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FREDRICK J. BRADFORD

April 4, 2008

**RE: Appeal of Executive Director's Negative Use Determination
regarding Valero Refining – Texas, L.P.;
TCEQ Use Determination No. 06-10284; TCEQ Docket No. 2007-0740-MIS-U; and
TCEQ Use Determination No. 06-10285; TCEQ Docket No. 2007-0724-MIS-U.**

Texas Commission on Environmental Quality
Office of the Chief Clerk, TCEQ, Mail Code 105
Building F
12100 Park 35
Austin, Texas 78753

Via Federal Express

Attn. Agenda Docket Clerk:

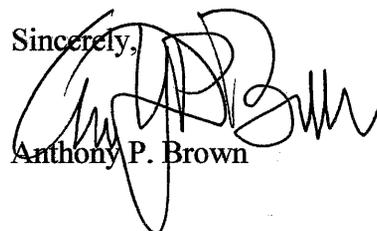
Enclosed please find an original and eleven copies of the following document for filing in the above referenced matter.

Galveston Central Appraisal District's Brief to the Appeal of the Executive Director's Decision

By copy of this letter, all persons on the mailing list provided by TCEQ are being furnished a copy of same.

Thank you for your attention in these matters.

Sincerely,


Anthony P. Brown

APB/SWG/des
Enclosures

2008 APR -7 AM 11:32
CHIEF CLERKS OFFICE
TEXAS COMMISSION
ON ENVIRONMENTAL
QUALITY

cc w/enclosures

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TCEQ DOCKET NOS. 2007-0724-MIS-U AND 2007-0740-MIS-U

IN THE MATTER OF THE § **BEFORE THE**
APPEAL OF THE EXECUTIVE § **TEXAS COMMISSION ON**
DIRECTORS'S NEGATIVE USE § **ENVIRONMENTAL QUALITY**
DETERMINATION REGARDING §
VALERO REFINING – TEXAS, L.P. §
TCEQ USE DETERMINATION NOS. §
06-10284 AND 06-10285 §

**GALVESTON CENTRAL APPRAISAL DISTRICT'S BRIEF TO THE APPEAL OF THE
EXECUTIVE DIRECTOR'S DECISION**

Galveston Central Appraisal District files this brief in support of the Negative Use Determination by the Executive Director of the Texas Commission on Environmental Quality concerning Applications #06-10284 and 06-10285 filed by Valero Refining – Texas L.P. (Valero). Pursuant to Title 30 of Chapter 17 of the Texas Administrative Code these Tier II applications were prepared by Valero and dated January 26, 2007. Application No. 06-10284 was for a Gasoline Desulphurization Project at Valero's Texas City refinery (Exhibit A1) and application No. 06-10285 was for the Diesel Hydro-Desulphurization Unit at Valero's Texas City refinery (Exhibit A2). The Executive Director issued a Negative Use Determination for both applications (Exhibits B1 and B2) finding that the equipment did not provide pollution control benefits pursuant to Texas Tax Code Section 11.31. Valero subsequently appealed those Negative Use Determinations on May 8, 2007. (Exhibits C1 and C2).

POLLUTION CONTROL PROPERTY EXEMPTION

The property tax exemption for pollution control property went into effect on January 1, 1994 when the Texas Constitution was amended and the Texas Tax Code Section 11.31 was enacted. In

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addition, the TCEQ adopted regulations codified at Title 30 of Chapter 17 of the Texas Administrative Code. The regulations set out the procedures for an owner of pollution control property to apply to the Commission for a Use Determination of pollution control property. Tax Code §11.31 was amended in 2001 and again in 2007. Only the 2001 amendments are applicable to this action, as the 2007 amendment did not go into effect until the 2008 tax year. The law in effect on January 1, 2007 is attached hereto as Exhibit D. Additionally, the regulations in effect as of January 1, 2007 are attached hereto as Exhibit E.

This appeal and the underlying application are primarily decided by the very first part of the Tax Code §11.31:

Section 11.31 Pollution Control Property

(a) 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. A person is not entitled to an exemption from taxation under this section solely on the basis that the person manufactures or produces a product or provides a service that prevents, monitors, controls, or reduces air, water, or land pollution.

This provides for the exemption for property used to control pollution, but not for property used to manufacture products that reduce pollution. The Office of the Attorney General of the State of Texas also specifically addressed this issue in Letter Opinion No. 96-128, which discussed the legislative intent of the law as shown through hearings and amendments to the original House Bill 1920 of the Seventy-Third Legislature's regular session. Representative Berlanga offered an amendment that is now substantially the second sentence of §11.31(a), and said "This amendment clarifies that a person cannot get the exemption just because the person manufactures a product that

is used for pollution control purposes”¹ Similarly, the debate in the Senate version also addressed this issue: “The property that is covered by the bill is property that prevents that business from pollution -- not the property that they use to conduct business.”²

The procedural framework in Chapter 17 of the Administrative Code had three “tiers” for processing applications for Use Determinations. Tier I relates to property listed on the Predetermined Equipment List, or P.E.L, which TCEQ has already determined to be pollution control property. Tier II relates to property used wholly for control of air, water, and/or land pollution, but is not on the P.E.L. Tier III relates to property that is only partially used for the control of pollution. Valero applied for a Use Determinations under Tier II, alleging the property is wholly used for the control of air, water, and/or land pollution, and not used for production.

To evaluate a Tier II application, TCEQ uses a flow chart found in §17.15 which is attached hereto as Exhibit F. The Executive Director must determine the use of each piece of property as it pertains to the property taxes of a particular site. Consequently, the Executive Director evaluates a particular site according to what is produced at that site including marketable products and by-products as well as pollutants. To the extent a particular piece of property is used to reduce the pollutants produced by that site, then that specific property is entitled to an exemption. On the other hand, property used for production is not entitled to an exemption. However, if property is used to

¹ Debate on H.B. 1920, on the Floor of the House, 73d Leg. (April 20, 1993);

² Hearings on H.B. 1920 & H.J.R. 86 before the Senate Comm. On Intergovernmental Relations, 73d Leg., (April 28, 1993); 1996 Tex. AG LEXIS 184 (Tex. AG 1996)

produce marketable products or byproduct and reduces pollution, then the property is entitled to a partial exemption that balances the production value and the pollution control value.³

The Executive Director must confine the analysis to a particular site because the purpose of the exemption is to encourage the implementation of property to reduce the pollutants produced by that site. To the extent a piece of equipment results in the reduction of pollution outside the confines of a site, it does not and should not affect the value of that site. This is analogous to the granting of exemptions for electric compressors in lieu of gas compressors. The use of electric compressors decrease the pollutants produced at its location, but require additional electricity consumption by the site. Consequently, the additional production of electricity at a power plant produces additional pollutants at that location. Since the variables and possibilities are difficult if not impossible to calculate, the Executive Director must base its determinations on a site by site basis. Thus the electric compressors that reduce pollution at the site are entitled to a positive use determination. This forms the basis of the flow chart decision point regarding the environmental benefit at the site.

EXECUTIVE DIRECTOR'S DETERMINATION

The Executive Director correctly made a Negative Use Determination on Valero's application. The gas and diesel desulphurization projects do not reduce pollution on the site and do not provide an environmental benefit at the site. Rather, they contribute to the overall refining process to manufacture products, either gas or diesel fuel, that meet specifications for fuel placed in automobiles. As stated in Tax Code §11.31(a), Valero is not entitled to an exemption taxation on the basis that they produce a product that prevents, monitors, controls, or reduces pollution. Valero is

³ See 30 T.A.C §17.17

producing a product and the property contained in these applications contributes to the production of that product.

Furthermore, Valero bases their use determination application on 40 CFR 80: Regulation of Fuels and Fuel Additives, but this regulation does not dictate the installation of this equipment. In fact, it does not dictate the installation of any equipment or process, instead it sets specifications for fuel sold for use in motor vehicles. These regulations control the specifications of fuels at a fuel pump, not at Valero's site. As such, 40 CFR 80 should not be the basis of these applications and the Executive Director should have provided a negative use determination accordingly and never reached the question of environmental benefit at the site.

PUBLIC POLICY

The Texas Constitution mandates that ad valorem taxes be imposed equally and uniformly, so as to be fair to all property owners.⁴ Since exemptions, by their very nature, go against the constitutional requirement of equality and uniformity, they are not favored by law and are strictly construed.⁵ The Texas Supreme Court has pronounced:

Statutory exemptions from taxation are subject to strict construction since they are the antithesis of equality and uniformity and because they place a greater burden on other taxpaying businesses and individuals. An exemption cannot be raised by implication, but must affirmatively appear, and all doubts are resolved in favor of taxing authority and against the claimant. Simply

⁴ *Harris County Appraisal Dist. v. United Investors Realty Trust*, 47 S.W.3d 648, 651 (Tex.App. – Houston [14th Dist.] 2001, pet. denied)

⁵ *N. Alamo Water Supply Corp. v. Willacy County Appraisal Dist.*, 804 S.W.2d 894, 898 (Tex. 1991).

stated, the burden of proof is on the claimant to clearly show that it comes within the statutory exemption.⁶ Courts of review should, in construing a statute, determine and give effect to the Legislature's intent.⁷

Lawmakers passed Tax Code §11.31 and Texas voters passed the constitutional amendment with the intention of providing tax breaks that would encourage the installation of equipment to reduce the production of pollution within the State of Texas. Valero seeks an application of these rules that would provide for exemption of the entire refining process. Granting positive use determinations for these applications would ratify the idea that if the final product has an environmental benefit, then the entire industry and all property contributing to that industry would be exempt from taxation. Neither law makers nor voters had any intention of exempting the entire refining industry or any other industry from ad valorem taxation.

⁶ *Bullock v. National Bancshares Corporation*, 584 S.W.2d 268, 271-72 (Tex. 1979); see also *Texas VOA Elderly Housing, Inc. v. Montgomery Appraisal Dist.*, 990 S.W.2d 938, 940 (Tex.App. – Beaumont 1999, no pet.) and *Willacy County Appraisal Dist. v. N. Alamo Water Supply Corp.*, 676 S.W.2d 632, 639 (Tex.App. – Corpus Christi 1984, writ ref'd n.r.e.) stating all laws granting exemptions must be interpreted narrowly and strictly; all doubts must be resolved against granting the exemption; and. *N. Alamo Water Supply Corp.*, 804 S.W.2d at 898 stating the burden of demonstrating the exemption applies is upon the claimant.

⁷ *National Liab. & Fire Ins. Co. v. Allen*, 15 S.W.3d 525, 527 (Tex. 2000)

CONCLUSION

The Executive Director correctly made a Negative Use Determination for Valero's Tier II applications that seek complete exemption for the property identified in Applications Nos. 06-10284 and 06-10285. The Executive Director's Negative Use Determinations should be upheld by the Commission.

Respectfully submitted,

McLEOD, ALEXANDER, POWEL and
APFFÉL, P.C.

BY: 

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ATTORNEYS FOR DEFENDANT
GALVESTON CENTRAL
APPRAISAL DISTRICT

APB/SWG/des

Enclosures

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing instrument was property forwarded to counsel of record on this 4th day of April, 2008



Anthony P. Brown

EXHIBIT A1

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



RECEIVED
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GALVESTON CAD

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution
February 09, 2007

CHIEF APPRAISER
GALVESTON COUNTY APPRAISAL DISTRICT
600 GULF FWY STE 113
TEXAS CITY TX 77591

This letter is to inform you that a Use Determination Application has been filed for:

VALERO REFINING COMPANY - TEXAS
VALERO TEXAS CITY REFINERY
1301 LOOP 197 SOUTH
TEXAS CITY TX 77590

a facility located in GALVESTON County.

A copy of the use determination application is attached to this letter.

This application has been assigned a tracking number of 06 -10284. We recommend that the appraisal district notify all affected taxing entities of the filing of this application. Please contact the Tax Relief for Pollution Control Property Program at (512) 239-6348 if you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Ronald L. Hatlett".

