

**TCEQ Docket Numbers**

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

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

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BEFORE THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

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CHIEF CLERKS OFFICE

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

**EXECUTIVE DIRECTOR'S RESPONSE BRIEF TO VALERO REFINING – TEXAS, L.P., DIAMOND SHAMROCK REFINING COMPANY, L.P., AND THE PREMCOR REFINING GROUP, INC.'S APPEAL OF THE EXECUTIVE DIRECTOR'S NEGATIVE USE DETERMINATIONS**

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 Use Determinations Issued to Valero Refining – Texas, L.P., Diamond Shamrock Refining Company, L.P., and the Premcor Refining Group, Inc. (hereinafter collectively referred to as Valero). The appeals were submitted by Parker Wilson on behalf of each of the companies. The affected county appraisal districts did not appeal the Executive Director's determinations.

For the reasons described below, the Executive Director respectfully requests that the Commission deny the instant appeals and affirm the Executive Director's negative use determinations.

**I.**

**PROGRAM BACKGROUND**

These appeals of the Executive Director's use determinations are filed pursuant to H.B. 3121 (77<sup>th</sup> Tex. Legislature, 2001) establishing an appeals process for use determinations and the

Commission rules implementing the legislation. See TEX. TAX CODE § 11.31 and 30 TEX. ADMIN. CODE § 17.25.

In 1993, the citizens of Texas voted to adopt a tax measure called Proposition 2 (Prop 2). Prop 2 was implemented when Article 8, § 1-1 was added to the Texas Constitution on November 2, 1993. The amendment allowed the legislature to “exempt from ad valorem taxation all or part of real and personal property used, constructed, acquired, or installed wholly or partly to meet or exceed rules or regulations adopted by any environmental protection agency of the United States, this state, or a political subdivision of this state for the prevention, monitoring, control, or reduction of air, water, or land pollution.”<sup>1</sup>

The Texas Legislature codified the constitutional amendment in 1993 as TEX. TAX CODE § 11.31 (effective January 1, 1994). The statutory language in the codified version mirrored the language of Article 8, § 1-1. The statute sets up a two-step process to obtain tax exemption for pollution control property. First, a person seeking tax exemption for pollution control property must obtain a positive use determination from the Executive Director that the property is used wholly or partly for pollution control. TEX. TAX CODE § 11.31(c) & (d). Second, once a person obtains a positive use determination from the Executive Director, the person then applies to the appraisal district where the property is located to receive the actual tax exemption. It is the performance of this second step by the chief appraiser that removes the property from the tax roll. TEX. TAX CODE § 11.31(i).

In 2001, the legislature amended Section 11.31 when it passed House Bill 3121 (effective September 1, 2001). This bill added several new procedural requirements to Section 11.31, including a provision requiring the establishment and implementation of a process to appeal use determinations. See TEX. TAX CODE § 11.31(e). The amendment authorized the Commission to adopt rules establishing specific standards for the Executive Director to follow in making use determinations for property that qualified for either full or partial determinations. See TEX. TAX CODE § 11.31(g).

Appeals under 30 TAC § 17.25<sup>2</sup> may be filed by either the applicant seeking the determination, or by the chief appraiser of the tax appraisal district affected by the determination. TEX. TAX CODE § 11.31(e); and 30 TEX. ADMIN. CODE § 17.25(a)(2). Appellant is required by 30 TEX. ADMIN. CODE § 17.25(b)(5) to explain the basis for the appeal. Under Section 11.31(i), “the chief appraiser shall accept a final determination by the executive director as conclusive evidence that the facility, device, or method is used wholly or partly as pollution control property.”

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<sup>1</sup> TEX. CONST. art. 8, § 1-1(a) (November 2, 2002).

<sup>2</sup> Unless otherwise specifically stated, all references to 30 TAC Chapter 17 refer to the rules as they existed prior to February 7, 2008.

## II.

### PROCEDURAL BACKGROUND

#### Valero Corpus Christi Refinery – Nueces County (Use Determination Number 06-10270)

On or about January 30, 2007, Valero Refining – Texas, L.P. filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) heat exchangers, (2) pumps, (3) compressors, (4) towers and reactors, (5) drums and vessels, (6) storage tanks, and (7) fired heaters. Valero stated that the devices were installed or retrofitted to comply with federally mandated gasoline desulfurization requirements under 40 C.F.R. §§ 80.190 – 80.415. On February 12, 2007, the application was declared to be administratively complete. The technical review of the application started on March 6, 2007.

On March 6, 2007, a notice of deficiency was forwarded to Valero advising Valero that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Valero to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

A copy of the March 6, 2007 notice of deficiency is attached to this pleading as **Executive Director's Exhibit 1**. Under 30 TEX. ADMIN. CODE § 17.12(2), Valero had 30 days to respond to the Executive Director's notice of deficiency. By correspondence dated April 2, 2007, Valero responded to the Executive Director's notice of deficiency. Valero failed to (1) heed the Executive Director's instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Valero insisted that the gasoline desulfurization project was intended to comply with federal environmental mandates. Valero stated that "Valero does not intend at this time to seek piecemeal use determinations for any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment." See **Executive Director's Exhibit 2**.

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a

negative use determination to Valero for the devices listed as part of its gasoline desulfurization project at the Corpus Christi Refinery. On May 8, 2007, Valero timely appealed the Executive Director's negative use determination.

Valero Corpus Christi Refinery – Nueces County (Use Determination Number 06-10271)

On or about January 30, 2007, Valero Refining – Texas, L.P. filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) towers and reactors, (2) heat exchangers, (3) pumps, (4) compressors, (5) drums and vessels, (6) tanks, and (7) heaters. Valero stated that the devices were installed or retrofitted to comply with federally mandated ultra low sulfur diesel requirements under 40 C.F.R. §§ 80.500 – 80.620. On February 12, 2007, the application was declared to be administratively complete. The technical review of the application started on March 6, 2007.

On March 6, 2007, a notice of deficiency was forwarded to Valero advising Valero that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Valero to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director's Exhibit 1.** Under 30 TEX. ADMIN. CODE § 17.12(2), Valero had 30 days to respond to the Executive Director's notice of deficiency. By correspondence dated April 2, 2007, Valero responded to the Executive Director's notice of deficiency. Valero failed to (1) heed the Executive Director's instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Valero insisted that the ultra low sulfur diesel project was intended to comply with federal environmental mandates. Valero stated that "Valero does not intend at this time to seek piecemeal use determinations for any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment."<sup>3</sup>

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Valero for the devices listed as part of its ultra low sulfur diesel

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<sup>3</sup> See **Executive Director's Exhibit 2.**

project at the Corpus Christi Refinery. On May 8, 2007, Valero timely appealed the Executive Director's negative use determination.

Valero Houston Refinery – Harris County (Use Determination Number 06-10281)

On or about January 30, 2007, Valero Refining – Texas, L.P. filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) new stabilizer, (2) exchangers/air coolers/pumps, (3) hydrogen compressors, (4) SHU reactors, (5) vessels/reactors/heaters, and (6) FCC main fractionator modifications. Valero stated that the devices were installed or retrofitted to comply with federally mandated gasoline desulfurization requirements under 40 C.F.R. §§ 80.190 – 80.415. On February 13, 2007, the application was declared to be administratively complete. The technical review of the application started on March 6, 2007.

On March 6, 2007, a notice of deficiency was forwarded to Valero advising Valero that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Valero to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director's Exhibit 1**. Under 30 TEX. ADMIN. CODE § 17.12(2), Valero had 30 days to respond to the Executive Director's notice of deficiency. By correspondence dated April 2, 2007, Valero responded to the Executive Director's notice of deficiency. Valero failed to (1) heed the Executive Director's instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Valero insisted that the gasoline desulfurization project was intended to comply with federal environmental mandates. Valero stated that "Valero does not intend at this time to seek piecemeal use determinations for any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment."<sup>4</sup>

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Valero for the devices listed as part of its gasoline desulfurization

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<sup>4</sup> See **Executive Director's Exhibit 2**.

project at the Houston Refinery. On May 8, 2007, Valero timely appealed the Executive Director's negative use determination.

Use Determination Number 06-10268 (Valero Houston Refinery – Harris County)

On or about January 30, 2007, Valero Refining – Texas, L.P. filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following pieces of equipment: (1) 2 new parallel reactors, (2) heat exchangers, (3) pumps, (4) SAT gas plant, (5) cooling towers, and (6) hydrogen compressors. Valero stated that the devices were installed or retrofitted to comply with federally mandated ultra low sulfur diesel requirements under 40 C.F.R. §§ 80.500 – 80.620. On February 12, 2007, the application was declared to be administratively complete. The technical review of the application started on March 6, 2007.

On March 6, 2007, a notice of deficiency was forwarded to Valero advising Valero that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Valero to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director's Exhibit 1**. Under 30 TEX. ADMIN. CODE § 17.12(2), Valero had 30 days to respond to the Executive Director's notice of deficiency. By correspondence dated April 2, 2007, Valero responded to the Executive Director's notice of deficiency. Valero failed to (1) heed the Executive Director's instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Valero insisted that the ultra low sulfur diesel project was intended to comply with federal environmental mandates. Valero stated that "Valero does not intend at this time to seek piecemeal use determinations for any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment."<sup>5</sup>

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Valero for the devices listed as part of its ultra low sulfur diesel

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<sup>5</sup> See **Executive Director's Exhibit 2**.

project at the Houston Refinery. On May 8, 2007, Valero timely appealed the Executive Director's negative use determination.

Diamond Shamrock McKee Refinery – Moore County (Use Determination Number 06-10283)

On or about January 30, 2007, Diamond Shamrock Refining Company, L.P. (a Subsidiary of Valero Energy Corporation) filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) CDHDS Tower, (2) polishing reactor, (3) modified hydro column, (4) storage tanks, (5) heaters, (6) vessels, (7) cooling tower, (8) modified reboiler, (9) compressor, and (10) exchangers. Diamond Shamrock stated that the devices were installed or retrofitted to comply with federally mandated gasoline desulfurization requirements under 40 C.F.R. §§ 80.190 – 80.415. On February 13, 2007, the application was declared to be administratively complete. The technical review of the application started on March 6, 2007.

