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Blas J. Coy, Jr., *Public Interest Counsel*

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: MIDLOTHIAN ENERGY LIMITED PARTNERSHIP
TCEQ DOCKET NO. 2012-1650-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. 2012-1650-MIS-U

IN THE MATTER OF THE APPEAL	§	
BY MIDLOTHIAN ENERGY	§	BEFORE THE
LIMITED PARTNERSHIP OF	§	TEXAS COMMISSION ON
NEGATIVE USE DETERMINATION	§	ENVIRONMENTAL QUALITY
NO. 12271	§	

**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 Midlothian Energy Limited Partnership's (Midlothian or Appellant) appeal of the negative use determination issued by the Executive Director (ED).

I. INTRODUCTION

In April 2008, Midlothian Energy submitted a Tier IV use determination application to the Texas Commission on Environmental Quality (TCEQ). Midlothian Energy sought use determinations for six thermally efficient heat recovery steam generators (HRSG) and 12 enhanced steam turbines associated with electric power generation at the Midlothian Energy Plant in Venus, Ellis County, Texas. The facility utilizes combined-cycle technology to power combustion turbines. These turbines are routed to the heat recovery steam generators where the exhaust heat is converted to high pressure and temperature steam used to turn steam turbines and generate additional electricity. The appeal states that by utilizing both the gas and steam turbines

to generate electricity, less fuel is used per kilowatt of power produced, thereby reducing the emission of exhaust gases (NOx, SO2, etc.). As required with a Tier IV application, Midlothian Energy calculated the pollution control percentage of the equipment to form the basis of its request for a 100% tax exemption for the HRSGs and a 100% tax exemption for the steam turbines.

On July 10, 2012, the ED issued a negative use determination for Midlothian Energy's facility. The ED stated that HRSGs and steam turbines are used solely for production and are not considered pollution control equipment.

On August 2, 2012, Midlothian Energy appealed the ED's negative use determination for the six HRSG units and 12 steam turbines. Midlothian argues that the equipment at issue was not installed wholly to produce electricity, and is therefore eligible for a positive use determination. Midlothian also argues that in issuing the negative determination, the ED failed to comply with both the Texas Tax Code and TCEQ rules. Finally, Midlothian points to past positive use determinations in claiming that the decision was arbitrary, capricious, and inconsistent with past agency practice. Midlothian Energy requests the Commission overturn the negative use determination and grant 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, 2008 Amendments

For applications submitted to the TCEQ prior to January 1, 2009, applicable TCEQ rules concerning tax relief for property used for environmental protection are found in Title 30 of the Texas Administrative Code, Chapter 17, as amended to be effective February 7, 2008.

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.”¹

Chapter 17 contains a list of items (the Equipment and Categories List, or ECL), predetermined as used either wholly or partly for pollution control purposes.² The ECL contains two parts: “Part A is a list of the property that the executive director has determined is used either wholly or partly for pollution control purposes, [and] Part B is a list of categories of property which is located in Texas Tax Code (TTC), §11.31(k).”³ In addition, there are four 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 Part A of the Equipment and Categories List;

¹ 30 TEX. ADMIN. CODE § 17.4(a) (2008).

² *Id.* at § 17.14.

³ *Id.* at § 17.14(a).

- Tier II-An application for property that is used wholly for the control of air, water, and/or land pollution, but not on the Equipment and Categories List, located in §17.14(a);
- Tier III-An application for property used partially for the control of air, water, and/or land pollution but that is not included on the Equipment and Categories List, located in §17.14(a);
- Tier IV-An application containing only pollution control property which falls under a category located in Part B of the figure in §17.14(a).⁴

Section 17.15(a) and (b) provide Decision Flow Charts for making use determinations.

There are two Decision Flow Charts, one for non-Tier IV applications and one for those applications with just items from Part B of the ECL.⁵

In addition, a partial use determination “must be requested for all property that is either not on Part A of the ECL . . . or does not fully satisfy the requirements for a 100% positive use determination.”⁶ To calculate partial use for Tier IV applications, the cost analysis procedure in § 17.17(d) must be used.⁷ Section 17.17(d) states “[i]t is the responsibility of the applicant to propose a reasonable method for determining the use determination percentage. It is the responsibility of the ED to review the proposed method and make the final determination.”⁸

Under § 17.25, an appellant has 20 days to appeal a use determination issued by the ED.⁹ 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.”¹⁰ Should the Commission remand the use determination, the ED shall conduct a new technical review and issue a new use determination.^{11 12} This

⁴ *Id.* at § 17.2(13, 14, 15, 16).

⁵ *Id.* at § 17.15(a), (b).

⁶ *Id.* at § 17.17(a).

⁷ *Id.*

⁸ *Id.* at § 17.17(d).

⁹ *Id.* at § 17.25(a)(2)(A), (B), (b).

¹⁰ *Id.* at §17.25(d)(2).