Ronald L. Hatlett
Tax Relief for Pollution Control Property Program

**TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
APPLICATION FOR USE DETERMINATION
FOR POLLUTION CONTROL PROPERTY**

The Texas Commission on Environmental Quality (TCEQ) has the responsibility to determine whether a property is a pollution control property. A person or political subdivision seeking a use determination for pollution control property must complete the attached application or use a copy or similar reproduction. For assistance in completing this form refer to the TCEQ guidelines document, *Property Tax Exemptions for Pollution Control Property*, as well as 30 TAC §17, rules governing this program. For additional assistance please contact the TCEQ Tax Relief for Pollution Control Property Program at 512/239-6348. The application should be completed and mailed, with the appropriate fee, to: TCEQ MC-214, Cashiers Office, P.O. Box 13088, Austin, Texas, 78711-3088.

1. GENERAL INFORMATION

A. What is the type of ownership of this facility?

- Corporation Sole Proprietor
 Partnership Utility
 Limited Partnership Other _____

B. Size of company: Number of Employees

- 1 to 99
 100 to 499
 500 to 999
 1,000 to 1,999
 2,000 or more

C. Business Description: (Provide a brief description of the type of business or activity at the facility)
The refinement of crude petroleum to produce gasoline.

781904
07-10-07

2. TYPE OF APPLICATION

A. Tier I \$150 Application Fee

If all property listed in Section 8 of this application is on the predetermined equipment list (PEL) or is necessary for the installation or operation of equipment on the list, then check this box.

B. Tier II \$1,000 Application Fee

If any property listed in Section 8 is not on the PEL, and all of this property is used 100% for pollution control, then check this box.

C. Tier III \$2,500 Application Fee

If any property listed in Section 8 is not on the PEL and if a partial use determination is being requested for ANY of the property included in the application, then check this box.

NOTE: Enclose a check or money order to the TCEQ along with the application to cover the required fee.

3. NAME OF APPLICANT

- A. Company Name: Valero Refining - Texas, L.P.
B. Mailing Address (Street or P.O. Box): PO Box 690110
C. City, State, ZIP: San Antonio, TX 78269

4. PHYSICAL LOCATION OF PROPERTY REQUESTING A TAX EXEMPTION

- A. Name of Facility or Unit: Valero Texas City Refinery
B. Type of Mfg. Process or Service: Ultra Low Sulfur Gasoline Refinery
C. Street Address: 1301 Loop 197 South
D. City, State, ZIP: Texas City, TX 77590 Galveston County
E. Tracking Number Assigned by Applicant (Optional): NA

AC-10084

F. Company Number or Registration Number: _____
(Required)

5. APPRAISAL DISTRICT WITH TAXING AUTHORITY OVER PROPERTY

A. Name of Appraisal District: Galveston County Appraisal District

B. Appraisal District Account Number: R293410

6. CONTACT NAME (must be provided)

A. Company/Organization Name: Valero Energy Corporation

B. Name of Individual to Contact: Trey Novosad

C. Mailing Address: PO Box 690110

D. City, State, ZIP: San Antonio, TX 78269-0110

E. Telephone number and fax number: 210-345-2700 fax:210-345-2495

F. E-Mail address (if available): Trey.Novosad@Valero.com

7. RELEVANT RULE, REGULATION, OR STATUTORY PROVISION

For each of the pollution control properties listed on this application, select the type of medium or media (air, water, waste) for which the property or device is required. Use the second column to cite the specific environmental rule, regulation, and/or law that is being met or exceeded by the installation of this property. The citation should be specific and should include the section and/or subsection of the rule, regulation, and/or law. Do not list permit numbers or registration numbers in this table. If the property or equipment was installed or constructed in response to an agreed order, do not list the order — list the rule, regulation, or law that requires the installation or construction of the property.

MEDIUM	RULE/REGULATION/LAW
Air	40 CFR, PART 80, REGULATION OF FUELS AND FUEL ADDITIVES, SUBPART H, GASOLINE SULPHUR
Water	
Waste	

8. DESCRIPTION OF PROPERTY (Complete for all applications)

Provide a description and purpose of the property for which this application is being filed. This description must include the anticipated environmental benefits for the prevention, monitoring, control, or reduction of air, water, or land pollution that will be realized by the installation of the property. Do not simply repeat the description from the predetermined equipment list. Instead describe the property and how it will be used at your facility. Include sketches of the equipment and flow diagrams of the processes where appropriate.

Land: If a use determination is being requested for land, provide a legal description and an accurate drawing of the property in question. Only that land which is actually used for pollution control purposes or that houses pollution control property is eligible for a positive use determination.

Used Equipment: If the property identified above has been purchased from another owner who previously used the property as pollution control property. Provide information that shows that the property was not taxable on or before January 1, 1994, by any taxing unit in which the property is now located.

DESCRIPTION/PURPOSE:
OF GASOLINE DESULPHURIZATION PROJECT
AT VALERO'S TEXAS CITY REFINERY

EPA required that the sulphur content in gasoline be reduced to 30 PPM in 2006. Valero evaluated seven technologies and selected C.D. Tech as the most effective method to minimize octane loss and yield loss, which run about 50% of overall operating costs of \$1.17 per barrel. Based on the design octane loss of $.8R + M/2$, with this method, estimated gasoline volume loss is 2,000 BPD.

Other technologies evaluated included UOP's ISAL, Phillips's 5ZORB, IFP's Prime G+, Mobil's Octgain, and Exxon's Scanfining.

Valero Energy Corporation, in compliance with federally mandated gasoline desulphurization requirements and at great expense, revamped its Texas City Refinery desulphurization equipment, by installing a new 53,000 BPD FCC gasoline C.D. Tech unit to reduce sulphur.

This environmental project necessitated the installation of a new heater and stack, new blend pumps, a new blend loop and related meters and valves.

Valero, as well, brought in a reformer gas compressor, two hydrogen recycle compressors, and a vent gas booster compressor. In addition, Valero installed two amine scrubbers, piping, etc.

All this equipment is wholly for pollution control as federally mandated by the EPA via 40CFR, Part 80, Subpart H, gasoline sulphur standards.

This project resulted in reducing to under 30 PPM the sulphur content in the gasoline products at this site for current production of 53,000 BPD, resulting in cleaner fuels and reduced emissions for consumers.

EQUIPMENT LIST
GASOLINE DESULPHURIZATION PROJECT AT VALERO'S
TEXAS CITY REFINERY

Heater and Stack
Blend Pumps
Blend Loop
Meters/Valves
Reformer Gas Compressor
2 Hydrogen Recycle Compressors
Booster Compressor
Amine Scrubber

9. DECISION FLOWCHART

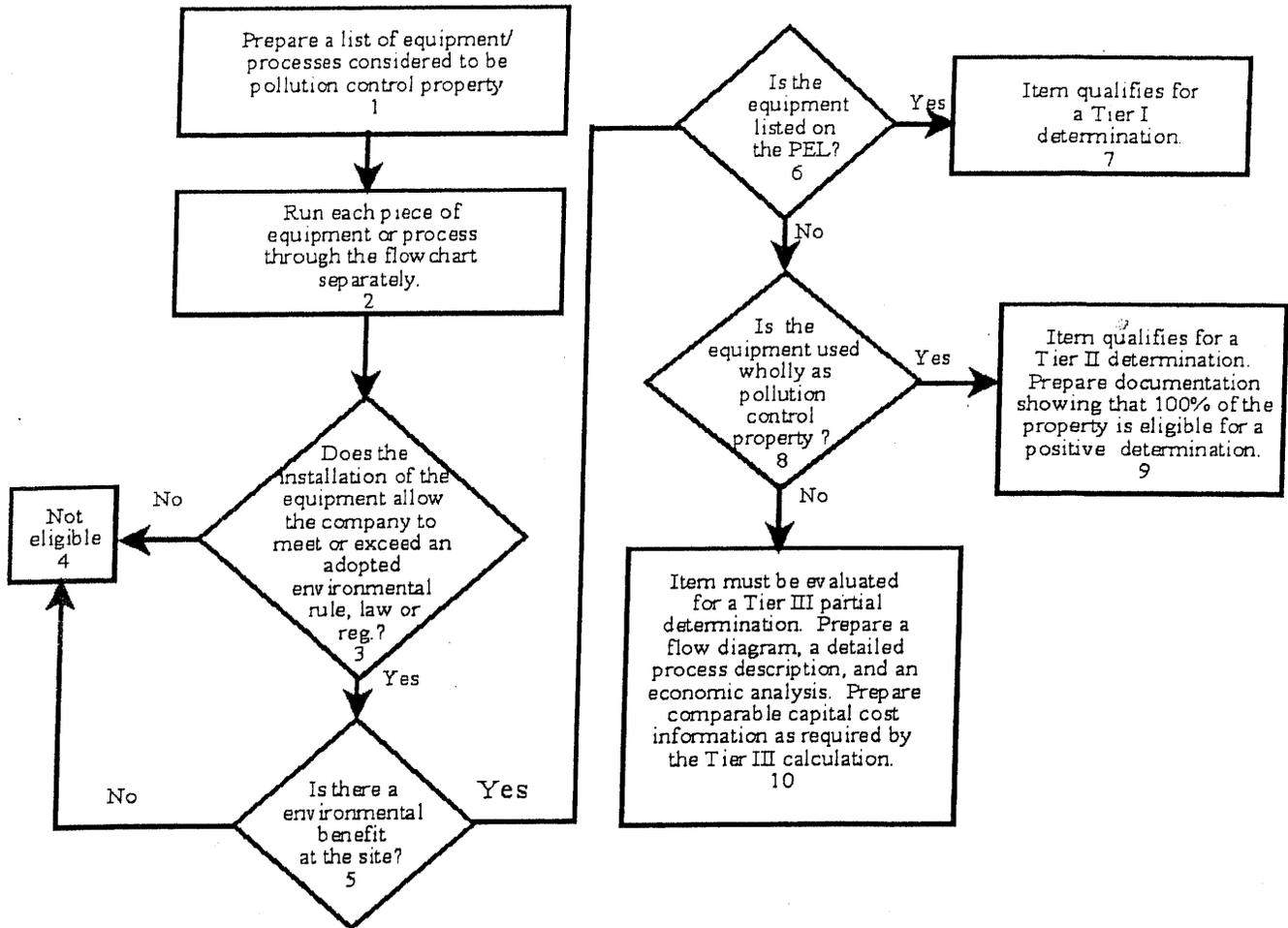
Each piece of equipment or process change must be processed through the following Decision Flow Chart. Each item of property listed on the application must result in a yes answer to boxes 3 and 5. Use the table in section 11 to document which box (7, 9 or 10) was the final destination of each piece of equipment.

The following instructions should be used with the flow chart. **The numbered items below do not correspond to the box numbers in the flow chart.**

1. Prepare a list of all process equipment and pollution control equipment that is considered to be pollution control property.
2. Each item on the list must be run through the flow chart separately. Some items will likely end at different points on the flow chart.
3. Determine whether the item is required to meet or exceed a state, local, or federal environmental regulation, rule or law. If no specific rule citation can be made, then this item does not qualify as pollution control property (Box 4).
4. Determine if there is an environmental benefit at the site where the equipment item is installed. A yes answer to this question is needed to continue evaluating the equipment. If the answer is no, then the equipment does not qualify (Box 4).
5. If the equipment is listed on the Predetermined Equipment List (PEL), then it qualifies as Tier I (Box 7). Determine the appropriate PEL number for each item.
6. Specify all PEL equipment for the project in a single list that is included with the application.
7. If the equipment is not on the PEL, then determine whether the equipment is used wholly for pollution control, i.e., the equipment is not production related and/or does not increase production or improve product quality.
8. If it is wholly for pollution control, then the equipment may qualify as 100% pollution control property under Tier II (Box 9). The applicant must provide sufficient written documentation and justification to prove that it qualifies.
9. If the equipment has both environmental and production elements, then the equipment must be evaluated as a Tier III partial determination (Box 10). The applicant must provide a detailed capital cost analysis following the procedures established in the Partial Determinations section of this document. The results of these calculations will determine the partial use percentage.