On March 6, 2007, a notice of deficiency was forwarded to Diamond Shamrock advising Diamond Shamrock that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Diamond Shamrock to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director's Exhibit 1.** Under 30 TEX. ADMIN. CODE § 17.12(2), Diamond Shamrock had 30 days to respond to the Executive Director's notice of deficiency. By correspondence dated April 2, 2007, Diamond Shamrock responded to the Executive Director's notice of deficiency. Diamond Shamrock failed to (1) heed the Executive Director's instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Diamond Shamrock insisted that the gasoline desulfurization project was intended to comply with federal environmental mandates. Diamond Shamrock stated that "Valero does not intend at this time to seek piecemeal use determinations for any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment."<sup>6</sup>

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<sup>6</sup> See **Executive Director's Exhibit 2.**

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Diamond Shamrock for devices listed as part of its gasoline desulfurization project at the McKee Refinery. On May 8, 2007, Diamond Shamrock timely appealed the Executive Director's negative use determination.

Diamond Shamrock McKee Refinery – Moore County (Use Determination Number 06-10282)

On or about January 30, 2007, Diamond Shamrock Refining Company, L.P. (a Subsidiary of Valero Energy Corporation) filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) additional reactor, (2) hydrogen compressor, (3) compressor, (4) amine absorbers, (5) heat exchangers, (6) pumps, (7) chloride absorber, (8) low Nox burners, (9) cooling, and (10) modified reactor exchangers. Diamond Shamrock stated that the devices were installed or retrofitted to comply with federally mandated ultra low sulfur diesel requirements under 40 C.F.R. §§ 80.500 – 80.620. On February 13, 2007, the application was declared to be administratively complete. The technical review of the application started on March 6, 2007.

On March 6, 2007, a notice of deficiency was forwarded to Diamond Shamrock advising Diamond Shamrock that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Diamond Shamrock to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director's Exhibit 1**. Under 30 TEX. ADMIN. CODE § 17.12(2), Diamond Shamrock had 30 days to respond to the Executive Director's notice of deficiency. By correspondence dated April 2, 2007, Diamond Shamrock responded to the Executive Director's notice of deficiency. Diamond Shamrock failed to (1) heed the Executive Director's instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Diamond Shamrock insisted that the ultra low sulfur diesel project was intended to comply with federal environmental mandates. Diamond Shamrock stated that "Valero does not intend at this time to seek piecemeal use determinations for any component

parts of these projects that standing alone would qualify for pollution control tax exempt treatment.”<sup>7</sup>

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Diamond Shamrock for the devices listed as part of its ultra low sulfur diesel project at the McKee Refinery. On May 8, 2007, Diamond Shamrock timely appealed the Executive Director’s negative use determination.

Premcor Port Arthur Refinery – Jefferson County (Use Determination Number 06-10280)

On or about January 30, 2007, The Premcor Refining Group, Inc. (a Subsidiary of Valero Energy Corporation) filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) GFU – 245; (2) GFU – 242 modifications, (3) cooling, (4) flare; (5) treater upgrade, (6) demo and site clearance, and (7) DSBL. Premcor stated that the devices were installed or retrofitted to comply with federally mandated gasoline desulfurization requirements under 40 C.F.R. §§ 80.190 – 80.415. On February 13, 2007, the application was declared to be administratively complete.

On March 6, 2007, a notice of deficiency was forwarded to Premcor advising Premcor that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Premcor to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director’s Exhibit 1**. Under 30 TEX. ADMIN. CODE § 17.12(2), Premcor had 30 days to respond to the Executive Director’s notice of deficiency. By correspondence dated April 2, 2007, Premcor responded to the Executive Director’s notice of deficiency. Premcor failed to (1) heed the Executive Director’s instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Premcor insisted that the gasoline desulfurization project was intended to comply with federal environmental mandates. Premcor stated that “Valero does not intend at this time to seek piecemeal use determinations for

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<sup>7</sup> See **Executive Director’s Exhibit 2**.

any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment.”<sup>8</sup>

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Premcor for the devices listed as part of its gasoline desulfurization project at the Port Arthur Refinery. On May 8, 2007, Premcor timely appealed the Executive Director’s negative use determination.

Premcor Port Arthur Refinery – Jefferson County (Use Determination Number 06-10279)

On or about January 30, 2007, The Premcor Refining Group, Inc. (a Subsidiary of Valero Energy Corporation) filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) SRU desulfurization unit revamp, (2) SWS desulfurization unit revamp, (3) ATU - 7842, (4) GFU – 241, (5) GFU – 243, (6) DHT – 246, and (7) utilities and offsites. Premcor stated that the devices were installed or retrofitted to comply with federally mandated ultra low sulfur diesel requirements under 40 C.F.R. §§ 80.190 – 80.415. On February 12, 2007, the application was declared to be administratively complete.

On March 6, 2007, a notice of deficiency was forwarded to Premcor advising Premcor that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Premcor to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director’s Exhibit 1.** Under 30 TEX. ADMIN. CODE § 17.12(2), Premcor had 30 days to respond to the Executive Director’s notice of deficiency. By correspondence dated April 2, 2007, Premcor responded to the Executive Director’s notice of deficiency. Premcor failed to (1) heed the Executive Director’s instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Premcor insisted that the ultra low sulfur diesel project was intended to comply with federal environmental mandates. Premcor stated that “Valero does not intend at this time to seek piecemeal use determinations for

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<sup>8</sup> See **Executive Director’s Exhibit 2.**

any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment.”<sup>9</sup>

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Premcor for the devices listed as part of its ultra low diesel sulfur project at the Port Arthur Refinery. On May 8, 2007, Premcor timely appealed the Executive Director’s negative use determination.

Valero Texas City Refinery – Galveston County (Use Determination Number 06-10284)

On or about January 30, 2007, Valero Refining – Texas, L.P. filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) heater and stack, (2) blend pumps, (3) blend loop, (4) meters/valves, (5) reformer gas compressor, (6) 2 hydrogen recycle compressors, (7) booster compressor, and (8) amine scrubber. Valero stated that the devices were installed or retrofitted to comply with federally mandated gasoline desulfurization requirements under 40 C.F.R. §§ 80.190 – 80.415. On February 13, 2007, the application was declared to be administratively complete. The technical review of the application started on March 6, 2007.

On March 6, 2007, a notice of deficiency was forwarded to Valero advising Valero that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Valero to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director’s Exhibit 1**. Under 30 TAC § 17.12(2), Valero had 30 days to respond to the Executive Director’s notice of deficiency. By correspondence dated April 2, 2007, Valero responded to the Executive Director’s notice of deficiency. Valero failed to (1) heed the Executive Director’s instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Valero insisted that the gasoline desulfurization project was intended to comply with federal environmental mandates. Valero stated that “Valero does not intend at this time to seek piecemeal use determinations for any

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<sup>9</sup> See **Executive Director’s Exhibit 2**.

component parts of these projects that standing alone would qualify for pollution control tax exempt treatment.”<sup>10</sup>

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Valero for the devices listed as part of its gasoline desulfurization project at the Texas City Refinery. On May 8, 2007, Valero timely appealed the Executive Director’s negative use determination.

Valero Texas City Refinery – Galveston County (Use Determination Number 06-10285)

On or about January 30, 2007, Valero Refining – Texas, L.P. filed a Tier II application with the Executive Director, seeking a use determination under Section 11.31 of the Texas Tax Code for the following devices: (1) two bed reactors, (2) exchangers, (3) replacement convection section, (4) air cooler, (5) pumps, (6) compressors, (7) tankage, and (8) large piping. Valero stated that the devices were installed or retrofitted to comply with federally mandated ultra low sulfur diesel requirements under 40 C.F.R. §§ 80.500 – 80.620. On February 13, 2007, the application was declared to be administratively complete. The technical review of the application started on March 6, 2007.

On March 6, 2007, a notice of deficiency was forwarded to Valero advising Valero that it failed to demonstrate that installation of the devices would result in environmental benefit at the site. The Executive Director requested additional information on this issue and directed Valero to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

See **Executive Director’s Exhibit 1.** Under 30 TEX. ADMIN. CODE § 17.12(2), Valero had 30 days to respond to the Executive Director’s notice of deficiency. By correspondence dated April 2, 2007, Valero responded to the Executive Director’s notice of deficiency. Valero failed to (1) heed the Executive Director’s instructions and (2) produce the additional information, explanations, and calculations requested by the Executive Director. Valero insisted that the ultra low sulfur diesel project was intended to comply with federal environmental mandates. Valero stated that “Valero does not intend at this time to seek piecemeal use determinations for any

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<sup>10</sup> See **Executive Director’s Exhibit 2.**

component parts of these projects that standing alone would qualify for pollution control tax exempt treatment.”<sup>11</sup>

On April 13, 2007, the Executive Director completed the technical review of the application without the requested additional information. On April 18, 2007, the Executive Director issued a negative use determination to Valero for the devices listed as part of its ultra low sulfur diesel project at the Texas City Refinery. On May 8, 2007, Valero timely appealed the Executive Director’s negative use determination.