¹¹ *Id.* at § 17.25 (e)(1)(A), (B).

determination may be appealed.¹³ If the Commission denies the appeal and affirms the use determination, this decision is final and appealable.¹⁴

C. 2010 Amendments to 30 TAC Chapter 17

The 81st Texas Legislature, Regular Session, 2009, passed House Bills 3206 and 3544, amending §11.31 of the Texas Tax Code by adding two new sections. On November 18, 2010, the TCEQ adopted changes to 30 Tex. Admin. Code Chapter 17 to incorporate the legislative changes.

The changes to 30 Tex. Admin. Code Chapter 17 abolished the Tier IV application, requiring that all use determination applications for property in Part B of the ECL now must calculate the partial determination percentage using the Cost Analysis Procedure (CAP)¹⁵ established by rule.¹⁶ Previously applicants submitted their own method for determining pollution control percentage. The Expedited Review List contains those items designated by the legislature as included in the TCEQ's nonexclusive list, which were previously in Part B of the ECL.¹⁷

¹² 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."¹² 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."¹² 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."¹² 35 Tex. Reg. 10965. See also Tex. H.B. 3206, 81st Leg., R.S. (2009).

Appellant submitted its application in April 2008, therefore HB 3206 and HB 3544 as well as the 2010 amendments to Chapter 17 abolishing Tier IV would not 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 IV application.

¹³ *Id.* at § 17.25(e)(2).

¹⁴ *Id.* at § 17.25(d)(3).

¹⁵ See *id.* at § 17.17(c).

¹⁶ *Id.* at §§ 17.10, 17.14, 17.17.

¹⁷ TEX. TAX CODE § 11.31(k).

These changes also included the addition of authority allowing the General Counsel to remand a matter set on Agenda to the ED, if requested by the ED or OPIC.¹⁸

III. TIMELINESS

Under § 17.25, an appellant has 20 days to appeal a use determination issued by the ED.¹⁹ 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 and stream generation units are "Production Equipment" was proper.

Appellant argues the ED's negative use determination is incorrect because it is inconsistent with the current classification of HRSGs and stream generation units in the Texas Tax Code and TCEQ rules. OPIC disagrees- the ED's action was permissible under applicable statutes and rules.

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

¹⁸ 30 TEX. ADMIN. CODE §17.25(d).

¹⁹ *Id.* at § 17.25(a)(2)(A), (b).

Property used solely for production purposes is not eligible for tax exemption under Tax Code § 11.31.²⁰ 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 pollution.²¹ 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.²²

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."²³

2. Statutory and regulatory classification of the equipment.

Appellant asserts that because HRSGs and steam generations units 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.

²⁰ 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).

²¹ TEX. TAX CODE § 11.31(d).

²² *Id.* at § 11.31(g)(3).

²³ *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).

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.²⁴ 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)²⁵ 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.**”²⁶

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] and steam turbines are used solely for production; therefore, [they] are not eligible for a positive use determination.”²⁷ 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

²⁴ 35 Tex.Reg. 10964 (Dec. 10, 2010).

²⁵ These lists include the 18 items listed in TTC § 11.31(k).

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

²⁷ Letter from Chance Goodin, Team Leader, Air Quality Division, TCEQ, to Greg Maxim, Director, Duff and Phelps, LLC (July 10, 2012).

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.²⁸ 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 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.²⁹ 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.³⁰

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

²⁸ 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.

²⁹*Mont Belvieu*, 2012 WL 3155763, at *11 (quoting *Rodriguez v. Service Lloyds Ins. Co.*, 997 S.W.2d, 248, 245–55 (Tex. 1999)).

³⁰*City of Waco v. Texas Comm'n on Envtl. 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)).

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.”³¹ All doubts are resolved against granting an exemption.³²

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.

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.^{33 34} 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.³⁵ Subsequently, the ED established through a workgroup that 61% would be more appropriate for HRSG’s, to account for the production gain and increased efficiency associated with the installation of HRSGs at a combined cycle power plant.³⁶

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

³¹ *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)).

³² *Id.*

³³ 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*).

³⁴ 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).

³⁵ *ED’s 2008 Consolidated Appeals Brief*, at 9.

³⁶ *ED’s 2008 Consolidated Appeals Brief*, at 10.

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 before these changes went into effect, though, using a Tier IV application and proposing its own formula.³⁷ On July 10, 2012, the ED issued a negative use determination for the Appellant's HRSGs. The ED stated 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.³⁸ 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."³⁹ 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.⁴⁰

³⁷ See F.N. 12 for a discussion of what statutes and rules apply to this application.

³⁸ *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).

³⁹ *Id.*

⁴⁰ *First Am. Title Ins., Co. v. Strayhorn*, 169 S.W.3d 298, 306 (Tex. App.—Austin 2005).

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 and steam turbines 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. 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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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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