Prop 2 Decision Flow Chart

Applicants must use this flowchart for each piece of equipment or process. In order for a piece of equipment or process to be eligible for a positive use determination the item must generate 'yes' answers to the questions asked in boxes 3 and 5.



10. PARTIAL PERCENTAGE CALCULATION

This section is to be completed only for Tier III applications. Process changes or construction of new process equipment that results in pollution control may result in a partial determination. On one or more separate sheets of paper, explain how the partial percentage was determined using the Cost Analysis Procedure that is described in the attached *Instructions for Completing Application Form*. Include financial data that demonstrates how this percentage was calculated. Provide as detailed information as possible, since the information provided will be used by the TCEQ to evaluate the use percentage requested in the application. Attach sketches and/or flow diagrams showing the property and its function. Examples of partial determinations are shown in Appendix C of the technical guidance document.

11. PROPERTY CATEGORIES AND COSTS

Identify the category and the estimated purchase cost of the property listed in Section 8. List each piece of property for which a use determination is being sought. If the application is for property that is listed on the predetermined equipment list, list the appropriate item number(s) in the PEL column. Place an "N" in the second column to certify

that the property was not taxable on or before January 1, 1994. Failure to answer this question for each piece of property will result in the issuance of a notice of deficiency letter and the possible rejection of the application. List the which box, (7, 9, or 10), was the final destination of each piece of property. List the estimated or actual purchase cost of the property. If the property is not wholly used for the purpose of pollution control, list the estimated percentage of pollution control calculated using the Partial Determination Cost Analysis Procedure.

Property	Property Taxable on or Before 1/10/94	Decision Flow Chart Box 7, 8, or 10	PEL Number	Estimated Purchase Cost	Partial Percentage
Texas City Refinery					
Land					
Property					
GASOLINE HYDRODESULPHURIZATION UNIT	N	9*	NA	\$97,778,121	100%
Totals				\$97,778,121	

12. EMISSION REDUCTION INCENTIVE GRANT

Will an application for an Emission Reduction Incentive Grant be filed for this property/project:

Yes No

13. APPLICATION DEFICIENCIES

After an initial review of the application, the TCEQ may determine that the information provided with the application is not sufficient to make a use determination. The TCEQ may send a notice of deficiency, requesting additional information that must be provided within 30 days of the written notice.

14. FORMAL REQUEST FOR SIGNATURE

By signing this application, you certify that this information is true to the best of your knowledge and belief.

NAME: *[Signature]* DATE: 01/26/2007

TITLE: DIRECTOR - AD VALOREM TAX

COMPANY: VALERO ENERGY CORPORATION

* Valero believes the subject property complies with the statutory requirements for a Pollution Control Property Tax Exemption.

Under Texas Penal Code, Section 37.10, if you make a false statement on this application, you could receive a jail term of up to one year and a fine up to \$2,000, or a prison term of two to 10 years and a fine of up to \$5,000.



Ad Valorem Tax

January 26, 2007

Senders Record – Certified Article Number
7160 3901 9849 5897 0367
2007 TCEQ Appl – TX Valero Refineries

Texas Commission on Environmental Quality
MC-214, Cashiers Office
P.O. Box 13088
Austin, TX 78711-3088

RE: Application for Use Determination for Pollution Control Property
Texas City Refinery Gasoline Desulphurization Project

Dear Sirs:

In accordance with the Texas Property Tax Code Section 11.31, Valero Refining – Texas, L.P., a Subsidiary of Valero Energy Corporation, respectfully submits the enclosed pollution control tax exemption application for our Texas City Refinery, along with the Tier II application fee of \$1,000. This pollution control project was federally mandated by the Environmental Protection Agency, and will successfully eliminate the vast majority of the sulphur content from the product pool produced at our Galveston County location.

This increasingly efficient process of sulphur reduction will continue to improve air quality by reducing sulphur emissions resulting from the combustion of petroleum products.

Respectfully yours,

A handwritten signature in black ink, appearing to read "Trey Novosad", written over a horizontal line.

Trey Novosad
Director – Ad Valorem Tax

TNN:srk

Enclosure

EXHIBIT A2

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



RECEIVED
FEB 20 2007
GALVESTON CAD

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution
February 09, 2007

CHIEF APPRAISER
GALVESTON COUNTY APPRAISAL DISTRICT
600 GULF FWY STE 113
TEXAS CITY TX 77591

This letter is to inform you that a Use Determination Application has been filed for:

VALERO REFINING COMPANY - TEXAS
VALERO TEXAS CITY REFINERY
1301 LOOP 197 SOUTH
TEXAS CITY TX 77590

a facility located in GALVESTON County.

A copy of the use determination application is attached to this letter.

This application has been assigned a tracking number of 06 -10285. We recommend that the appraisal district notify all affected taxing entities of the filing of this application. Please contact the Tax Relief for Pollution Control Property Program at (512) 239-6348 if you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Ronald L. Hatlett".

Ronald L. Hatlett
Tax Relief for Pollution Control Property Program

F. Company Number or Registration Number: _____
(Required)

5. APPRAISAL DISTRICT WITH TAXING AUTHORITY OVER PROPERTY

A. Name of Appraisal District: Galveston County Appraisal District

B. Appraisal District Account Number: R293410

6. CONTACT NAME (must be provided)

A. Company/Organization Name: Valero Energy Corporation

B. Name of Individual to Contact: Trey Novosad

C. Mailing Address: PO Box 690110

D. City, State, ZIP: San Antonio, TX 78269-0110

E. Telephone number and fax number: 210-345-2700 fax:210-345-2495

F. E-Mail address (if available): Trey.Novosad@Valero.com

7. RELEVANT RULE, REGULATION, OR STATUTORY PROVISION

For each of the pollution control properties listed on this application, select the type of medium or media (air, water, waste) for which the property or device is required. Use the second column to cite the specific environmental rule, regulation, and/or law that is being met or exceeded by the installation of this property. The citation should be specific and should include the section and/or subsection of the rule, regulation, and/or law. Do not list permit numbers or registration numbers in this table. If the property or equipment was installed or constructed in response to an agreed order, do not list the order — list the rule, regulation, or law that requires the installation or construction of the property.

MEDIUM	RULE/REGULATION/LAW
Air	40 CFR, PART 80, REGULATION OF FUELS AND FUEL ADDITIVES, SUBPART I, MOTOR VEHICLE, NON-ROAD, LOCOMOTIVE AND MARINE DIESEL FUEL.
Water	
Waste	

8. DESCRIPTION OF PROPERTY (Complete for all applications)

Provide a description and purpose of the property for which this application is being filed. This description must include the anticipated environmental benefits for the prevention, monitoring, control, or reduction of air, water, or land pollution that will be realized by the installation of the property. Do not simply repeat the description from the predetermined equipment list. Instead describe the property and how it will be used at your facility. Include sketches of the equipment and flow diagrams of the processes where appropriate.

Land: If a use determination is being requested for land, provide a legal description and an accurate drawing of the property in question. Only that land which is actually used for pollution control purposes or that houses pollution control property is eligible for a positive use determination.

Used Equipment: If the property identified above has been purchased from another owner who previously used the property as pollution control property. Provide information that shows that the property was not taxable on or before January 1, 1994, by any taxing unit in which the property is now located.

DESCRIPTION/PURPOSE: OF REFINERY REVAMP AT TEXAS CITY REFINERY

EPA's Clean Air Highway Diesel final rule known as the "2007 Heavy-Duty Highway Rule" requires a 97 percent reduction in the sulphur content of highway diesel fuel, from its previous level of 500 parts per million (ppm), to 15 ppm. By addressing diesel fuel and engines together as a single system, EPA contends that this fuels regulation will provide annual emission reductions equivalent to removing the pollution from more than 90 percent of today's trucks and buses, or about 13 million trucks and buses, when the current heavy-duty vehicle fleet has been completely replaced in 2030. The expected annual, nationwide reductions in emissions oxides of nitrogen and soot, or particulate matter (PM) from cars and trucks is estimated by EPA at 2.6 million tons and 110,000 tons respectively.

EPA required that 80% of on-road diesel contain less than 15 PPM sulphur by 2006. Valero evaluated various means to arrive at that goal and selected a new hydrotreating method as the most practical and cost efficient approach. We deemed other new, innovative technologies as relatively untested and expensive. It was decided that an end-run sulphur content of 7 PPM was a reasonable and workable target.

Valero, in order to comply with the mandates of federal diesel desulphurization regulations, at considerable expense to itself, revamped its Diesel Hydrodesulphurization Unit, DHDSU, at the Texas City Refinery in order to turn out ultra low sulfur diesel of 7 PPM.

This revamping necessitated new storage capacity for LCO and LCGO and ULSD/kerosene segregation, a new 2-bed reactor, a replacement convection section with larger diameter tubes, new exchangers, a replacement air cooler, and larger amine booster pumps.

A new replacement convection system with larger diameter tubes was installed, and the gas trim condenser was replaced with 2 shells in series, E1761 and E1762 exchangers. Larger sized impellers were necessary, as were larger inlet nozzles, and fire protection systems were additionally required.

Additionally, new tankage, cooling pumps and motors, larger piping, fire protection systems, various valves, trays, etc. were required on this environmental project in order to meet regulatory mandates.

This environmental project was undertaken for pollution control as federally mandated by the EPA via 40CFR, Part 80, Subpart I, motor vehicles, off - road and marine diesel fuels standards.

This project reduces to 7 PPM the sulphur content in the distillate products at this site, resulting in cleaner fuels and reduced emissions for consumers, at the rate of 34,000 BPD straight - run diesel, 8,000 BPD oil hydrotreated diesel, and 6,000 BPD kerosine.

EQUIPMENT LIST ULSD PROJECT AT VALERO'S TEXAS CITY REFINERY

- 2-Bed Reactors
- Exchangers
- Replacement Convection Section
- Air Cooler
- Pumps
- Compressors
- Tankage
- Larger Piping