### III.

#### **THE NATURE OF VALERO’S ALLEGED POLLUTION CONTROL PROJECTS**

Valero filed ten use determination applications for five of its refineries. Five of the applications involve gasoline desulfurization projects while the other five involve ultra low sulfur diesel projects. Both projects involve the removal of sulfur from feedstock through the process of catalytic hydrotreating.<sup>12</sup> The following excerpts describe the process of removing sulfur from feedstock through hydrotreating:

“Catalytic hydrotreating is a hydrogenation process used to remove about 90% of contaminants such as nitrogen, sulfur, oxygen, and metals from liquid petroleum fractions. These contaminants, if not removed from the petroleum fractions as they travel through the refinery processing units, can have detrimental effects on the equipment, the catalysts, and the quality of the finished product. Typically, hydrotreating is done prior to processes such as catalytic reforming so that the catalyst is not contaminated by untreated feedstock. Hydrotreating is also used prior to catalytic cracking to reduce sulfur and improve product yields, and to upgrade middle-distillate petroleum fractions into finished kerosene, diesel fuel, and heating fuel oils. In addition, hydrotreating converts olefins and aromatics to saturated compounds.”<sup>13</sup>

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<sup>11</sup> See **Executive Director’s Exhibit 2.**

<sup>12</sup> There are other methods used “to chemically remove sulfur from hydrocarbon compounds which comprise diesel fuel. This is usually accomplished through catalyzed reaction with hydrogen at moderate to high temperature. A couple of specific examples of this process are hydrotreating and hydrocracking. A modified version of hydrotreating which operates solely in the liquid state was announced recently. Another process was announced recently which uses a moving bed catalyst to both remove and adsorb the sulfur using hydrogen at moderate temperature and pressure. There are other low temperature and pressure processes being developed which don’t rely on hydrotreating, such as biodesulfurization, and chemical oxidation. Sulfur can be removed via these processes up front in the refinery, such as from crude oil, before being processed in the refinery into diesel fuel. Or, sulfur can be removed from those refinery streams which are to be blended directly into diesel fuel. Finally, another method to moderately reduce sulfur is to shift sulfur-containing hydrocarbon compounds to other fuels produced by the refinery.” See “Draft Regulatory Impact Analysis: Control of Emissions from Nonroad Diesel Engines; Chapter 5: Fuel Standard Feasibility,” EPA420-R-03-008 (April 2003).

<sup>13</sup> “Petroleum Refining Processes,” OSHA Technical Manual, Section IV: Chapter 2. Available via [http://www.osha.gov/dts/osta/otm/otm\\_iv/otm\\_iv\\_2.html](http://www.osha.gov/dts/osta/otm/otm_iv/otm_iv_2.html). Last viewed, February 22, 2008.

“Hydrotreating for sulfur removal is called hydrodesulfurization. In a typical catalytic hydrodesulfurization unit, the feedstock is deaerated and mixed with hydrogen, preheated in a fired heater (600°-800° F) and then charged under pressure (up to 1,000 psi) through a fixed-bed catalytic reactor. In the reactor, the sulfur and nitrogen compounds in the feedstock are converted into H<sub>2</sub>S and NH<sub>3</sub>. The reaction products leave the reactor and after cooling to a low temperature enter a liquid/gas separator. The hydrogen-rich gas from the high-pressure separation is recycled to combine with the feedstock, and the low-pressure gas stream rich in H<sub>2</sub>S is sent to a gas treating unit where H<sub>2</sub>S is removed. The clean gas is then suitable as fuel for the refinery furnaces. The liquid stream is the product from hydrotreating and is normally sent to a stripping column for removal of H<sub>2</sub>S and other undesirable components. In cases where steam is used for stripping, the product is sent to a vacuum drier for removal of water. Hydrodesulfurized products are blended or used as catalytic reforming feedstock.”<sup>14</sup>

Valero claims it was required to embark on the gasoline hydrodesulfurization and ultra low sulfur diesel projects to meet or exceed EPA fuel additives regulations contained in Title 40, Code of Federal Regulations, Part 80, Subparts H and I. Whether or not Valero is meeting or exceeding federal environmental regulation is not at issue in this case.

The primary issue is whether or not the pieces of equipment listed as part of both projects are production properties. The refinery manufacturing process and product specification require Valero to reduce the sulfur content in its refined gasoline and diesel fuels. In addition to high quality finished product, improved product yield, and protection of refinery equipment, one significant reason for eliminating sulfur from a petroleum refinery naphtha streams is that sulfur, even in very low concentrations, destroys the catalysts in the catalytic reforming units that are used to upgrade the octane rating of the naphtha streams.<sup>15</sup> For example, refineries currently producing highway diesel fuel which must meet a 500 ppm cap standard hydrotreat their distillate to remove much of the sulfur present and improve the cetane.<sup>16</sup> Additionally, production of elemental sulfur is a byproduct of hydrodesulfurization process.<sup>17</sup> The H<sub>2</sub>S that is

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<sup>14</sup> Id. See “Draft Regulatory Impact Analysis: Control of Emissions from Nonroad Diesel Engines; Chapter 5: Fuel Standard Feasibility,” EPA420-R-03-008 (April 2003) for additional process description.

<sup>15</sup> Id. See also, “Petroleum Refining Processes,” OSHA Technical Manual, Section IV: Chapter 2. Available via [http://www.osha.gov/dts/osta/otm/otm\\_iv/otm\\_iv\\_2.html](http://www.osha.gov/dts/osta/otm/otm_iv/otm_iv_2.html). Last viewed, February 22, 2008.

<sup>16</sup> Id.

<sup>17</sup> Id. “In 2005, elemental sulfur and byproduct sulfuric acid were produced at 115 operations in 29 states and the U.S. Virgin Islands. Total shipments were valued at about \$400 million. Elemental sulfur production was 8.8 million tons; Louisiana and Texas accounted for about 45% of domestic production. Elemental sulfur was recovered at petroleum refineries, natural-gas-processing plants, and coking plants by 38 companies at 109 plants in 26 States and the U.S. Virgin Islands. . . . Domestic elemental sulfur production provided 66% of domestic consumption . . .” See Joyce A. Ober, U.S. Geological Survey, Mineral Commodity Summaries (January 2006). Available online at <http://minerals.usgs.gov/minerals/pubs/commodity/sulfur/sulfumcs06.pdf>.

extracted from the hydrodesulfurization process is reduced to elemental sulfur in a sulfur recovery unit (SRU). The SRU which is considered to be the H<sub>2</sub>S control device is given only a partial determination because it produces sulfur as a marketable byproduct. Valero is a major producer of elemental sulfur in the United States.<sup>18</sup> Elemental sulfur is a marketable product used for the manufacturing of sulfuric acid, agricultural chemicals and fertilizers, petroleum refining, and metal mining.<sup>19</sup>

#### IV.

#### APPELLANTS' CLAIMS

Appellants, Valero Refining – Texas, L.P., Diamond Shamrock Refining Company, L.P., and The Premcor Refining Group, Inc. (hereinafter collectively referred to as Valero) contend that they are not required to demonstrate that installation of the devices involved in the respective appeals will result in environmental benefit at the site under Section 11.31 of the Texas Tax Code to be eligible for pollution tax exemption. This position misconstrues the statute and fails to acknowledge the Commission rules promulgated to implement the relevant sections of TEX. TAX CODE § 11.31.

#### V.

#### SUMMARY OF THE EXECUTIVE DIRECTOR'S LEGAL POSITION

1. The properties, devices, and installations involved in this case are not used solely for the control of air, water, or land pollution. Valero refused to comply with Section 11.31(c) of the Texas Tax Code and Section 17.17 of the Commission rules by refusing to furnish the Executive Director information necessary to make a partial determination as required by the statutes and regulations. A byproduct of the desulfurization process is the production of elemental sulfur. Valero failed to use the cost analysis procedure even at the urging of the Executive Director in order to accurately make a partial use determination.
2. Valero's appeals must be denied because a person is not entitled to tax exemption for pollution control property solely on the basis that the person manufactures or produces a product that prevents, controls, or reduces air, water, or land pollution.
3. The Executive Director's determinations should be affirmed because the properties, devices, and installations involved in the respective appeals do not provide environmental benefit at the site as required by 30 TEX. ADMIN. CODE § 17.15. The environmental benefit associated with gasoline desulfurization and ultra low sulfur diesel occurs offsite wherever the end user burns the fuel. Removal of additional sulfur from the product

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<sup>18</sup> Valero produces approximately 440 "thousands of long tons of elemental sulfur, excluding values produced or reclaimed in the form of sulfuric acid, hydrogen sulfide, or pyrites" from at least 9 locations in the United States. See Chemical Profiles at <http://www.the-innovation-group.com/chemprofile.htm> or at <http://www.the-innovation-group.com/chemprofiles/sulfur.htm>.

<sup>19</sup> Id. See U.S. Geological Survey, Mineral Commodity Summaries (January 2006). Available via <http://minerals.usgs.gov/minerals/pubs/commodity/sulfur/sulfumcs06.pdf>.

stream will result in a net increase in sulfur dioxide (SO<sub>2</sub>) emissions at the site because it is not possible to obtain 100% efficiency from control equipment. Any amount of sulfur removed from the product stream that is not converted into H<sub>2</sub>S and recovered through the SRU will result in the emission of SO<sub>2</sub> at the site.

4. The Executive Director's negative use determination should be affirmed because Valero failed to comply with 30 TEX. ADMIN. CODE § 17.12(2)(A) & (B) authorizing the Executive Director to issue notice of deficiencies and requiring an applicant to provide adequate response to the Executive Director's notice of deficiencies. TEX. TAX CODE §11.31(c) and (g).

5. The Executive Director's Use Determinations should be affirmed because they were issued in accordance with the Commission's decision and guidance provided in the XTO Energy case involving the extraction of hydrogen sulfide from natural gas. (Docket No. 2005-1008-AIR-U/Use Determination No. 04-8353, September 28, 2005).

## VI.

### LEGAL ANALYSIS

- 1. The properties, devices, and installations involved in this case are not used solely for the control of air, water, or land pollution. Valero refused to comply with Section 11.31(c) of the Texas Tax Code and Section 17.17 of the Commission rules by refusing to furnish the Executive Director information necessary to make a partial determination as required by the statutes and regulations. A necessary byproduct of the desulfurization process is the production of elemental sulfur. Valero failed to use the cost analysis procedure even at the urging of the Executive Director in order to accurately make a partial use determination.**

The pre-requisite for obtaining a tax exemption for pollution control property is that the equipment must be installed to control air, water, or land pollution. Article 8, § 1-1(a) of the Texas Constitution states that "the legislature may exempt from ad valorem taxation all or part of real and personal property used, constructed, acquired, or installed wholly or partly to meet or exceed rules or regulations adopted by any environmental protection agency of the United States, this state, or a political subdivision of this state for the prevention, monitoring, control, or reduction of air, water, or land pollution."

