 1, 2008); 35 Tex.Reg 10965 (Dec. 10, 2010).

¹⁸ *ED's 2008 Consolidated Appeals Brief*, at 9.

¹⁹ *ED's 2008 Consolidated Appeals Brief*, at 10.

²⁰ See F.N. 12 for a discussion of what statutes and rules apply to this application.

that HRSGs are used solely for production, and therefore not eligible for a positive use determination.

Appellant argues that the Commission cannot issue a negative use determination on this HRSG because the Commission has already issued several positive use determinations on similar equipment. OPIC again must defer to the review by the ED's technical staff with expertise in this area.

OPIC does note that the Commission is not bound by prior decisions, as a reviewing court would be.²¹ But an administrative agency may be called upon to "explain its reasoning when it appears...that an agency has departed from its earlier administrative policy or there exists an apparent inconsistency in agency determinations."²² An agency may also change its interpretation of a statutory tax scheme, as long as the new interpretation is not in conflict with a statute or formally promulgated rule.²³

The record is not complete at this time, and will not be complete until the Commissioners issue a final order. The appeals process, as laid out in 30 TEX. ADMIN. CODE Chapter 17, affords the opportunity for the ED to provide more information to the public on how it reached its determination, and for the Commissioners to consider this information before making a determination. The July 10, 2012 letter provides no information as to why the ED no longer considers HRSGs pollution control equipment and why the ED considers HRSGs purely production equipment and therefore ineligible for a positive or partial use determination. At this time, without contrary compelling information showing that the ED was incorrect, OPIC defers to the ED's conclusion.

²¹ *Flores v. Employees Ret. Sys. of Texas*, 74 S.W.3d 532, 544-45 (Tex. App.—Austin 2003, pet. denied) (quoting *City of El Paso v. El Paso Elec. Co.*, 851 S.W.2d 896, 900 (Tex.App.—Austin 1993, writ denied).

²² *Id.*

²³ *First Am. Title Ins., Co. v. Strayhorn*, 169 S.W.3d 298, 306 (Tex. App.—Austin 2005).

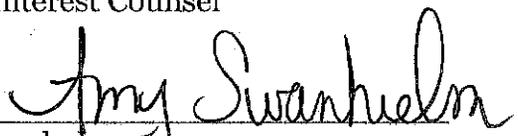
OPIC also anticipates that the ED's response brief will provide adequate explanation to allow the Commissioners to make a fully informed decision on the Appellant's use determination.

V. CONCLUSION AND RECOMMENDATION

For the above reasons, OPIC recommends the Commission affirm the ED's negative use determination.

Respectfully submitted,

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Public Interest Counsel

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CERTIFICATE OF SERVICE

I hereby certify that on October 4, 2012, the original and seven true and correct copies of the foregoing document were filed with the TCEQ Chief Clerk, and copies were served to all parties listed on the attached mailing list via hand delivery, facsimile transmission, inter-agency mail, or by deposit in the U.S. Mail.



Amy Swanholm

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TCEQ DOCKET NO. 2012-1648-MIS-U

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