9. DECISION FLOWCHART

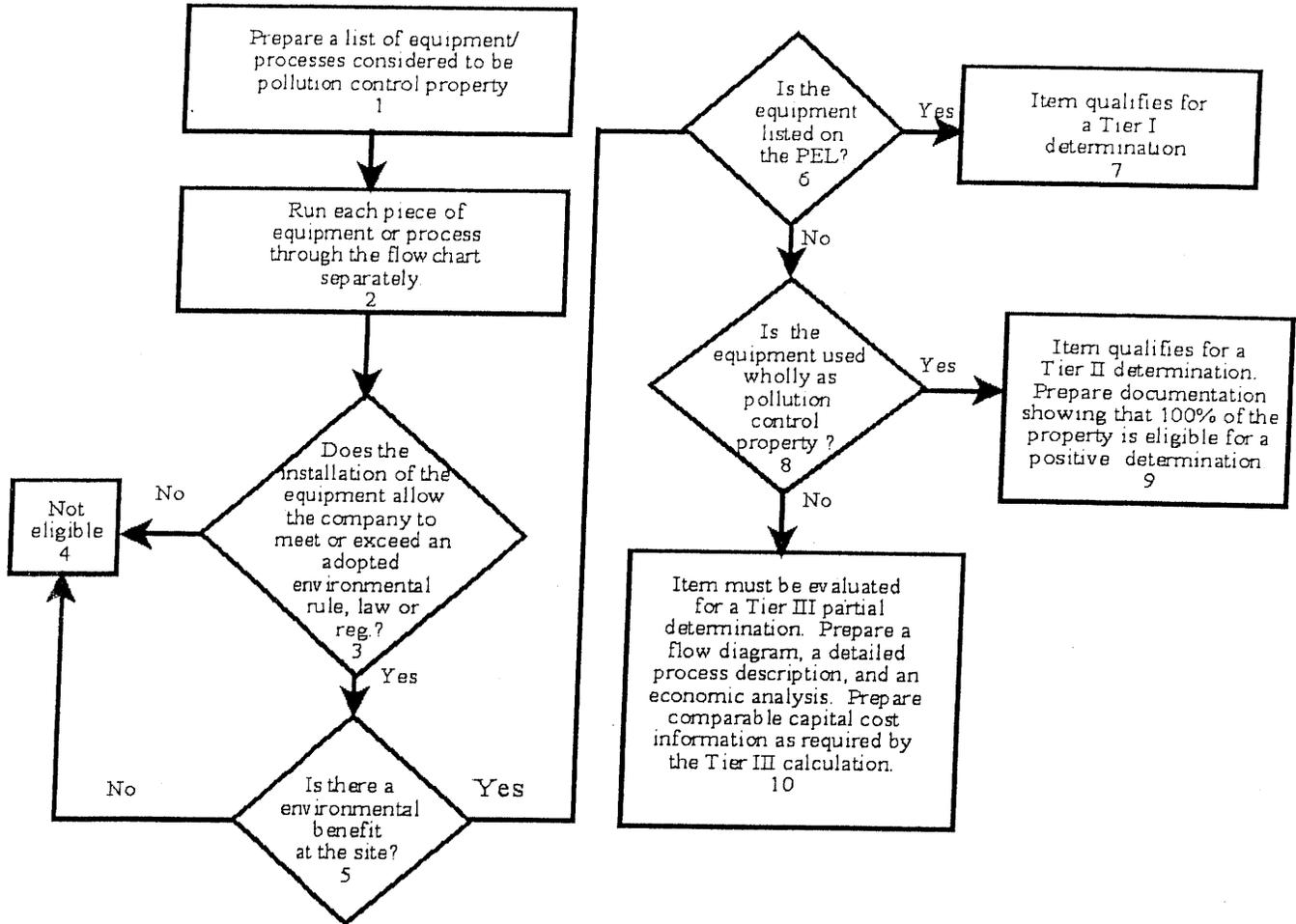
Each piece of equipment or process change must be processed through the following Decision Flow Chart. Each item of property listed on the application must result in a yes answer to boxes 3 and 5. Use the table in section 11 to document which box (7, 9 or 10) was the final destination of each piece of equipment.

The following instructions should be used with the flow chart. **The numbered items below do not correspond to the box numbers in the flow chart.**

1. Prepare a list of all process equipment and pollution control equipment that is considered to be pollution control property.
2. Each item on the list must be run through the flow chart separately. Some items will likely end at different points on the flow chart.
3. Determine whether the item is required to meet or exceed a state, local, or federal environmental regulation, rule or law. If no specific rule citation can be made, then this item does not qualify as pollution control property (Box 4).
4. Determine if there is an environmental benefit at the site where the equipment item is installed. A yes answer to this question is needed to continue evaluating the equipment. If the answer is no, then the equipment does not qualify (Box 4).
5. If the equipment is listed on the Predetermined Equipment List (PEL), then it qualifies as Tier I (Box 7). Determine the appropriate PEL number for each item.
6. Specify all PEL equipment for the project in a single list that is included with the application.
7. If the equipment is not on the PEL, then determine whether the equipment is used wholly for pollution control, i.e., the equipment is not production related and/or does not increase production or improve product quality.
8. If it is wholly for pollution control, then the equipment may qualify as 100% pollution control property under Tier II (Box 9). The applicant must provide sufficient written documentation and justification to prove that it qualifies.
9. If the equipment has both environmental and production elements, then the equipment must be evaluated as a Tier III partial determination (Box 10). The applicant must provide a detailed capital cost analysis following the procedures established in the Partial Determinations section of this document. The results of these calculations will determine the partial use percentage.

Prop 2 Decision Flow Chart

Applicants must use this flow chart for each piece of equipment or process. In order for a piece of equipment or process to be eligible for a positive use determination the item must generate 'yes' answers to the questions asked in boxes 3 and 5.



10. PARTIAL PERCENTAGE CALCULATION

This section is to be completed only for Tier III applications. Process changes or construction of new process equipment that results in pollution control may result in a partial determination. On one or more separate sheets of paper, explain how the partial percentage was determined using the Cost Analysis Procedure that is described in the attached *Instructions for Completing Application Form*. Include financial data that demonstrates how this percentage was calculated. Provide as detailed information as possible, since the information provided will be used by the TCEQ to evaluate the use percentage requested in the application. Attach sketches and/or flow diagrams showing the property and its function. Examples of partial determinations are shown in Appendix C of the technical guidance document.

11. PROPERTY CATEGORIES AND COSTS

Identify the category and the estimated purchase cost of the property listed in Section 8. List each piece of property for which a use determination is being sought. If the application is for property that is listed on the predetermined equipment list, list the appropriate item number(s) in the PEL column. Place an "N" in the second column to certify

that the property was not taxable on or before January 1, 1994. Failure to answer this question for each piece of property will result in the issuance of a notice of deficiency letter and the possible rejection of the application. List the which box, (7, 9, or 10), was the final destination of each piece of property. List the estimated or actual purchase cost of the property. If the property is not wholly used for the purpose of pollution control, list the estimated percentage of pollution control calculated using the Partial Determination Cost Analysis Procedure.

Property	Property Taxable on or Before 1/10/94	Decision Flow Chart Box 7, 8, or 10	PEL Number	Estimated Purchase Cost	Partial Percentage
Texas City Refinery					
Land					
Property					
DIESEL HYDROTREATER	N	9*	NA	\$41,048,683	100%
Totals				\$41,048,683	

12. EMISSION REDUCTION INCENTIVE GRANT

Will an application for an Emission Reduction Incentive Grant be filed for this property/project:

Yes No

13. APPLICATION DEFICIENCIES

After an initial review of the application, the TCEQ may determine that the information provided with the application is not sufficient to make a use determination. The TCEQ may send a notice of deficiency, requesting additional information that must be provided within 30 days of the written notice.

14. FORMAL REQUEST FOR SIGNATURE

By signing this application, you certify that this information is true to the best of your knowledge and belief.

NAME:  DATE: 01/26/2007

TITLE: DIRECTOR - AD VALOREM TAX

COMPANY: VALERO ENERGY CORPORATION

* Valero believes the subject property complies with the statutory requirements for a Pollution Control Property Tax Exemption.

Under Texas Penal Code, Section 37.10, if you make a false statement on this application, you could receive a jail term of up to one year and a fine up to \$2,000, or a prison term of two to 10 years and a fine of up to \$5,000.

Senders Record – Certified Article Number

7160 3901 9849 5897 0367
2007 TCEQ Appl – TX Valero Refineries

January 26, 2007

Texas Commission on Environmental Quality
MC-214, Cashiers Office
P.O. Box 13088
Austin, TX 78711-3088

RE: Application for Use Determination for Pollution Control Property
Texas City Refinery Ultra Low Sulfur Diesel Project

Dear Sirs:

In accordance with the Texas Property Tax Code Section 11.31, Valero Refining – Texas, L.P., a Subsidiary of Valero Energy Corporation, respectfully submits the enclosed pollution control tax exemption application for our Texas City Refinery, along with the Tier II application fee of \$1,000. This pollution control project was federally mandated by the Environmental Protection Agency, and will successfully eliminate the vast majority of the sulphur content from the product pool produced at our Galveston County location.

This increasingly efficient process of sulphur reduction will continue to improve air quality by reducing sulphur emissions resulting from the combustion of petroleum products.

Respectfully yours,



Trey Novosad
Director – Ad Valorem Tax

TNN:srk

Enclosure

EXHIBIT B1

Kathleen Hartnett White, *Chairman*
Larry R. Soward, *Commissioner*
H. S. Buddy Garcia, *Commissioner*
Glenn Shankle, *Executive Director*



TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution
April 18, 2007

CHIEF APPRAISER
GALVESTON COUNTY APPRAISAL DISTRICT
600 GULF FWY STE 113
TEXAS CITY TX 77591

This letter is to inform you that the technical review of Use Determination Application, 06-10284, for:

VALERO TEXAS CITY REFINERY
1301 LOOP 197 SOUTH
TEXAS CITY TX 77590

has been completed. The outcome of this review is as follows:

A negative determination for this project. This application is 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) (30 TAC 17.25). 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 4. A yes answer is received for Box 3 since 40 CFR 80 is considered to be a valid adopted rule. Box 4 requires that the installation and use of the property produces an environmental benefit at the site. When we evaluate low sulfur fuel projects with regard to Box 4 of the DFC we receive a 'no' answer. 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.

Section 11.31(a) of the Tax Code reads 'A person is not entitled to an exemption from taxation under this section solely on the basis that the person manufactures or produces a product or provides a service that prevents, monitors, controls, or reduces air, water, or land pollution.' The equipment listed on this application is used for the purpose of producing a product which is designed to control air pollution, the Tax Code excludes this equipment from being eligible for a positive determination.

House Bill 3121, enacted during the 77th Legislature Session, established a process for appealing a use determination. The Texas Commission on Environmental Quality (TCEQ) rules that implement the appeals process are at 30 TAC 17.25. Pursuant to 17.25(a)(1), an appeal must be filed within 20 days of receipt of the use determination. Should you choose to appeal the use determination, please submit a copy of your appeal to the TCEQ Tax Relief for Pollution Control Property program at the time of filing the appeal with the Chief Clerk of the commission. If you have any questions or require any additional information please contact the TCEQ Tax Relief for Pollution Control Property program at (512) 239-6348.

Sincerely,

A handwritten signature in black ink, appearing to read "Ronald L. Hatlett".

Ronald L. Hatlett
Tax Relief for Pollution Control Property Program

TAX RELIEF FOR POLLUTION CONTROL PROPERTY: TECHNICAL REVIEW DOCUMENT

Reviewed By: RLH App. No.: 06 - 10284 Review Start Date: 3/6/2007
Company Name: VALERO REFINING COMPANY - TEXAS
Facility Name: VALERO TEXAS CITY REFINERY

TIER LEVEL

What Tier is this application? The application was filed as a Tier II application.

The equipment listed on this application is not located on the predetermined equipment list. Therefore it is not a Tier I application. Further review is required in order to determine if it is correctly filed as a Tier II or if it should be a Tier III.

RELEVANT RULE, REGULATION, OR STATUTORY PROVISION

The rule listed in the application is:
40 CFR 80 H

40 CFR 80 H: AIR PROGRAMS, REGULATION OF FUELS AND FUEL ADDITIVES, Subpart H--GASOLINE SULFUR. This is a valid rule.

DESCRIPTION OF PROPERTY

Description: Is an adequate description and purpose of the property provided? Does it list the anticipated environmental benefits? Are sketches and flow diagrams provided if needed?

The property is described as:

Gasoline Desulphurization Project (Equipment List): Heater & Stack; Blend Pumps; Blend Loop; Meters/Valves; Reformer Gas Compressor; 2 Hydrogen Recycle Compressors; Booster Compressor; and Amine Scrubber.

The description is adequate.

DECISION FLOWCHART

Mark the appropriate boxes: Box 3 Y Box 5 N Box 6 Box 8 Box 10

Reason this box was chosen:

This project does not make it through Box 5 with a yes answer.

TIER III APPLICATIONS

Did the applicant use the CAP? Recalculate the CAP. Does your calculation agree with the applicants?

There is no Tier III calculation provided.

PROPERTY CATEGORIES AND COSTS

Is the table completed correctly? Has the applicant certified that all listed property became taxable for the first time after January 1, 1994? Is all information necessary for conducting the technical review included.

Yes

TECHNICAL REVIEW

Is the application technically complete? If the answer is no, what is missing? Provide the language used in the NOD letter. If yes then develop the use determination language.

Technically complete when received: N

1st NOD: See file

NOD RESPONSE

1st NOD: Disagree that there is not any environmental benefit at the site.

Full Property Description:

Gasoline Desulphurization Project (Equipment List): Heater & Stack; Blend Pumps; Blend Loop; Meters/Valves; Reformer Gas Compressor; 2 Hydrogen Recycle Compressors; Booster Compressor; and Amine Scrubber.

DETERMINATION

Provide the reason for your determination.