Section 11.31(a) of the Texas Tax Code mirrors this constitutional pledge by stating that a "person is entitled to an exemption from taxation of all or part of real and personal property that the person owns and that is used wholly or partly as a facility, device, or method for the control of air, water, or land pollution." Section 11.31(b) defines facility, device, or method for the control of air, water, or land pollution as "... any structure, building, installation, excavation, machinery, equipment, or device, and any attachment or addition to or reconstruction, replacement, or improvement of that property, that is used, constructed, acquired, or installed

wholly or partly to meet or exceed rules or regulations adopted by any environmental protection agency of the United States, this state, or a political subdivision of this state for the prevention, monitoring, control, or reduction of air, water, or land pollution.”

Section 17.4(a) of the Commission rules states that for an applicant 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.”

Section 11.31(d) authorizes the Executive Director to determine whether a piece of equipment is used wholly or partly to control air, water, or land pollution. Under Section 17.17(a), a “partial determination must be requested for all property that is not on the predetermined equipment list and that is not wholly used for pollution control. In order to calculate a partial determination the cost analysis procedure” must be used (emphasis added). A “pollution-reducing production equipment, property that serves both a production and a pollution-reducing purpose, is not entitled to a tax exemption on the total value of the property.” Texas Attorney General Opinion No. JC-0372. The owner of a production property that does not control air, water, or land pollution is not entitled to receive pollution tax exemption. If a property generates a marketable byproduct, the applicant for a use determination must use the equation contained in Section 17.17(c) to calculate the net present value of the by product which is then used to reduce the partial determination.<sup>20</sup>

Desulfurization equipment such as hydrotreater or hydrocracker are production properties not included in the predetermined equipment list for which Valero is required by rules to request a partial determination. In this case, Valero did not request a partial determination; when directed to do so by the Executive Director, Valero failed to comply; Valero did not use the cost analysis procedure as required by Commission rules, 30 TAC § 17.17(a); Valero did not take into account the fact that the devices involved in the respective appeals generate a marketable byproduct; and Valero failed to calculate the net present value of the byproduct (elemental sulfur) as required by 30 TAC § 17.17(c). The regulations require Valero to request a partial determination for the properties associated with its desulfurization projects. Valero refused to request a partial determination as required by the regulations even at the urging of the Executive Director.<sup>21</sup> Valero’s appeals must necessarily be denied for failure to fulfill its statutory and regulatory obligations.

Valero failed to acknowledge that the properties involved in the respective appeals are production properties used to refine crude oil and naphtha streams to produce gasoline and diesel

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<sup>20</sup> “For property that generates a marketable byproduct (BP), the net present value of the BP is used to reduce the partial determination. The value of the BP is calculated by subtracting the transportation and storage of the BP from the market value of the BP. This value is then used to calculate the net present value (NPV) of the BP over the lifetime of the equipment.” 30 TAC § 17.17(c). The equation for calculating byproduct is attached as a graph to Section 17.17(c).

<sup>21</sup> See March 6, 2007 notice of deficiency issued to Valero by the Executive Director attached herein as **ED’s Exhibit 1** and incorporated by reference as if fully set forth.

fuels. In applying the constitutional mandate, the statutory directives and the Commission rules, the Executive Director, with very limited exceptions, determined that the properties associated with Valero's gasoline hydrodesulfurization and ultra low sulfur diesel projects are production properties. The properties were not installed to prevent or control air, water, or land pollution. The following is a discussion of the properties associated with each project:

Houston Refinery Ultra Low Sulfur Diesel Project (Use Determination No. 06-10268)

The properties listed for this project in the application consists primarily of a new co-processing hydrotreating/hydrocracking unit manufactured by UOP (A Honeywell Company). The unit is used to process refinery crude – not just to lower the sulfur content of gasoline or diesel that has already been refined. The unit allowed the processing of higher sulfur crude oil by increasing sulfur removal capability. The process description for gasoline desulfurization located on UOP's website states that: “[UOP's] unique multi-technology approach not only enables you to desulfurize FCC naphtha and control product octane, but it offers the potential to improve feedstock and product flexibility, increase on stream efficiencies, reduce operating costs and enhance product blending capabilities.”<sup>22</sup> This statement by the manufacturer of the hydrotreater/hydrocracker unit highlights the non-pollution control aspects of this equipment.

The hydrotreating project includes the installation of two parallel reactors with associated equipment and a new sulfur recovery unit. The sulfur recovery unit was not claimed in the application. The hydrotreater is used to remove sulfur from the product streams and as such is considered to be process equipment. Removal of sulfur from process streams is not pollution control because the sulfur can remain in the product and will not cause a condition of air pollution until the product is sold and burned as fuel. Removal of sulfur is a necessary production requirement in the crude refining business. Sulfur removal improves the quality of the product, and protects Valero's process equipment from contamination, corrosion, and other damages. “Upgrading . . . heavy refinery streams to highway diesel fuel improves the stream's market price by 10 – 30 c/gal.”<sup>23</sup> After the sulfur is removed from the process stream as H<sub>2</sub>S, further treatment of the H<sub>2</sub>S is considered to be pollution control because it prevents emissions of H<sub>2</sub>S into the atmosphere. Valero however did not furnish sufficient information for the Executive Director to make a partial determination on the H<sub>2</sub>S removal.

The equipment list also includes heat exchangers, pumps, SAT gas plant, cooling towers, and hydrogen compressors. Cooling towers are not pollution control properties. Cooling towers are specifically excluded as pollution control properties in the predetermined equipment list.<sup>24</sup> The gas plant is eligible for a partial use determination, but Valero refused to request a partial determination for this equipment. The remaining items on the list are part of the hydrotreater which is considered to be production/process equipment.

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<sup>22</sup> UOP, A Honeywell Company, Refining, Gasoline Desulfurization, available via [http://www.uop.com/refining/1061\\_1.html](http://www.uop.com/refining/1061_1.html). Last viewed, February 22, 2008.

<sup>23</sup> See “Draft Regulatory Impact Analysis: Control of Emissions from Nonroad Diesel Engines; Chapter 5: Fuel Standard Feasibility, P. 5-8, n. c,” EPA420-R-03-008 (April 2003).

<sup>24</sup> See TCEQ Property Tax Exemptions for Pollution Control Property, Draft Guidelines Document for Preparation of Use Determination applications, Predetermined Equipment List, P A-7, No. W-58 (October, 2006).

### Houston Refinery Gasoline Desulfurization Project (Use Determination No. 06-10281)

This project revamps "B" & "D" unifiners and the FCCU fractionator at Valero's Houston refinery. Unifiner is a trade name for hydrodesulfurization. The application does not specify what the raw feed is, but it would typically be naphtha from the crude distillation unit. Knowing the feedstock is important as this will show the stage in the manufacturing process where sulfur is being removed and the purpose of the sulfur removal. The list of equipment includes 2 hydrogen recycle compressors for "D" unifiner and an amine treating section for "A" unifiner. Note that the reference to "A" unifiner in the application is an oddity since Valero claims to be revamping "B" & "D" unifiners. There seems to be an error in specifying the correct units. The other equipment listed includes three reactors, a preheater, feed pumps, coolers, an amine absorber, piping, a hydrodesulfurization (HDS) reactor, selective hydrogenation, several heat exchangers, knockout drum, reciprocating recycle gas compressors, FCC fractionator and depentanizer towers, and a new S.H.U reactor (Valero did not provide a description for the S.H.U reactor and the Executive Director is reluctant to guess what the acronym S.H.U means). The devices listed as part of this project are not pollution control properties. None of the equipment is included in the predetermined equipment list. They are process devices used in the refinery process to produce gasoline. The manufacturing process requires Valero to remove at least 90% of the sulfur in the feedstock to "improve product yields . . . upgrade middle-distillate petroleum fractions into finished kerosene, diesel fuel, and heating oil," and to protect refinery equipment, catalysts and noble gases.<sup>25</sup> Profitability is an additional incentive for desulfurization or sulfur removal.<sup>26</sup>

### Corpus Christi Refinery Gasoline Desulfurization Project (Use Determination No. 06-10270)

This project involves the installation of a naphtha splitter, amine absorber and stripper, drums, reboilers, pumps, compressors, etc. for feed stream distillation. It also includes a new control system with logic controllers, a high pressure protection system, new power substation, and new power supplies. The installations appear to treat sulfur contained in raw feed stream rather than sulfur in previously refined gasoline. None of this equipment would be eligible separately as pollution control property. The naphtha splitter is production equipment which separates the light and heavy naphtha streams for further processing to produce refined gasoline. The Commission has previously ruled that amine absorbers are not pollution control properties. The absorber removes H<sub>2</sub>S from product streams which improves the quality of the product. However, once the H<sub>2</sub>S is removed, further processing to convert to elemental sulfur in an SRU or combustion in a flare is considered to be pollution control because they prevent H<sub>2</sub>S emissions into the atmosphere. None of the property contained on the equipment list would be considered to be pollution control property. They are process and production equipment.

### Corpus Christi Refinery Ultra Low Sulfur Diesel Project (Use Determination No. 06-10271)

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<sup>25</sup> See "Petroleum Refining Processes," OSHA Technical Manual, Section IV: Chapter 2. Available via [http://www.osha.gov/dts/osta/otm/otm\\_iv/otm\\_iv\\_2.html](http://www.osha.gov/dts/osta/otm/otm_iv/otm_iv_2.html). Last viewed, February 22, 2008.

<sup>26</sup> See footnote 12.

This project involves the installation of a new diesel hydrotreater unit that treats sulfur contained in raw feed streams including east plant crude diesel, coker gas oil, gas oil treater diesel, and diesel streams from the RESID hydrotreating and crude units. This unit is an integral part of the refining process and treats various process streams within the refinery. It does not treat previously refined diesel fuel.

The project includes a steam methane reformer for producing hydrogen for the hydrotreater. The steam methane reformer is purely process equipment that does not control pollution. The hydrotreater includes parallel reactors, separator, heat exchangers, pumps, drums and vessels, tankage, heaters, compressors, cooling, piping, utilities, infrastructure, and logistics. None of this equipment would be separately eligible for positive use determination as pollution control property.