Equipment fails to make it through Box 5 of the DFC. Under the rules there is only one possible outcome. An additional reason for the negative determination is 11.31a of the Tax Code. Which states that a person is not entitled to a positive determination for producing a product which controls pollution.

Provide the language for the final determination.
A negative determination for this project.

***** ED Approval Required: N *****

Reviewed by: *Gary E. McArthur*

Date: 4/13/2007

Peer Reviewed By: *Ronald Hallett*

Date: 4/13/2007

EXHIBIT B2

Kathleen Hartnett White, *Chairman*
 Larry R. Soward, *Commissioner*
 H. S. Buddy Garcia, *Commissioner*
 Glenn Shankle, *Executive Director*



TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution
 April 18, 2007

CHIEF APPRAISER
 GALVESTON COUNTY APPRAISAL DISTRICT
 600 GULF FWY STE 113
 TEXAS CITY TX 77591

This letter is to inform you that the technical review of Use Determination Application, 06-10285, for:

VALERO TEXAS CITY REFINERY
 1301 LOOP 197 SOUTH
 TEXAS CITY TX 77590

has been completed. The outcome of this review is as follows:

A negative determination for this project. This application is 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) (30 TAC 17.25). 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 4. A yes answer is received for Box 3 since 40 CFR 80 is considered to be a valid adopted rule. Box 4 requires that the installation and use of the property produces an environmental benefit at the site. When we evaluate low sulfur fuel projects with regard to Box 4 of the DFC we receive a 'no' answer. 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.

Section 11.31(a) of the Tax Code reads 'A person is not entitled to an exemption from taxation under this section solely on the basis that the person manufactures or produces a product or provides a service that prevents, monitors, controls, or reduces air, water, or land pollution.' The equipment listed on this application is used for the purpose of producing a product which is designed to control air pollution, the Tax Code excludes this equipment from being eligible for a positive determination.

House Bill 3121, enacted during the 77th Legislature Session, established a process for appealing a use determination. The Texas Commission on Environmental Quality (TCEQ) rules that implement the appeals process are at 30 TAC 17.25. Pursuant to 17.25(a)(1), an appeal must be filed within 20 days of receipt of the use determination. Should you choose to appeal the use determination, please submit a copy of your appeal to the TCEQ Tax Relief for Pollution Control Property program at the time of filing the appeal with the Chief Clerk of the commission. If you have any questions or require any additional information please contact the TCEQ Tax Relief for Pollution Control Property program at (512) 239-6348.

Sincerely,

Ronald L. Hatlett
 Tax Relief for Pollution Control Property Program

TAX RELIEF FOR POLLUTION CONTROL PROPERTY: TECHNICAL REVIEW DOCUMENT

Reviewed By: RLH App. No.: 06 - 10285 Review Start Date: 3/6/2007
 Company Name: VALERO REFINING COMPANY - TEXAS
 Facility Name: VALERO TEXAS CITY REFINERY

TIER LEVEL

What Tier is this application? The application was filed as a Tier II application.

The equipment listed on this application is not located on the predetermined equipment list. Therefore it is not a Tier I application. Further review is required in order to determine if it is correctly filed as a Tier II or if it should be a Tier III.

RELEVANT RULE, REGULATION, OR STATUTORY PROVISION

The rule listed in the application is:
 40 CFR 80 I

40 CFR 80 I: AIR PROGRAMS, REGULATION OF FUELS AND FUEL ADDITIVES, Subpart I-- Motor Vehicles, Nonroad, Locomotive, And Marine Diesel Fuel. This is a valid rule.

DESCRIPTION OF PROPERTY

Description: Is an adequate description and purpose of the property provided? Does it list the anticipated environmental benefits? Are sketches and flow diagrams provided if needed?

The property is described as:

ULSD Refinery Revamp (Equipment List): 2-Bed Reactors; Exchangers; Replacement Convection Section; Air Cooler; Pumps; Compressors; Tankage; and Larger Piping.

The description is adequate.

DECISION FLOWCHART

Mark the appropriate boxes: Box 3 Y Box 5 N Box 6 Box 8 Box 10

Reason this box was chosen:

This project does not make it through Box 5 with a yes answer.

TIER III APPLICATIONS

Did the applicant use the CAP? Recalculate the CAP. Does your calculation agree with the applicants?

There is no Tier III calculation provided.

PROPERTY CATEGORIES AND COSTS

Is the table completed correctly? Has the applicant certified that all listed property became taxable for the first time after January 1, 1994? Is all information necessary for conducting the technical review included.

Yes

TECHNICAL REVIEW

Is the application technically complete? If the answer is no, what is missing? Provide the language used in the NOD letter. If yes then develop the use determination language.

Technically complete when received: N

1st NOD: See file

NOD RESPONSE

1st NOD: Disagree that there is not any environmental benefit at the site.

Full Property Description:

ULSD Refinery Revamp (Equipment List): 2-Bed Reactors; Exchangers; Replacement Convection Section; Air Cooler; Pumps; Compressors; Tankage; and Larger Piping.

DETERMINATION

Provide the reason for your determination.

Equipment fails to make it through Box 5 of the DFC. Under the rules there is only one possible outcome. An additional reason for the negative determination is 11.31a of the Tax Code. Which states that a person is not entitled to a positive determination for producing a product which controls pollution.

Provide the language for the final determination.
A negative determination for this project.

***** ED Approval Required: N *****

Reviewed by: *Gary E. McArthur*

Date: 4/13/2007

Peer Reviewed By: *Ronald A. Hallett*

Date: 4/13/2007

EXHIBIT C1

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY (TCEQ)

TO: Chief Appraiser
Galveston County Appraisal District
600 Gulf Fwy, Suite 113
Texas City, TX 77591

Ron Hatlett, TCEQ, SBEA, Mail Code 110

Stephanie Bergeron, TCEQ, OLS-Environmental Law, Mail Code 173

Celeste Baker, TCEQ, OGC, Mail Code 101

Office of Public Interest Counsel, TCEQ, Mail Code 103

FROM: Office of the Chief Clerk, TCEQ, Mail Code 105

DATE: May 11, 2007

RE: 30 TAC § 17.25 - Appeal of Use Determination Issued by the
Executive Director Regarding Valero Texas City Refinery,
TCEQ ID No. 06-10284, Docket No. 2007-0740-MIS-U

The enclosed appeal was filed in the Office of the Chief Clerk (OCC) of the Texas Commission on Environmental Quality (TCEQ) by the Applicant on the date indicated by the Chief Clerk's date stamp. Pursuant to 30 TAC § 17.25(c)(1) and (2), the Chief Clerk is delivering a copy of the appeal to the Executive Director and to the Chief Appraiser.

As required in § 17.25(c)(3), OCC will schedule the appeal for consideration at a future commission meeting, and you should expect to receive adequate notice of that date in the near future.



TEXAS
COMMISSION ON ENVIRONMENTAL QUALITY

CHIEF CLERK

Parker Wilson
Managing Counsel
Environmental/Safety and
Regulatory Affairs Law

May 8, 2007

Ms. LaDonna Castañuela
Chief Clerk
Texas Commission on Environmental Quality
MC 105
P.O. Box 13087
Austin, TX 78711-3087

Re: Appeal of Negative Use Determination for Pollution Control Property Use
Determination Application No. 06-10284; Valero Texas City Refinery
Gasoline Desulphurization Project

Dear Ms. Castañuela:

Pursuant to 30 TAC §17.25, Valero Refining – Texas, L.P. (“Valero”) is hereby filing an appeal of the negative use determination made by the Executive Director of the Texas Commission on Environmental Quality (“TCEQ”) with respect to Valero’s use determination application (No. 06-10284) for certain pollution control property installed at the Valero Texas City Refinery, 1301 Loop 197 South, Texas City, Texas, 77590. A copy of the application and resulting negative use determination is attached to this letter.

On April 18, 2007, the Executive Director denied Valero a positive use determination relating to the refinery’s Gasoline Desulphurization project on two grounds. First, the Executive Director determined that the pollution control property (including heater and stack, blend pumps, blend loop, meters and valves, reformer gas compressor, two hydrogen recycle compressors, booster compressor, and amine scrubber – all installed and undertaken to comply with a federal mandate to produce low emitting, low-sulfur gasoline) does not “provide an environmental benefit at the site.” However, Tax Code § 11.31 contains no prerequisite that the “facility, device, or method for the control of air, water, or land pollution” provide a direct onsite environmental benefit in order to qualify for the pollution control property tax exemption.

Second, the Executive Director found that the pollution control property installed by Valero is used for the purpose of “producing a product which is designed to control air pollution.” This is simply not the case. Valero does not manufacture pollution control property, particularly as contemplated by the statute, and therefore it should not be disqualified from receiving a positive use determination with respect to the purchase and installation of the above-referenced pollution control property.

Ms. LaDonna Castañuela
May 8, 2007
Page 2

Fundamental fairness, as well as a careful reading of the authorizing statute, dictates that the Proposition 2 tax exemption apply equally to all pollution control properties that are required by the government to be used, constructed, acquired, or installed in Texas. This is so regardless of whether the environmental benefit manifests itself onsite, within the borders of the facility, or offsite, outside the borders of the facility. As a result of the negative use determination, Valero is now presumptively ineligible to seek the property tax exemption to which it is entitled. Valero therefore requests that the Commission take under consideration the Executive Director's initial negative use determination.

I appreciate your time and attention to this matter. Please don't hesitate to contact me at your convenience at (210) 345-5894 should you have any questions or need additional information.

Sincerely,



Parker Wilson

Enc.

Cc: TCEQ
Tax Relief for Pollution Control Property MC-110
P.O. Box 13087
Austin, TX 78711-3087

Roy Martin
Trey Novosad
Rich Walsh

EXHIBIT C2

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY (TCEQ)

TO: Chief Appraiser
Galveston County Appraisal District
600 Gulf Fwy, Suite 113
Texas City, TX 77591

Ron Hatlett, TCEQ, SBEA, Mail Code 110

Stephanie Bergeron, TCEQ, OLS-Environmental Law, Mail Code 173

Celeste Baker, TCEQ, OGC, Mail Code 101

Office of Public Interest Counsel, TCEQ, Mail Code 103

FROM: Office of the Chief Clerk, TCEQ, Mail Code 105

DATE: May 11, 2007

RE: 30 TAC § 17.25 - Appeal of Use Determination Issued by the
Executive Director Regarding Valero Texas City Refinery,
TCEQ ID No. 06-10285, Docket No. 2007-0724-MIS-U

The enclosed appeal was filed in the Office of the Chief Clerk (OCC) of the Texas Commission on Environmental Quality (TCEQ) by the Applicant on the date indicated by the Chief Clerk's date stamp. Pursuant to 30 TAC § 17.25(c)(1) and (2), the Chief Clerk is delivering a copy of the appeal to the Executive Director and to the Chief Appraiser.

As required in § 17.25(c)(3), OCC will schedule the appeal for consideration at a future commission meeting, and you should expect to receive adequate notice of that date in the near future.



TE
COMM
OFF
CHIEF CLERK'S OFFICE

Parker Wilson
Managing Counsel
Environmental/Safety and
Regulatory Affairs Law

May 8, 2007

Ms. LaDonna Castañuela
Chief Clerk
Texas Commission on Environmental Quality
MC 105
P.O. Box 13087
Austin, TX 78711-3087

Re: Appeal of Negative Use Determination for Pollution Control Property Use
Determination Application No. 06-10285; Valero Texas City Refinery
Ultra Low Sulfur Diesel Project

Dear Ms. Castañuela:

Pursuant to 30 TAC §17.25, Valero Refining – Texas, L.P. (“Valero”) is hereby filing an appeal of the negative use determination made by the Executive Director of the Texas Commission on Environmental Quality (“TCEQ”) with respect to Valero’s use determination application (No. 06-10285) for certain pollution control property installed at the Valero Texas City Refinery, 1301 Loop 197 South, Texas City, Texas, 77590. A copy of the application and resulting negative use determination is attached to this letter.