#### Port Arthur Refinery Ultra Low Sulfur Diesel Project (Use Determination No. 06-10279)

This project involved revamping and expansion of Valero's Port Arthur refinery. The installations include a revamp of two existing Gulfing hydrotreating units (GFU 241 & 243), south sulfur recovery unit (SRU) and sour water stripper (SWS), and the construction of a new diesel hydrotreater (DHT 246). Also included are new utilities, off-site requirements, infrastructure and logistical requirements, heat exchangers, pumps, compressors, drums, heaters, cooling and piping. The SRU and SWS would be eligible for a partial positive use determination. However, Valero chose not to request a partial determination. The amine treating unit, revamped hydrotreating units, new diesel hydrotreater, and utilities are process and production properties not eligible for a positive use determination. It appears that these production properties were installed as part of Valero's refinery capacity expansion project.

#### Port Arthur Refinery Gasoline Desulfurization Project (Use Determination No. 06-10280)

This revamp project includes modifying an existing gasoline hydrotreater (GFU 242) and installing a new one (GFU 245). Valero did not specify the feed stream the hydrotreaters are used to desulfurize. The project includes upgrade of the LPG treater-caustic regenerator system, FCCU tie-ins, and installation of new tankage, new pumps, and new piping. An LPG treater is typically used to remove mercaptans from liquefied petroleum gas and would not be related to gasoline desulfurization. Additional information would be needed to determine if this equipment has another function. Valero failed to provide the additional information in response to the Executive Director's March 6, 2007 notice of deficiency.

The equipment list also includes cooling, flare, demo & site clearance, and DSBL. The flare is a pollution control device and would be eligible for a positive determination. The DSBL is not explained and it cannot be determined what this equipment is. The rest of the items on the equipment list are production properties not eligible for a positive use determination as previously discussed.

#### McKee Refinery Ultra Low Sulfur Diesel Project (Use Determination No. 06-10282)

This project revamped the diesel hydrodesulfurization unit at Valero's McKee Refinery. The project involved installation of a new reactor, hydrogen compressor with related equipment, recycle gas compressor and suction drum, amine absorber, amine pumps, diesel feed charge pump, chloride absorber, heat exchanger, modified reactor diesel feed exchangers, ultra low NOx burners, a quench, and piping with controls. The ultra low NOx burners, and possibly the chlorine absorber would be eligible for a positive determination. The chlorine absorber's eligibility would depend on whether it is preventing chlorine emissions into the atmosphere. Valero had an opportunity to furnish a clarification in its response to the Executive Director's notice of deficiency, but failed to do so. The rest of the items on the equipment list are process or production related properties which are not entitled to positive use determination.

McKee Refinery Gasoline Desulfurization Project (Use Determination No. 06-10283)

The McKee Refinery project revamped existing hydrodesulfurization units and incorporated one existing hydro column into the design. The list of equipment includes a hydrodesulfurization tower, polishing reactor, modified hydro column, storage tanks, heaters, vessels, cooling tower, modified reboiler, compressors, and heat exchangers. As previously discussed, none of this equipment is eligible for a positive determination. Cooling towers are specifically excluded as pollution control property in the predetermined equipment list. The devices are production or process properties not eligible for positive use determinations. Their installation will not prevent or control pollution.

Texas City Refinery Gasoline Desulfurization Project (Use Determination No. 06-10284)

This project revamped the Texas City Refinery desulfurization equipment. The project description stated that Valero installed a new CD Tech gasoline desulfurization unit capable of refining 53,000 barrels-per-day (BPD). The equipment list includes heater and stack, blend pumps, blend loop with meters and valves, reformer gas compressor, two hydrogen recycle compressors, vent gas booster compressor, and two amine scrubbers with related equipment. The list does not contain the new CD Tech desulfurization unit, and it is unclear whether the listed equipment constitutes the new unit or if it was inadvertently omitted from the list. In any event, all the devices listed are part of the production or process line at the refinery and are therefore not eligible for a positive use determination.

Texas City Refinery Ultra Low Sulfur Diesel Project (Use Determination No. 06-10285)

This project revamped the diesel desulfurization unit at the Texas City refinery to produce ultra low sulfur diesel. The project includes new storage capacity for light cycle oil and light cycle gas oil, ultra light sulfur diesel/kerosene segregation, two bed reactor, replacement convection section with larger tubes, new heat exchangers, replacement air cooler, and larger amine booster pumps. Other equipment includes replacement gas trim condenser, larger impellers and inlet nozzles, fire protection systems, tankage, cooling pumps & motors, piping, valves, and trays. The referenced devices are production related and do not qualify as pollution control property.

- 2. Valero's appeals must be denied because a person is not entitled to tax exemption for pollution control property solely on the basis that the**

**person manufactures or produces a product that prevents, controls, or reduces air, water, or land pollution.**

Under Section 11.31(a) of the Tax Code, an applicant is not eligible for a positive use determination solely on the basis that the applicant manufactures or produces a product that prevents, controls, or reduces air, water, or land pollution. TEX. TAX CODE § 11.31(a). The Commission rules provide that “property is not entitled to an exemption from taxation solely on the basis that the property is used to manufacture or produce a product or provide a service that prevents, monitors, controls, or reduces air, water, or land pollution.” 30 TEX. ADMIN. CODE § 17.6(1). Hydrodrotreating devices are installed for the production of low sulfur gasoline or diesel; equipment installed solely for the production of a product that reduces or prevents pollution is not eligible for pollution tax exemption. A property that does not control pollution is not eligible for tax exemption. As discussed in the next section, a property that controls pollution must control pollution at the site where it is installed in order to be eligible for tax exemption.

Hydrodesulfurization is a known refinery production process used to remove sulfur from crude oil and other refinery feedstock. The process involved in hydrodesulfurization is commonly referred to as hydrotreating. The equipment used for hydrotreating is commonly referred to as a hydrotreater. The goal of the production process is to produce gasoline or diesel with low sulfur content. In this case, Valero’s production goal is to produce gasoline or diesel that meets federally imposed specifications. The fact that the gasoline or diesel is being produced to meet federal regulatory requirements does not change the characterization of the process as being a necessary process in gasoline and diesel refining. The equipment used in hydrotreating does not control pollution. The equipment is used to produce either gasoline or diesel low in sulfur. The low sulfur gasoline does not cause or contribute to pollution during the manufacturing process. Diesel and gasoline are commercial products for which Valero charges a distinct price. Equipment used solely to manufacture a commercial product is not eligible for a positive use determination. The cost of installing hydrodesulfurization equipment is factored into the price of gasoline depending on the amount of sulfur in the gasoline.<sup>27</sup> It is safe to assume that such production costs are passed on to the consumers.

- 3. The Executive Director’s determinations should be affirmed because the properties, devices, and installations involved in the respective appeals do not provide environmental benefit at the site as required by 30 TEX. ADMIN. CODE § 17.15. The environmental benefit associated with gasoline desulfurization and ultra low sulfur diesel occur offsite wherever the end user burns the fuel.**

A piece of pollution control equipment must provide environmental benefit at the site to be eligible for a pollution tax exemption under the Prop 2 program. See 30 TEX. ADMIN. CODE § 17.15 (effective January 9, 2002). The properties, devices, and installations involved in Valero’s desulfurization projects do not provide environmental benefits at their sites. The environmental benefit associated with gasoline desulfurization and ultra low sulfur diesel occur offsite wherever the end user burns the fuel. To the contrary, removal of additional sulfur from the product

<sup>27</sup> See footnote 12.

stream will result in a net increase in sulfur dioxide (SO<sub>2</sub>) emissions at the site because it is not possible to obtain 100% efficiency from control equipment. Any amount of sulfur removed from the product stream that is not converted into H<sub>2</sub>S and recovered through the SRU will result in the emission of SO<sub>2</sub> at the site.

The genealogy of the environmental benefit at the site requirement has its roots in the statute. An applicant for a pollution tax exemption must present information to the Executive Director detailing the anticipated environmental benefit from installation of the equipment. TEX. TAX CODE § 11.31(c)(1). The legislature specifically directed the Commission to adopt rules to implement tax exemption for pollution control properties. TEX. TAX CODE § 11.31(g). The legislature further advised that rules adopted by the Commission must:

- (1) Establish specific standards for considering applications for [pollution tax exemption] determinations;
- (2) Be sufficiently specific to ensure that determinations are equal and uniform; and
- (3) Allow for determinations that distinguish the proportion of property that is used to control, monitor, prevent, or reduce pollution from the proportion of property that is used to produce goods or services.

Pursuant to this legislative mandate, the Commission adopted rules establishing a review standard to determine the pollution control status of a piece of equipment. 27 Tex. Reg. 185, 186–191, 303–306 (January 4, 2002). In the standards promulgated by the Commission, an applicant for a use determination is specifically instructed to determine the environmental benefit that the property will provide “at the site where it is installed. If environmental benefit at the site cannot be identified, the property [will] not [be] eligible for a positive use determination.” 30 TEX. ADMIN. CODE § 17.15, Figure n. 4 (effective January 9, 2002). The review standards included the environmental benefit at the site requirement as part of the “Prop 2 Decision Flow Chart” promulgated by the Commission to determine whether an item qualifies as pollution control property under Tier I, Tier II, or Tier III of the rules.<sup>28</sup> Id. “The Prop 2 Decision Flow Chart shall be used for each item of pollution control property or process to determine whether the particular equipment item will qualify as pollution control property. The executive director *shall* apply the standards in the Prop 2 Decision Flow Chart when acting on a use determination application”<sup>29</sup> (emphasis added).

For the properties associated with Valero’s desulfurization projects to qualify as pollution control properties, the properties must generate a “yes” answer to box 4 in the Prop 2 Decision Flow

<sup>28</sup> See also, 30 TAC § 17.2(11), (12), and (13) (effective January 9, 2002). Property included on the predetermined list is categorized as Tier I property; property which is 100% pollution control property, but not included in the predetermined equipment list is categorized as Tier II property; and property which is partially for pollution control and partially for process or product improvement is categorized as Tier III property. The tiered categories also provide a basis for the fee structure depending on the application type.

<sup>29</sup> See 30 TAC § 17.15 (effective January 9, 2002).

Chart (flow chart).<sup>30</sup> Box 4 of the flow chart asks if there is an environmental benefit at the site as a result of installation of the equipment. In evaluating the list of equipment submitted by Valero, a “no” answer was generated in box 4 of the flow chart. A “no” answer in box 4 drew a negative use determination for the devices associated with Valero’s desulfurization projects.

The environmental benefit at the site rule spawned out of a workgroup assembled by the Executive Director in 2000 to solicit input regarding the program guidelines and the procedures for considering use determination applications. The group consisted of “representatives of industry, appraisal districts, taxing authorities, and consumer and environmental groups.”<sup>31</sup> The workgroup provided recommendations for the “standards used for determining if property qualifies as pollution control property.” *Id.* The workgroup’s recommendations, including environmental benefit at the site, were incorporated into the program guidelines and constituted the basis for the 2001 rulemaking to implement House Bill (HB) 3121.<sup>32</sup> *Id.* Industry representative supported the Prop 2 decision flow chart, particularly the environmental benefit at the site requirement. Their only objection which was heeded by the Executive Director was the removal of “quantifiable” as a qualifier to environmental benefit at the site. At the October 17, 2000 workgroup meeting, Jim Woodrick with the Texas Chemical Council, and William Allaway with the Texas Taxpayers and Research Association recommended that step 5 in the decision flow chart reads: “Is there an environmental benefit at the site?” as opposed to the original language which asked if there is “a quantifiable environmental benefit at the site?” The Commission adopted the version proposed by Jim Woodrick and William Allaway. The rule which ushered in the environmental benefit at the site on January 9, 2002 was adopted without a single comment from industry representatives and the public on the issue.

The requirement for environmental benefit at the site has also been the subject of litigation in the Travis County District Court.<sup>33</sup> In Trent Wind Farm v. Texas Commission on Environmental Quality, the applicant (Trent Wind Farm) applied for use determination for 100 wind turbine units with each intended to provide about 1.5 megawatts of electric power. The Executive Director issued a negative use determination for the wind turbines on the basis that they do not provide environmental benefit at the site. The wind turbines do not generate any pollution at the

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<sup>30</sup> In the Prop 2 Decision Flow Chart included in the rules, Box 4 asks “is there a environmental benefit at the site?” However, in the decision flow chart attached to the application, the same question is asked in Box 5. For an applicant using the flow chart in the application, if a “no” answer is generated in Box 5 that means the item is not eligible for pollution control tax exemption.

<sup>31</sup> 27 Tex. Reg. 185, 186 (January 4, 2002).

<sup>32</sup> HB 3121 was enacted by the 77<sup>th</sup> Tex. Legislature, 2001. Among other things, the bill created an appeals process for a use determination applicant and the chief appraiser for the appraisal district where the pollution control property is located; requires the Executive Director to provide a copy of the use determination to the chief appraiser for the appraisal district where the property is located; and mandates the Commission to adopt rules “(1) establish[ing] specific standards for considering applications for determinations; (2) [the rules adopted] be sufficiently specific to ensure that determinations are equal and uniform; and (3) allow for determinations that distinguish the proportion of property that is used to control, monitor, prevent, or reduce pollution from the proportion of property that is used to produce goods or services.”

<sup>33</sup> Trend Wind Farm, L.P. v. Texas Commission on Environmental Quality, Cause No. GN2-04045, In the 200<sup>th</sup> Judicial District Court of Travis County, Texas (Filed November, 2002).

site and as such do not control any pollution at the site. On July 15, 2002, Trent Wind Farm appealed the Executive Director's decision to the Commission. On October 10, 2002, the Commission considered Trent Wind Farm's appeal. In an order dated October 11, 2002, the Commission denied the appeal and affirmed the Executive Director's decision granting the negative use determination on the basis that the application did not meet the requirement of 30 TEX. ADMIN. CODE § 17.15.<sup>34</sup> A copy of the order is attached herein and incorporated as if fully set forth as **Executive Director's Exhibit 3.** Trent Wind Farm appealed the Commission's decision to the district court challenging the environmental benefit at the site requirement. Specifically, Trent Wind Farm claimed in its original petition that "Section 11.31 does not include an 'at the site' requirement, but the Commission appears to have instituted an 'at the site' requirement in Decision Box 5 of the flow chart that has been adopted as part of 30 Tex. Admin. Code § 17.15." Trent Wind Farm surmised that the "imposition of the 'at the site' criteria that was not contemplated by the terms of the statute is ultra vires."

Both parties filed motions for summary judgment. On April 19, 2004, the 200<sup>th</sup> Judicial District Court of Travis County, Texas granted the motion for summary judgment of the Texas Commission on Environmental Quality and ruled that there are no genuine issues of material fact as to any element of Trent Wind Farm's claim; that Trent Wind Farm is not entitled to judgment as matter of law; and that the Commission is entitled to judgment as a matter of law. The district court then affirmed the orders and actions of the Commission. A copy of the final judgment entered in Trent Wind Farm v. Texas Commission on Environmental Quality is attached herein and incorporated as if fully set forth as **Executive Director's Exhibit 4.**

The Commission recently revisited the environmental benefit at the site requirement in the context of the rulemaking to implement House Bill (HB) 3732 (80<sup>th</sup> Tex. Legislature, 2007). At the proposal agenda meeting for proposed rules to implement HB 3732, the Commission solicited comment on the environmental benefit at the site requirement. 33 Tex. Reg. 932, 937 (February 1, 2008). The overwhelming majority of commenters supported retention of the environmental benefit at the site requirement. *Id.* at 937-938. The Commission, therefore expressly retained the environmental benefit at the site as a requirement for eligibility for a positive use determination. *Id.* The rule preamble for adoption of the amendments implementing HB 3732, states that "the commission will continue to require environmental benefit at the site as required by the statutes and regulations. . . . [HB 3732] does not nullify the requirement to require environmental benefit at the site." *Id.* at 938.

There is a continuing need for the requirement of environmental benefit at the site in the efficacious implementation of the Prop 2 program. Absent this requirement, the concept of pollution control will be nebulous and elusive. The communities and individuals who bear the tax burden may not benefit from the pollution prevention that Prop 2 was intended to deliver. Requiring an environmental benefit at the site ensures that the taxpayers who absorb the pollution tax burden immediately benefit from the pollution being controlled as a result of installation of the equipment. In the instant case, hydrotreaters will not provide environmental benefits in the communities where they are installed. For example, if Valero manufactures diesel with sulfur content of 15ppm in Galveston County, and pipes or trucks the diesel to Louisiana for

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<sup>34</sup> An Order concerning the Appeal by AEP-Trent Wind Farm of the Executive Director's Negative Use Determination for Application No. 01-5861, TCEQ Docket No. 2002-1045-AIR-U (October 11, 2002).

sale, the pollution benefit will occur in Louisiana leaving the citizens of Galveston County who bore the tax burden with no discernable benefit. Environmental benefit at the site provides the quid pro quo benefit to the counties deprived of tax revenues when an item is taken off the tax roll as a result of a positive use determination. Accordingly, the Executive Director's negative use determination for the devices associated with Valero's desulfurization projects should be affirmed since the devices do not provide environmental benefit at the site where they are installed.

4. **The Executive Director's negative use determination should be affirmed because Valero failed to comply with 30 TEX. ADMIN. CODE § 17.12(2)(A) & (B) authorizing the Executive Director to issue notice of deficiencies and requiring an applicant to provide adequate response to the Executive Director's notice of deficiencies. TEX. TAX CODE §11.31(c) and (g).**

The Executive Director's negative use determination should be affirmed because Valero failed to comply with 30 TEX. ADMIN. CODE § 17.12(2)(A) & (B) authorizing the Executive Director to issue notice of deficiencies and requiring an applicant to provide adequate response to the Executive Director's notice of deficiencies. If an applicant requests tax exemption for "property that is not used wholly for the control of air, water, or land pollution," in addition to other requirements, the applicant shall "present such financial or other data as the executive director requires by rule for the determination of the proportion of the installation that is pollution control property." TEX. TAX CODE §11.31(c) and (g). Under Section 17.12(2)(B) of the Commission rules, "additional technical information may be requested within 60 days of issuance of an administrative completeness letter. If the applicant does not provide the requested technical information within 30 days, the application will be sent back to the applicant without further action by the Executive Director and the application fee will be forfeited."

As indicated above, on March 6, 2007, a notice of deficiency was forwarded to Valero requesting additional information and directing Valero to:

- (1) Evaluate the submitted equipment list, isolate the Tier I items, and list them separately in its response to the notice of deficiency;
- (2) Evaluate the balance of the property using the decision flow chart. If you find property which you consider to be 100% pollution control property which is not listed on the predetermined equipment list, list such property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits; and
- (3) If there is property which meets the requirements of the decision flow chart and is used only partially for pollution control, you will need to use the cost analysis procedure to determine the percentage which qualifies as pollution control equipment.

On April 2, 2007, Valero provided the following response to the Executive Director's request for additional information:

It is Valero's position that these environmental projects fully comply with the letter and intent of Federal mandates, and indisputably conform to the statutory requirements for pollution property tax relief as set forth in Section 11.31 of the Texas Property Code. Valero had no choice but to install these properties wholly and exclusively to meet new emissions standards as set forth in 40 CFR 80: Regulation of Fuels and Fuel Additives. Valero had no other plans to construct any portion of these projects for any other purposes. They are 100% environmental. Valero does not intend at this time to seek piecemeal use determinations for any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment (emphasis added).<sup>35</sup>

Valero's summary response was no response at all. The response failed to address the Executive Director's specific requests for additional information. The response also failed to address the primary deficiency noted in the notice; failure of the installations to provide environmental benefit at the site. Valero cannot rebuff a statutory and regulatory request by the Executive Director and expect to be rewarded by the Commissioners. The Executive Director's negative use determination should be affirmed because Valero failed to comply with 30 TEX. ADMIN. CODE § 17.12(2)(A) & (B) authorizing the Executive Director to issue a notice of deficiency and requiring Valero to provide adequate response to the Executive Director's notice of deficiency.