On April 18, 2007, the Executive Director denied Valero a positive use determination relating to the refinery’s Ultra Low Sulfur Diesel project on two grounds. First, the Executive Director determined that the pollution control property (including two-bed reactors, exchangers, replacement convection section, air cooler, pumps, compressors, tankage, and larger piping – all installed to comply with a federal mandate to produce low emitting, ultra-low-sulfur diesel fuel) does not “provide an environmental benefit at the site.” However, Tax Code § 11.31 contains no prerequisite that the “facility, device, or method for the control of air, water, or land pollution” provide a direct onsite environmental benefit in order to qualify for the pollution control property tax exemption.

Second, the Executive Director found that the pollution control property installed by Valero is used for the purpose of “producing a product which is designed to control air pollution.” This is simply not the case. Valero does not manufacture pollution control property, particularly as contemplated by the statute, and therefore it should not be disqualified from receiving a positive use determination with respect to the purchase and installation of the above-referenced pollution control property.

Ms. LaDonna Castañuela
May 8, 2007
Page 2

Fundamental fairness, as well as a careful reading of the authorizing statute, dictates that the Proposition 2 tax exemption apply equally to all pollution control properties that are required by the government to be used, constructed, acquired, or installed in Texas. This is so regardless of whether the environmental benefit manifests itself onsite, within the borders of the facility, or offsite, outside the borders of the facility. As a result of the negative use determination, Valero is now presumptively ineligible to seek the property tax exemption to which it is entitled. Valero therefore requests that the Commission take under consideration the Executive Director's initial negative use determination.

I appreciate your time and attention to this matter. Please don't hesitate to contact me at your convenience at (210) 345-5894 should you have any questions or need additional information.

Sincerely,



Parker Wilson

Enc.

Cc: TCEQ
Tax Relief for Pollution Control Property MC-110
P.O. Box 13087
Austin, TX 78711-3087

Roy Martin
Trey Novosad
Rich Walsh

EXHIBIT D

1 of 3 DOCUMENTS

TEXAS STATUTES AND CODES ANNOTATED BY LEXISNEXIS(R)

ARCHIVE MATERIAL

*** This document is current through the 2006 3rd Called Session ***

*** Annotations current through Jan. 2, 2007 ***

TAX CODE
TITLE 1. PROPERTY TAX CODE
SUBTITLE C. TAXABLE PROPERTY AND EXEMPTIONS
CHAPTER 11. TAXABLE PROPERTY AND EXEMPTIONS
SUBCHAPTER B. EXEMPTIONS

Tex. Tax Code § 11.31 (2006)

§ 11.31. Pollution Control Property

(a) 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. A person is not entitled to an exemption from taxation under this section solely on the basis that the person manufactures or produces a product or provides a service that prevents, monitors, controls, or reduces air, water, or land pollution. Property used for residential purposes, or for recreational, park, or scenic uses as defined by Section 23.81, is ineligible for an exemption under this section.

(b) In this section, "facility, device, or method for the control of air, water, or land pollution" means land that is acquired after January 1, 1994, or 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. This section does not apply to a motor vehicle.

(c) In applying for an exemption under this section, a person seeking the exemption shall present in a permit application or permit exemption request to the executive director of the Texas Natural Resource Conservation Commission information detailing:

(1) the anticipated environmental benefits from the installation of the facility, device, or method for the control of air, water, or land pollution;

(2) the estimated cost of the pollution control facility, device, or method; and

(3) the purpose of the installation of such facility, device, or method, and the proportion of the installation that is pollution control property.

If the installation includes property that is not used wholly for the control of air, water, or land pollution, the person seeking the exemption shall also 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.

(d) Following submission of the information required by Subsection (c), the executive director of the Texas Natural Resource Conservation Commission shall determine if the facility, device, or method is used wholly or partly as a facility, device, or method for the control of air, water, or land pollution. As soon as practicable, the executive director shall send notice by regular mail to the chief appraiser of the appraisal district for the county in which the property is located that the person has applied for a determination under this subsection. The executive director shall issue a letter to the person stating the executive director's determination of whether the facility, device, or method is used wholly or partly to control pollution and, if applicable, the proportion of the property that is pollution control property. The executive director shall send a copy of the letter by regular mail to the chief appraiser of the appraisal district for the county in which the property is located.

(e) Not later than the 20th day after the date of receipt of the letter issued by the executive director, the person seeking the exemption or the chief appraiser may appeal the executive director's determination to the Texas Natural Resource Conservation Commission. The commission shall consider the appeal at the next regularly scheduled meeting of the commission for which adequate notice may be given. The person seeking the determination and the chief appraiser may testify at the meeting. The commission may remand the matter to the executive director for a new determination or deny the appeal and affirm the executive director's determination. On issuance of a new determination, the executive director shall issue a letter to the person seeking the determination and provide a copy to the chief appraiser as provided by Subsection (d). A new determination of the executive director may be appealed to the commission in the manner provided by this subsection. A proceeding under this subsection is not a contested case for purposes of Chapter 2001, Government Code.

(f) The commission may charge a person seeking a determination that property is pollution control property an additional fee not to exceed its administrative costs for processing the information, making the determination, and issuing the letter required by this section.

(g) The commission shall adopt rules to implement this section. Rules adopted under this section must:

- (1) establish specific standards for considering applications for 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.

(h) The executive director may not make a determination that property is pollution control property unless the property meets the standards established under rules adopted under this section.

(i) A person seeking an exemption under this section shall provide to the chief appraiser a copy of the letter issued by the executive director of the Texas Natural Resource Conservation Commission under Subsection (d) determining that the facility, device, or method is used wholly or partly as pollution control property. 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.

(j) This section does not apply to a facility, device, or method for the control of air, water, or land pollution that was subject to a tax abatement agreement executed before January 1, 1994.

HISTORY: Stats. 2001 77th Leg. Sess. Ch. 881, effective September 1, 2001.

LexisNexis (R) Notes:

CASE NOTES

1. Trial court's finding that removal of a taxpayer's Tex. Tax Code Ann. § 11.31 pollution control exemption by a county appraisal district's chief appraiser was void because the district failed to give the proper statutory notice required by Tex. Tax Code Ann. § 11.43(h) was error because the district had jurisdiction for the chief appraiser to cancel the pollution exemption. The taxpayer waived its claim of lack of notice under Tex. Tax Code Ann. § 11.43(h) by filing its protest of the loss of the exemption pursuant to Tex. Tax Code Ann. § 41.41(9) and voluntarily appearing before the appraisal review board, which afforded it due process. *Harris County Appraisal Dist. v. Pasadena Prop., LP*, 197 S.W.3d 402, 2006 Tex. App. LEXIS 5077 (Tex. App. Eastland 2006).

2. Trial court's finding that removal of a taxpayer's Tex. Tax Code Ann. § 11.31 pollution control exemption by a county appraisal district's chief appraiser was void because the district failed to give the proper statutory notice required by Tex. Tax Code Ann. § 11.43(h) was error because the district had jurisdiction for the chief appraiser to cancel the pollution exemption. The taxpayer waived its claim of lack of notice under Tex. Tax Code Ann. § 11.43(h) by filing its protest of the loss of the exemption pursuant to Tex. Tax Code Ann. § 41.41(9) and voluntarily appearing before the appraisal review board, which afforded it due process. *Harris County Appraisal Dist. v. Pasadena Prop., LP*, 197 S.W.3d 402, 2006 Tex. App. LEXIS 5077 (Tex. App. Eastland 2006).

3. Chief appraiser's failure to provide the notice to a taxpayer required by Tex. Tax Code Ann. § 11.43(h) makes his cancellation of the Tex. Tax Code Ann. § 11.31 ad valorem exemption voidable, not void, because a taxpayer must be afforded an opportunity to protest the cancellation. *Harris County Appraisal Dist. v. Pasadena Prop., LP*, 197 S.W.3d 402, 2006 Tex. App. LEXIS 5077 (Tex. App. Eastland 2006).

4. Trial court's finding that removal of a taxpayer's Tex. Tax Code Ann. § 11.31 pollution control exemption by a county appraisal district's chief appraiser was void because the district failed to give the proper statutory notice required by Tex. Tax Code Ann. § 11.43(h) was error because the district had jurisdiction for the chief appraiser to cancel the pollution exemption. The taxpayer waived its claim of lack of notice under Tex. Tax Code Ann. § 11.43(h) by filing its protest of the loss of the exemption pursuant to Tex. Tax Code Ann. § 41.41(9) and voluntarily appearing before the appraisal review board, which afforded it due process. *Harris County Appraisal Dist. v. Pasadena Prop., LP*, 197 S.W.3d 402, 2006 Tex. App. LEXIS 5077 (Tex. App. Eastland 2006).

5. Chief appraiser's failure to provide the notice to a taxpayer required by Tex. Tax Code Ann. § 11.43(h) makes his cancellation of the Tex. Tax Code Ann. § 11.31 ad valorem exemption voidable, not void, because a taxpayer must be

afforded an opportunity to protest the cancellation. *Harris County Appraisal Dist. v. Pasadena Prop., LP*, 197 S.W.3d 402, 2006 Tex. App. LEXIS 5077 (Tex. App. Eastland 2006).

TREATISES AND ANALYTICAL MATERIALS

1. 4-70 Texas Real Estate Guide § 70.01, LITIGATION: GOVERNMENTAL CLAIMS, REAL PROPERTY TAX SUITS, Overview, Texas Real Estate Guide.
2. 17-260 Dorsaneo, Texas Litigation Guide § 260.01, Pleadings in Real Estate Litigation (Chs. 250-285), Governmental Claims (Chs. 260-261), Overview, Dorsaneo, Texas Litigation Guide.
3. 69 Tex Jur TAXATION § 343, Texas Jurisprudence, Third Edition, Taxation, § 343 Miscellaneous exemptions, Copyright 2003 West Group.

LAW REVIEWS

1. 47 SMU L. Rev. 1131, Environmental Law, Spring, 1994.
2. 47 SMU L. Rev. 1649, Taxation, Spring, 1994.
3. 55 SMU L. Rev. 979, ARTICLE: Environmental Law, Summer, 2002.
4. 55 SMU L. Rev. 1219, ARTICLE: Oil, Gas and Mineral Law, Summer, 2002.
5. 55 SMU L. Rev. 1315, ARTICLE: Taxation, Summer, 2002.
6. 34 Houston Lawyer 43, FEATURE: PROPERTY TAX RELIEF -- NOT JUST BLOWING SMOKE, by Edward C. Lewis, July/August, 1996, Copyright (c) 1996 Houston Bar Association, The Houston Lawyer.

EXHIBIT E

LEXSEE 27 TEXREG 185

TEXAS REGISTER

ISSUE: Volume 27, Number 1

ISSUE DATE: January 4, 2002

SUBJECT: ADOPTED RULES

27 TEXREG 185

TEXAS ADMINISTRATIVE CODE CITATION: 30 TAC §§ 17.2, 17.4, 17.10, 17.12, 17.15, 17.17, 17.20, 17.25

TITLE 30. ENVIRONMENTAL QUALITY

PART 1. TEXAS NATURAL RESOURCE CONSERVATION COMMISSION.

CHAPTER 17. TAX RELIEF FOR PROPERTY USED FOR ENVIRONMENTAL PROTECTION

[*189]

§ 17.2. Definitions.

Unless specifically defined in the TCAA, the TSWDA, the Texas Water Code (TWC), or the Texas Health and Safety Code (THSC), or in the rules of the commission, the terms used by the commission have the meanings commonly ascribed to them in the fields of pollution control or property taxation. In addition to the terms which are defined by the TCAA, the TSWDA, TWC, and THSC, the following words and terms, when used in this chapter, shall have the following meanings, unless the context clearly indicates otherwise.

- (1) Byproduct--A chemical or material that would normally be considered a waste material requiring disposal or destruction, but due to pollution control property is now used as a raw material in a manufacturing process or as an end product. The pollution control property extracts, recovers, or processes the waste material so that it can be used in another manufacturing process or an end product.
- (2) Capital cost new--The estimated total capital cost of the equipment or process.
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- (3) Capital cost old--This is the cost of comparable equipment or process without the pollution control feature.
- (4) Cost analysis procedure--A procedure which uses cost accounting principles to calculate the percentage of a project or process that qualifies for a positive use determination as pollution control property.
- (5) Decision flow chart--A flow chart which is used to determine if a property or process is eligible for a determination as pollution control property.
- (6) Installation--The act of establishing, in a designated place, property that is put into place for use or service.
- (7) Partial Determination--A determination that an item of property or a process is not used wholly as pollution control. This is property that is not on the predetermined equipment list (PEL) and that is not used wholly for pollution control.

- (8) Pollution control property--A facility, device, or method for control of air, water, or land pollution as defined by Texas Tax Code, § 11.31(b).
- (9) Predetermined equipment list--A list of property that the executive director has determined is either wholly or partially for pollution control purposes.
- (10) Production capacity factor--A calculated value used to adjust the value of a partial use determination to reflect capacity considerations.
- (11) Tier I--An application which contains property that is on the PEL or that is necessary for the installation or operation of property located on the PEL.
- (12) Tier II--An application for property that is used wholly for the control of air, water, and/or land pollution, but not on the PEL.
- (13) Tier III--An application for property used partially for the control of air, water, and/or land pollution.
- (14) Use determination--A finding, either positive or negative, by the executive director that the property is used wholly or partially for pollution control purposes and listing the percentage of the property that is determined to be used for pollution control.
- (15) Use determination letter--The letter sent to the applicant and the chief appraiser which includes the executive director's use determination. In addition to the use determination, the letter will also include at least the following information:
- (A) the name of the applicant;
 - (B) the name and location of the facility;
 - (C) the property description;
 - (D) in the case of a Tier III application, a copy of the Cost Analysis Procedure worksheet; and
 - (E) any other information the executive director deems relevant to the use determination.

§ 17.12. Application Review Schedule.

Following submission of the information required by § 17.10 of this title (relating to Application for Use Determination), the executive director shall determine whether the pollution control property is used wholly or partly for the control of air, water, or land pollution. If the determination is that the property is used partly for pollution control, the executive director shall determine the proportion of the property used for pollution control.

- (1) As soon as practicable, the executive director shall send notice by regular mail to the chief appraiser of the appraisal district for the county in which the property is located that the person has applied for a use determination under this chapter.
- (2) Within 30 days of receipt of an application for use determination, the executive director shall mail written notification informing the applicant that the application is administratively complete or that it is deficient.

(A) If the application is deficient, the notification shall specify the deficiencies, and allow the applicant 30 days to provide the requested information. If the applicant does not submit an adequate response, the application will be sent back to the applicant without further action by the executive director and the application fee will be forfeited under § 17.20(b) of this title (relating to Application Fees).

(B) 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 under § 17.20(b) of this title.

(C) If an application is sent back to the applicant under subparagraphs (A) or (B) of this paragraph, the applicant may refile the application and pay the appropriate fee as required by § 17.20 of this title.

(3) The executive director shall determine whether the property is used wholly or partly to control pollution. The executive director is authorized to grant positive use determinations for some or all of the property included in the application that is deemed pollution control property.

(A) If a positive use determination is made, the executive director shall issue a use determination letter to the applicant which describes the proportion of the property that is pollution control property.

(B) If a negative use determination is made, the executive director shall issue a denial letter explaining the reason for the denial.

(C) A letter enclosing a copy of the use determination shall be sent by regular mail to the chief appraiser of the appraisal district for the county in which the property is located.

§ 17.15. Review Standards.

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.

[*303] Figure: 30 TAC § 17.15

Prop 2 Decision Flow Chart

Applicants must use this flow chart for each piece of equipment or process change. In order for a piece of equipment or process change to be eligible for a positive use determination the item must generate 'yes' answers to the questions asked in boxes 3 and 4.

[SEE CHART IN ORIGINAL]

Where:

1 Prepare a list of all property that is considered to be pollution control property.

2 Process each item on the list through the flow chart separately.

3 Determine the specific state, local, or federal environmental regulation, rule or law that is being met or exceeded by the use of this property. If an adopted state, local, or federal environmental regulation, rule or law can not be identified the property is not eligible for a positive use determination.

[*304] 4 Determine the environmental benefit that this property provides at the site where it is installed. If an environmental benefit at the site can not be identified, the property is not eligible for a positive use determination.

5 If the equipment is listed on the Predetermined Equipment List (PEL), determine the reference number for that item. Include all PEL equipment for the project in a single list that is included with the application.

6 If the equipment is not on the PEL, determine whether the equipment is used wholly for pollution control. If the equipment is used wholly for pollution control, the equipment shall qualify as 100% pollution control property.

7 If the equipment is not used wholly for pollution control the equipment must be evaluated as a partial determination.

§ 17.17.Partial Determinations.

(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 percentage, the cost analysis procedure described in subsection (b) of this section must be used.

(b) The following calculation (cost analysis procedure) must be used to determine the creditable partial percentage for a property or project which is not used wholly for pollution control:

[*305] Figure: 30 TAC § 17.17(b)

$$\frac{[(\text{Production Capacity Factor} \times \text{Capital Cost New}) - \text{Capital Cost Old} - \text{Byproduct}]}{\text{Capital Cost New}} \times 100$$

Where:

1 The Production Capacity Factor (PCF) is calculated by dividing the capacity of the existing equipment or process by the capacity of the new equipment or process. When there is an increase in production capacity PCF is used to adjust the capacity of the new equipment or process to the capacity of the existing equipment or process. When there is a decrease in production capacity PCF is used to adjust the capacity of the existing equipment or process to the production capacity of the new equipment or process. In this case, the method of calculation shown in § 17.17(b) is modified so that PCF is applied to Capital Cost Old rather than Capital Cost New.

2 Capital Cost New is the estimated total capital cost of the new equipment or process.

3 Capital Cost Old is the cost of comparable equipment or process without the pollution control. The standards used for calculating Capital Cost Old are as follows:

3.1 If comparable equipment without the pollution control feature is on the market in the United States, then an average market price of the most recent generation of technology must be used.

3.2 If the conditions in variable 3.1 of § 17.17(b) do not apply and the company is replacing an existing unit, then the company shall convert the original cost of the unit to today's dollars by using a published industry specific standard. If the production capacity of the new equipment or process is lower than the production capacity of the old equipment or process CCO is divided by the PCF in order to reduce CCO to reflect the same capacity as CCN.

3.3 If the conditions in variables 3.1 and 3.2 of § 17.17(b) do not apply, and the company can obtain an estimate of the cost to manufacture the alternative equipment without the pollution control feature, then an average estimated cost to manufacture the unit must be used. The comparable unit must be the most recent generation of technology.

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(c) 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. The equation for calculating BP is as follows:

[*306] Figure: 30 TAC § 17.17(c)

[See formula in printed version]

i Byproduct Value - The retail value of the recovered byproduct for a one year period. Typically, the most recent three-year average price of the material as sold on the open market should be used in the calculation. If the price varies from state-to-state, the applicant shall calculate an average, and explain how the figures were determined.

ii Storage and Transport - These costs are the costs to store and transport the byproduct. These costs will reduce the market value of the byproduct. The applicant shall provide verification of how these costs were determined and itemized.

iii n - This is the estimated useful life in years of the equipment that is being evaluated for a use determination.

iv Interest rate - This is the current Prime Lending Rate that is in effect at the time the application is submitted. The Prime Lending Rate is defined by the Wall Street Journal as the base rate on corporate loans posted by at least 75% of the nation's 30 largest banks. The Prime Lending Rate is posted daily in the Wall Street Journal and on most financial or investment web sites.

(d) If the cost analysis procedure produces a negative number or a zero, the property is not eligible for a positive use determination.

§ 17.25. Appeals Process.

(a) Applicability.

(1) This subchapter applies to appeals of use determinations issued by the executive director for use determination applications that are declared administratively complete on or after September 1, 2001. A proceeding based upon an appeal filed under this subchapter is not a contested case for purposes of Texas Government Code, Chapter 2001.

(2) Persons who may appeal a determination by the executive director. The following persons may appeal a use determination issued by the executive director:

(A) the applicant seeking a use determination; and

(B) the chief appraiser of the appraisal district for the county in which the property for which a use determination is sought is located.

(b) Form and timing of appeal. An appeal must be in writing and be filed by United States mail, facsimile, or hand delivery with the chief clerk of the commission within 20 days after the receipt of the executive director's determination letter. A person is presumed to have been notified on the third regular business day after the date the notice of the executive directors action is mailed by first class mail. If an appeal meeting the requirements of this subsection is not filed within the time period specified, the executive director's use determination is final. An appeal filed under this subchapter must:

(1) provide the name, address, and daytime telephone number of the person who files the appeal;

- (2) give the name and address of the entity to which the use determination was issued;
- (3) provide the use determination application number for the application for which the use determination was issued;
- (4) request commission consideration of the use determination; and
- (5) explain the basis for the appeal.

(c) Appeal processing. The chief clerk shall:

- (1) deliver or mail to the executive director a copy of the appeal;
- (2) deliver or mail a copy of the appeal to the applicant if the appeal was filed by the chief appraiser or to the chief appraiser if the appeal was filed by the applicant; and
- (3) schedule the appeal for consideration at the next regularly scheduled commission meeting for which adequate notice can be given.

(d) Action by the commission.

- (1) The person seeking the determination and the chief appraiser may testify at the commission meeting at which the appeal is considered.
- (2) The commission may remand the matter to the executive director for a new determination or deny the appeal and affirm the executive director's use determination.
- (3) If the commission denies the appeal and affirms the executive director's use determination, the commission's decision shall be final and appealable.

(e) Action by the executive director.

(1) If the commission remands a use determination to the executive director, the executive director shall:

(A) conduct a new technical review of the application which includes an evaluation of any information presented during the commission meeting; and

(B) upon completion of the technical review, issue a new determination. A copy of the new determination shall be mailed to both the applicant and the chief appraiser of the county in which the property is located.

(2) A new determination by the executive director may be appealed to the commission in the manner provided by this subchapter.

(f) Withdrawn appeals. An appeal may be withdrawn by the entity who requested the appeal. The withdrawal must be in writing, and give the name, address, and daytime telephone number of the person who files the withdrawal, and the withdrawal shall indicate the identification number of the use determination. The withdrawal must be filed by United States mail, facsimile, or hand delivery with the chief clerk of the commission.

HISTORY:

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the

agency's legal authority.

Filed with the Office of the Secretary of State on December 20, 2001.

TRD-200108163

Stephanie Bergeron

Director, Environmental Law Division

Texas Natural Resource Conservation Commission

Effective date: January 9, 2002

Proposal publication date: September 28, 2001

For further information, please call: (512) 239-6087

NOTES:

The Texas Natural Resource Conservation Commission (TNRCC or commission) adopts the amendments to § 17.2, Definitions; § 17.4, Applicability; § 17.10, Application for Use Determination; § 17.12, Application Review Schedule; and § 17.20, Application Fees. The commission also adopts new § 17.15, Review Standards; § 17.17, Partial Determinations; and § 17.25, Appeals Process.

Sections 17.2, 17.12, 17.15, 17.17 and 17.25 are adopted with changes to the proposed text as published in the September 28, 2001, issue of the Texas Register (26 TexReg 7420) and will be republished. Sections 17.4, 17.10, and 17.20 are adopted and will not be republished.