**5. The Executive Director's Use Determinations should be affirmed because they were issued in accordance with the Commission's decision and guidance provided in the XTO Energy case involving the extraction of hydrogen sulfide from natural gas. (Docket No. 2005-1008-AIR-U/Use Determination No. 04-8353, September 28, 2005).**

In XTO Energy, the Commission was confronted with and rejected a similar argument that separation of sulfur from a product stream qualifies as pollution control. XTO Energy involves the removal of hydrogen sulfide and sulfur dioxide from natural gas while the instant case involves removal of sulfur from diesel or gasoline product stream. In XTO Energy, the Appellant argued that "the plant, taken as a whole, is a pollution control device designed with the sole purpose to treat sour gas by removing Hydrogen Sulfide (H<sub>2</sub>S) and Sulfur Dioxide (SO<sub>2</sub>) due to environmental concerns and to comply with the requirements of related Air Control Permits.<sup>36</sup>" The Executive Director granted a 100% Tier II positive use determination for all the pieces of equipment associated with the process. The Commission disagreed with the 100% use determination and remanded the case to the Executive Director to reevaluate the use determination in light of the guidance and direction provided by the Commission during the

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<sup>35</sup> See Executive Director's Exhibit 2.

<sup>36</sup> See XTO Energy Response Brief in Docket No. 2005-1008-AIR-U.

agenda deliberations. The following excerpts<sup>37</sup> from the Commission deliberation in XTO Energy are dispositive of the Valero appeals:

**Commissioner Soward:**

“... I don't think anybody is really challenging the part of the operation or facility that are used to dispose of what is stripped off. The issue is the part before you strip, the process of stripping it off. Is that pollution control or is that enhancement of a product? And that is the whole issue here and for me, for me to say it's a pollution control, you have to show me something that says it's intended to be nothing but that. And I don't think the market, I don't think the industry says that. I think they strip it off to make it more marketable and then what they do with it becomes a pollution control issue, and we can look at that from a tax standpoint. They don't have to strip it off at all.”

**Commissioner Marquez:**

“... There's a different restrictions that they have to meet like so many other people that do business, and so they end up with a waste, now how they handle that waste after it becomes a waste ... may be subject to some of the tax benefits, but the act of separating the waste from the product is not a pollution.”

“... And you know I go to the decision flow chart on step 5, “is there an environmental benefit at the site?” There is no environmental benefit at the site by just removing the sulfur from the gas. Now, once you start purifying it, and you apply pollution control devices to it, then yes, it prevents hydrogen sulfide from leaking out at that site. And that part of it, maybe, may qualify. But I agree with Commissioner Soward the fact that the sulfur is being separated from the gas I just do not see that as being pollution control device.”

**Commissioner Marquez:**

“There's no difference than some refiners coming in a few years ago saying, “we have to build a new refinery that makes reformulated gasoline. Reformulated gasoline is required; you know, is a pollution control issue; reduces pollution and so the entire refinery now is a pollution control device. You know, they try to stretch this too far.”

**Commissioner Soward:**

“... And I think it's a common rule of law that, you know, exemptions from taxation are discouraged and you strictly construe any statutes or regulations that would allow an exemption from taxes. I didn't make that policy, that's the

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<sup>37</sup> The excerpts are derived from the transcript of the September 28, 2005 Commission Agenda meeting. The transcriber has made an honest effort to transcribe the transcript. In some instances, there may be gaps, and the transcription may not be verbatim. This is done for easy reading to avoid duplication.

Legislature. And I think we have to strictly construe application of the statute when it comes to these and that's why I say, to me, it's clear that once it's stripped off and you have a disposal issue, then that comes within our world, as far as the use exemption. But prior to that, it's simply a business and processing issue that the Legislature hadn't granted an exemption to. So, I think we are totally consistent with the Tax Code and the legislative intent by being very strict in how we apply this even to this fact situation."

**Commissioner Marquez:**

"... Not having a detailed flow diagram and not having studied the process, I've got to admit, I'm going here on some shaky notice on this. But the extraction part, I do not see that as being a pollution control process. What do you do with the sulfur once it has been removed, could very well be a pollution control process, and then if there is value obtained from the sale of the sulfur, then those pieces of equipment that qualify as pollution control, then some of that may be taxable and some ... may be not."

**Commissioner Soward:**

"... I don't agree with running the extraction part, I think you need to run the disposal part, if you will, through the flow chart."

**Commissioner Soward:**

"... I just think we ought to remand it back and let the three parties of interest discuss the issues and see what they can workout. I think they've gotten at least guidance from a couple of us on one side of the issue."

It is clear from the Commission deliberation that (1) separation of sulfur from gasoline or diesel does not qualify as pollution control, (2) separation of sulfur from gasoline or diesel does not provide environmental benefit at the site, (3) equipment used for the treatment and disposal of sulfur after it has been separated from gasoline or diesel may qualify as pollution control property, and (4) the byproduct generated after the separation of sulfur from gasoline or diesel in preparation for disposal should be factored into the calculation of the pollution control status of the equipment for which pollution property tax exemption is sought.

**VII.**

**CONCLUSION**

After careful consideration of the appeals filed by the Appellants on use determination numbers 06-10268, 06-10270, 06-10271, 06-10279, 06-10280, 06-10281, 06-10282, 06-10283, 06-10284, and 06-10285, the Executive Director concludes that the negative use determinations for the devices listed as part of Appellants' gasoline desulfurization and ultra low sulfur diesel projects were not issued in error. The Appellants failed to provide any factual or legal basis upon which

the Commission should reverse the Executive Director's negative use determinations in this case. The allegations propounded by the Appellants do not alter the findings and the final negative use determinations issued by the Executive Director. The Executive Director's negative use determinations in this case are consistent with the terms and mandates set forth in the relevant statutes and rules.

Accordingly, the Executive Director respectfully requests that the Commission deny the instant appeals and affirm the negative use determination for each of the devices associated with Appellant's desulfurization projects.

Alternatively, if Valero chooses to comply fully with the March 6, 2007 notice of deficiency, and any subsequent notice of deficiencies as may be warranted during the review of the respective applications, the Commission may remand the appeals to the Executive Director to review the specific items for eligibility for pollution tax exemption under Tier I, II, or III of the Commission rules as they existed prior to February 7, 2008.

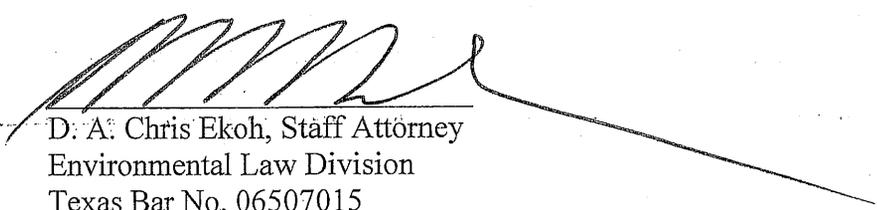
Respectfully submitted,

TEXAS COMMISSION ON ENVIRONMENTAL  
QUALITY

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Stephanie Bergeron-Purdue,  
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Robert Martinez, Director  
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REPRESENTING THE EXECUTIVE DIRECTOR,  
TEXAS COMMISSION ON ENVIRONMENTAL  
QUALITY

CERTIFICATE OF SERVICE

I certify that on April 7, 2008, the original and 11 copies of the "Executive Director's Response Brief to Valero Refining – Texas, L.P., Diamond Shamrock Refining Company, L.P., and the Premcor Refining Group, Inc.'s Appeal of the Executive Director's Negative Use Determinations" was filed with the Office of the Chief Clerk, Texas Commission on Environmental Quality, and was served by first-class mail, agency mail, or facsimile to all persons on the attached mailing list.



D. A. Chris Ekoh, Staff Attorney  
Environmental Law Division  
Texas Commission on Environmental Quality

## MAILING LIST

### Valero Appeals

2007-0732-MIS-U (UD 06-10270/Valero Corpus Christi Refinery – Nueces County)

2007-0733-MIS-U (UD 06-10271/Valero Corpus Christi Refinery – Nueces County)

2007-0734-MIS-U (UD 06-10281/Valero Houston Refinery – Harris County)

2007-0735-MIS-U (UD 06-10268/Valero Houston Refinery – Harris County)

2007-0736-MIS-U (UD 06-10283/Diamond Shamrock McKee Refinery – Moore County)

2007-0737-MIS-U (UD 06-10282/Diamond Shamrock McKee Refinery – Moore County)

2007-0738-MIS-U (UD 06-10280/Valero Port Arthur Refinery – Jefferson County)

2007-0739-MIS-U (UD 06-10279/Valero Port Arthur Refinery – Jefferson County)

2007-0724-MIS-U (UD 06-10285/Valero Texas City Refinery – Galveston County)

2007-0740-MIS-U (UD 06-10284/Valero Texas City Refinery – Galveston County)

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EXECUTIVE DIRECTOR'S

EXHIBIT 1

Kathleen Hartnett White, *Chairman*  
Larry R. Soward, *Commissioner*  
Glenn Shankle, *Executive Director*



## TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

*Protecting Texas by Reducing and Preventing Pollution*

March 6, 2007

Valero Energy Corporation  
Trey Novosad  
PO Box 690110  
San Antonio, TX 78269-0110

Mr. Novosad,

This letter is to inform you that the technical review of the following Use Determination Applications has begun:

06-10282	Diamond Shamrock - Mckee Refinery	Refinery Revamp Project
06-10283	Diamond Shamrock - Mckee Refinery	Gasoline Desulfurization Project
06-10280	Premcor Refining Grp - Port Arthur	Gasoline Desulfurization
06-10279	Premcor Refining Grp - Port Arthur	Ultra Low Sulfur Diesel Project
06-10281	Valero Refining - Houston Refinery	Gasoline Desulfurization
06-10268	Valero Refining - Houston Refinery	ULSD Houston Hydrotreater
06-10270	Valero Refining - Corpus Refinery	Gasoline Desulfurization
06-10271	Valero Refining - Corpus Refinery	Ultra Low Sulfur Diesel
06-10285	Valero Refining - Texas City Ref	ULSD Refinery Revamp
06-10284	Valero Refining - Texas City Ref	Gasoline Desulfurization Project

During the review it was determined that the following information is missing and/or incomplete:

These ten Tier II applications are for equipment installed in order to meet 40 CFR 80: Regulation of Fuels and Fuel Additives. This regulation requires refiners of gasoline and diesel to reduce the sulfur content in their end products. In order to qualify for a positive use determination the property in question must be processed through the Decision Flow Chart (DFC). In order for the property to successfully process through the DFC, 'yes' answers must be the result of evaluating the property against boxes 3 and 5. A yes answer is received for Box 3 since 40 CFR 80 is considered to be a valid adopted rule.

Box 5 requires that the installation and use of the property produces an environmental benefit at the site. When we evaluate these low sulfur projects with regard to the DFC we receive a 'no' answer at Box 5. The environmental benefit of these projects occurs when the consumer uses the low sulfur content fuels. These projects do not provide an environmental benefit at the site and as projects are not eligible for positive use determinations.

With that said, in looking at the equipment lists provided with these applications we see property which is located on the predetermined equipment list. This includes items such as Low NOx Burners. The next step is for you to perform the following:

1. Evaluate the equipment lists and remove the Tier I equipment. List these items separately in your response.
2. Evaluate the balance of the property using the DFC. If you find property which you consider to be 100% pollution control property, but which you can not find on the predetermined equipment list, list this property separately from the Tier I property. This property will be treated as Tier II property. Include an explanation of how this property serves only as pollution control with no other benefits.
3. If there is property which meets the requirements of the DFC and is used only partially for pollution control you will need to use the Cost Analysis Procedure (30 TAC 17.17) to determine the percentage of the property which qualifies as pollution control equipment.

If you decide to ask for a partial determination you will need to send an additional fee payment of \$1,500 in order to turn the application into a Tier III application.

Please provide this additional information as soon as possible. As per 30 TAC 17.12(2) the applicant must respond to a notice of deficiency (NOD) by providing the additional information required within 30 days of receipt of the NOD or the application will be returned. Once the additional information has been received the technical review of this application will resume. If you have any questions or require assistance in developing the additional required information please contact the Tax Relief for Pollution Control Property Program at (512) 239-6348. Your response may be faxed to 512/239-6763, electronically mailed to [rhatlett@tceq.state.tx.us](mailto:rhatlett@tceq.state.tx.us), or sent by U.S. Mail to:

Tax Relief for Pollution Control  
Property Program MC110  
PO Box 13087  
Austin TX 78711-3087

Sincerely,



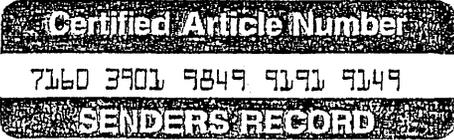
Ronald Hatlett  
Tax Relief for Pollution Control Property Program

EXECUTIVE DIRECTOR'S

EXHIBIT 2



April 2, 2007



Mr. Ron Hatlett  
Tax Relief for Pollution Control Property Program  
PO Box 13087  
Austin, TX 78711-3087

RE: Applications for Use Determination for Pollution Control Property

Dear Mr. Hatlett:

I am writing in response to your letter of March 6, 2007 regarding the following Use Determination Applications:

06-10282	Diamond Shamrock—McKee Refinery	Refinery Revamp Project
06-10283	Diamond Shamrock—McKee Refinery	Gasoline Desulfurization
06-10280	Premcor Refining Group—Port Arthur	Gasoline Desulfurization
06-10279	Premcor Refining Group—Port Arthur	Ultra Low Sulfur Diesel
06-10281	Valero Refining—Houston Refinery	Gasoline Desulfurization
06-10268	Valero Refining—Houston Refinery	ULSD Hydrotreater
06-10270	Valero Refining—Corpus Refinery	Gasoline Desulfurization
06-10271	Valero Refining—Corpus Refinery	Ultra Low Sulfur Diesel
06-10285	Valero Refining—Texas City Refinery	ULSD Refinery Revamp
06-10284	Valero Refining—Texas City Refinery	Gasoline Desulfurization

It is Valero's position that these environmental projects fully comply with the letter and intent of Federal mandates, and indisputably conform to the statutory requirements for pollution control property tax relief as set forth in Section 11.31 of the Texas Property Tax Code. Valero had no choice but to install these properties wholly and exclusively to meet new emissions standards as set forth in 40CFR 80: Regulation of Fuels and Fuel Additives. Valero had no other plans to construct any portion of these projects for any other purposes. They are 100% environmental. Valero does not intend at this time to seek piecemeal use determinations for any component parts of these projects that standing alone would qualify for pollution control tax exempt treatment.

Valero respectfully requests that the TCEQ make positive use determinations on each of the administratively complete Tier II Use Determination Applications set forth above.

Sincerely,

Trey Novosad  
Director – Ad Valorem Tax

TNN:srk

EXECUTIVE DIRECTOR'S

EXHIBIT 3

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

THE STATE OF TEXAS  
COUNTY OF TRAVIS



I hereby certify that this is a true and correct copy of a Texas Commission on Environmental Quality document, which is filed in the permanent records of the Commission. Given under my hand and the seal of office on

*LaDonna Castanuela* OCT 21 2002

LaDonna Castanuela, Chief Clerk  
Texas Commission on Environmental Quality

**AN ORDER** concerning the Appeal by AEP-Trent Wind Farm of the Executive Director's Negative Use Determination for Application No. 01-5861; TCEQ Docket No. 2002-1045-AIR-U

On October 10, 2002, the Texas Commission on Environmental Quality (Commission) considered the appeal by AEP-Trent Wind Farm of the Executive Director's negative use determination for Application No. 01-5861, relating to AEP-Trent Wind Farm's request for tax exempt status for the wind farm it operates in Nolan and Taylor Counties. The appeal was evaluated under the requirements in the applicable statutes and Commission rules.

After considering the written filings and argument made by interested persons, the Commission affirmed the Executive Director's determination that the property in question was not entitled to a tax exemption was correct, as the application did not meet the requirements in 30 TAC §17.15. Thus, the Commission denied the appeal.

NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY that the appeal by AEP-Trent Wind Farm of the Executive Director's negative use determination for Application No. 01-5861 is DENIED and the Executive Director's determination is AFFIRMED.

Issue date: OCT 11 2002

TEXAS COMMISSION ON  
ENVIRONMENTAL QUALITY

*Robert J. Huston*  
Robert J. Huston, Chairman

EXECUTIVE DIRECTOR'S

EXHIBIT 4

CAUSE NO. GN2-04045

TRENT WIND FARM, L.P.	§	IN THE DISTRICT COURT OF
Plaintiff,	§	
	§	
v.	§	
	§	
TEXAS COMMISSION ON	§	TRAVIS COUNTY, TEXAS
ENVIRONMENTAL QUALITY and	§	
MARGARET HOFFMAN,	§	
EXECUTIVE DIRECTOR OF THE	§	
TEXAS COMMISSION ON	§	
ENVIRONMENTAL QUALITY,	§	
Defendants.	§	200 <sup>TH</sup> JUDICIAL DISTRICT

FINAL JUDGMENT

On January 9, 2004, the parties appeared. They are Trent Wind Farm, L.P. ("Trent Wind Farm"), Plaintiff, and the Texas Commission on Environmental Quality and Margaret Hoffman, Executive Director of Texas Commission on Environmental Quality (collectively, the "TCEQ"), Defendants. The court heard Trent Wind Farm's Motion for Summary Judgment, and its responses and replies, and heard the TCEQ's Motion for Summary Judgment, and its responses and replies.

On January 30, 2004, the TCEQ filed its Additional Motion for Summary Judgment, to which Trent Wind Farm filed a response on February 20, 2004. The court considered the additional motion and response by submission on February 27, 2004. The TCEQ's Motion for Summary Judgment and its Additional Motion for Summary Judgment are treated as one motion with alternative grounds and are referred to collectively as the TCEQ's Motion for Summary Judgment.

After considering the pleadings, motions, evidence, briefs, responses, and arguments of the parties, the Court is of the opinion (1) that there are no genuine issues of material fact regarding any element of the Plaintiff's cause of action; (2) that, as a matter of law, the Plaintiff is not entitled to judgment; and (3) that, as a matter of law, the Defendants are

**FILED**

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*[Signature]*  
DISTRICT CLERK  
TRAVIS COUNTY, TEXAS

entitled to judgment. The Court hereby GRANTS the TCEQ's Motion for Summary Judgment and DENIES Trent Wind Farm's Motion for Summary Judgment.

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED that Trent Wind Farm's Motion for Summary Judgment is DENIED, that the TCEQ's Motion for Summary Judgment is GRANTED, and that the orders and actions of the Texas Commission on Environmental Quality are AFFIRMED.

IT IS FURTHER ORDERED that costs are taxed to the Plaintiff.

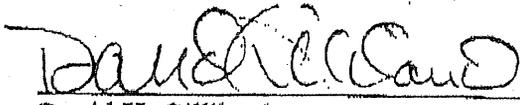
All requested relief not expressly granted is DENIED. This judgment disposes of all the claims of all the parties in this cause and is intended to be final and appealable.

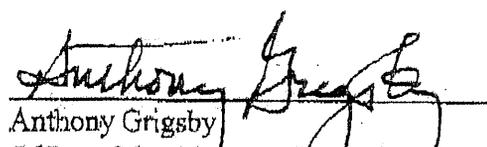
Signed on April 19, 2004

  
JUDGE SCOTT H. JENKINS

Agreed as to Form:

WL6092PC084

  
David H. Gilliland  
Clark, Thomas & Winters, P.C.  
Attorneys for Plaintiff

  
Anthony Grigsby  
Office of the Attorney General  
Natural Resources Division  
Attorneys for Defendants