BACKGROUND AND SUMMARY OF THE FACTUAL BASIS FOR THE ADOPTED RULES

The program for providing tax relief for pollution control property was established under a constitutional amendment listed as Proposition 2 on the state ballot on November 2, 1993. This amendment added § 1-1 to the Texas Constitution, Article VIII, which provides, in part, that "the legislature by general law 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...for the prevention, monitoring, control or reduction of air, water, or land pollution." The 73rd Legislature added § 11.31, Pollution Control Property, to Texas Tax Code (TTC), Chapter 11 and § 26.045 to TTC, Chapter 26 to implement the new constitutional provision. In accordance with TTC, § 11.31, obtaining a tax exemption for pollution control property is a two-step process. First, the person seeking the exemption must obtain a positive determination from the commission that the property is used wholly or partially for pollution control (i.e., to meet or exceed environmental regulatory requirements). Second, once a person obtains a positive determination, it then applies to the local appraisal district, which completes the second step by granting the tax exemption.

The commission adopted Chapter 277 of its regulations on September 30, 1994, to establish the procedures for obtaining a use determination for pollution control property under Proposition 2. In 1998, Chapter 277 was changed to Chapter 17 to be consistent with the commission's policy to place general or multimedia rules within the Chapter 1--100 series of the commission's rules in Title 30 of the Texas Administrative Code (TAC).

In 2000, program staff assembled a workgroup consisting of representatives of industry, appraisal districts, taxing

authorities, and consumer and environmental groups to discuss potential changes to the program guidelines manual, which describes procedures for processing use determination applications, including applications for property that is used only partially for pollution control. Potential changes developed in meetings with the workgroup were discussed with the commission at a work session in November 2000. Based on guidance provided at that work session, in January 2001, a number of changes were made to the procedures set out in the program guidelines document for processing use determination applications. These changes include revision of the standards used for determining if property qualifies as pollution control property, the establishment of a cost analysis procedure for calculating partial determinations, and the development of several definitions as discussed in the SECTION BY SECTION DISCUSSION. The program guidelines document, as revised, forms the basis for this rulemaking in the implementation of House Bill (HB) 3121, enacted by the 77th Legislature, 2001.

House Bill 3121 amended TTC, § 11.31 in several respects. First, HB 3121 requires that the commission adopt specific standards for considering applications to ensure that use determinations, including partial determinations, are equal and uniform. Second, HB 3121 creates an appeals process for a person seeking a use determination from the executive director (ED), or for the chief appraiser of the appraisal district for the county in which the property is located. Third, HB 3121 requires the commission's ED to provide a copy of the use determination to the chief appraiser of the appraisal district for the county in which the property is located.

The adopted amendments to Chapter 17 and the adopted new sections in Chapter 17 will implement the requirements of HB 3121. In addition, the adopted change to § 17.20 will raise the Tier I application fee from \$50 to \$150. This fee increase is necessary for the commission to continue to recover its operating costs to run the use determination program. There is a variable mix of Tier I, Tier II, and Tier III applications from year-to-year and the total revenue generated by the program for the last two years has been insufficient to meet budgetary requirements. Since the program is required to be self-funded in accordance with TTC, § 11.31, fees must be increased. The vast majority of applications submitted each year are Tier I. Also, the complexity of Tier I applications has increased over the last several years, requiring increased staff time to review them. It is appropriate, therefore, to increase the Tier I fee in order to recoup a higher percentage of the operating costs attributable to processing those applications.

SECTION BY SECTION DISCUSSION

The adopted changes to § 17.2 include the addition of language to clarify that terms used in this chapter are also used in the field of property taxation, not just pollution control; and the addition of the following term definitions: byproduct, capital cost new, capital cost old, cost analysis procedure, decision flow chart, partial determination, production capacity factor, Tier I, Tier II, and Tier III. These terms are used in new § 17.15 and § 17.17 and the definitions are needed to explain the cost analysis procedure. In response to comments, § 17.2(10) and § 17.2(14) have been changed from the proposed language and § 17.2(15) has been added. Section 17.2(10) has been changed to reflect that new property receives the same treatment as replacement property and § 17.2(14) has been changed to explain that a use determination includes the percentage of the property that is considered to be pollution control property. New § 17.2(15) has been added to define "use determination letter."

The adopted changes to § 17.4 will correct a grammatical error and add a requirement for the ED to follow the standards established within this chapter in making a final use determination on pollution control property.

The adopted change to § 17.10 will add a requirement that for property which is not used wholly for pollution control purposes, the cost analysis procedure listed in § 17.17 must be followed and the calculation must be shown in the application and that the Decision Flow Chart, § 17.15, must be included in the application.

The adopted change to § 17.12 will add a requirement that the ED provide a copy of the final use determination to the appraisal district where the property is located. The final use determination contains a description of the pollution control property for which a use determination was requested. In response to a comment, § 17.12(3)(C) has been

changed to clarify that a copy of the use determination will be enclosed with the letter to be mailed to the appropriate appraisal district.

Adopted new § 17.15 describes the review standards to be used in determining the pollution control property status of each property item for which a use determination is requested. A decision flow chart is provided to determine whether a particular property item qualifies as pollution control property and whether it qualifies as pollution control equipment under the Tier I, Tier II, or Tier III fee structure. Tier I property is property which is included on the predetermined equipment list (PEL). The PEL is a list of property that the ED has determined is either wholly or partially for pollution control purposes. Tier II property is that property which is 100% pollution control property but is not contained on the PEL. Tier III property is partially for pollution control and partially for process or product improvement and is therefore only eligible for a partial pollution control property use determination. In response to a comment, the phrase "process change" has been changed to "process." This was done to reflect that a new process will receive the same consideration as a replacement process.

Adopted new § 17.17 describes the required calculation procedure for a Tier III partial pollution control property use determination. This procedure is followed for applications that are partially for pollution control and partially for process or product improvement and thereby do not qualify as 100% pollution control property. In response to a comment, footnotes 1 and 3.2 (Figure: 30 TAC § 17.17(b)) were changed to allow for the adjustment of capital cost old in cases where the production capacity of the replacement property is lower than the capacity of the replaced property.

The adopted change to § 17.20 will raise the Tier I application fee from \$50 to \$150. This fee increase is necessary for the commission to continue to recover its operating costs to run the use determination program.

Adopted new § 17.25 will describe the procedures for appealing a use determination made by the ED. This section allows an appeal by only the use determination applicant or the chief appraiser of the appraisal district for the county in which the property is located. Section 17.25 also describes the procedures followed by the TNRCC chief clerk to process the appeal, possible actions by the commission after hearing the appeal, and required action by the ED if the determination is remanded to the ED by the commission. Section 17.25(b) has been clarified to state that the ED's use determination shall be final if a proper appeal is not timely filed. Further, § 17.25(d)(3) has been added to clarify that the commission's decision to deny an appeal and uphold the ED's use determination shall constitute the agency action which is final and appealable.

FINAL REGULATORY IMPACT ANALYSIS DETERMINATION

The commission has determined that this rulemaking is not subject to Texas Government Code, § 2001.0225, because it does not meet the definition of a "major environmental rule" as defined in that statute. Furthermore, it does not meet any of the four applicability requirements listed in § 2001.0225(a).

"Major environmental rule" means a rule, the specific intent of which, is to protect the environment or reduce risks to human health from environmental exposure and that may adversely affect in a material way the economy, productivity, competition, jobs, the environment, or the public health and safety of the state or a sector of the state. The adopted rulemaking does not meet the definition of "major environmental rule" because the specific intent of the rulemaking is procedural in nature. The rulemaking revises procedures for providing notice to the chief appraiser of the county in which the property is located, adds procedures and definitions contained in the program guidelines manual as revised, for determining whether property is used for the control of air pollution, adds procedures describing how certain persons may appeal a decision by the ED, and increases the fee for a Tier I application.

In addition, even if the adopted rule is a major environmental rule, a draft regulatory impact assessment is not required because the rules do not exceed a standard set by federal law, exceed an express requirement of state law, exceed a requirement of a delegation agreement, or propose to adopt a rule solely under the general powers of the agency. The

rules do not exceed a standard set by federal law. The adopted rules do not exceed an express requirement of state law because they are authorized by the following state statutes: Texas Government Code, § 2001.004, which requires state agencies to adopt rules of practice stating the nature and requirements of all available formal and informal state agency procedures; and TTC, § 11.31, which authorizes the ED to determine if property is used for the control of air pollution, as well as the other statutory authorities cited in the STATUTORY AUTHORITY analysis of this preamble. In addition, this rulemaking is in direct response to HB 3121, and does not exceed any of the requirements of this bill, nor does it exceed the requirements of the Texas Constitution, Article VIII, § 1-l. This rulemaking does not adopt a rule solely under the general powers of the agency, but rather under a specific state laws (i.e., TTC, Chapter 11, Subchapter B (Exemptions); and Texas Government Code, § 2001.004). Finally, this rulemaking is not being adopted on an emergency basis to protect the environment or to reduce risks to human health from environmental exposure.

TAKINGS IMPACT ASSESSMENT

The commission determined that the adopted rules are not subject to Texas Government Code, Chapter 2007. The specific primary purpose of the rulemaking is to revise commission rules relating to procedures for processing use determination applications requesting a determination of whether certain property qualifies as pollution control property as required by HB 3121. As amended by HB 3121, TTC, § 11.31(d) requires the ED to provide a copy of a use determination to the appraisal district, § 11.31(e) allows appeal by the applicant or the appraisal district to the commission of a use determination by the ED, and § 11.31(g) requires the commission to establish specific standards to be followed for considering use determination applications. These new requirements and other revisions to § 11.31 are described in the BACKGROUND AND SUMMARY OF THE FACTUAL BASIS FOR THE ADOPTED RULES and SECTION BY SECTION DISCUSSION portions of this rulemaking. The adopted rule revisions and new sections do not substantively change the program requirements that are already in place. The adopted rules will substantially advance the stated purpose by providing specific procedural requirements for processing use determination applications. Promulgation and enforcement of these rules will not burden private real property. The adopted rule revisions and new sections do not affect private property in a manner which restricts or limits an owner's right to the property that would otherwise exist in the absence of governmental action. Consequently, these adopted rule revisions and new sections do not meet the definition of a taking under Texas Government Code, § 2007.002(5).

CONSISTENCY WITH THE COASTAL MANAGEMENT PROGRAM

The commission has determined that the adopted rulemaking does not relate to an action or actions subject to the Texas Coastal Management Program (CMP) in accordance with the Coastal Coordination Management Act of 1991, as amended (Texas Natural Resources Code, §§ 33.201 et seq.) and the commission's rules in 30 TAC Chapter 281, Subchapter B, concerning Consistency with the Texas Coastal Management Program. The rules do not govern air pollutant emissions, on-site sewage disposal systems, or underground storage tanks. The rulemaking revises procedures for providing notice to the chief appraiser of the county in which the property is located, adds procedures and definitions contained in the program guidelines manual as revised, for determining whether property is used for the control of air pollution, adds procedures describing how certain persons may appeal a decision by the ED, and increases the fee for a Tier 1 application. These actions concern only the procedural rules of the commission, are not substantive in nature, do not govern or authorize any actions subject to the CMP, and are not themselves capable of adversely affecting a coastal natural resource area (Title 31 Natural Resources and Conservation Code, Chapter 505; 30 TAC §§ 281.40,).

HEARING AND COMMENTERS

The commission held a public hearing in Austin on October 23, 2001. The public comment period closed on October 29, 2001. One commenter provided oral comments at the public hearing and also submitted written comments. In addition, three commenters provided written comments only.

The commenters were: Texas Center for Policy Studies (TCPS), which presented oral and written comments endorsed by Clean Water Action, Environmental Defense's Texas Office, Public Citizen's Texas Office, Lone Star Chapter of the Sierra Club, the Sustainable Energy and Economic Development Coalition, Consumer's Union, Texas Campaign for the Environment, League of Conservation Voters, and the Center for Public Policy Priorities. Commenters submitting written comments only were Association of Texas Intrastate Natural Gas Pipelines (ATINGP); Texas Taxpayers And Research Association (TTARA); and Ryan Valuation Services (RVS).

Analysis of Comments

TCPS stated that it only had two brief additions to the proposed rules. First, TCPS suggested that the phrase "use determination letter" should be defined or, alternatively, that additional explanation be provided in § 17.12(3)(C) regarding the contents of use determination letter. Specifically, TCPS suggested that the use determination letter contain a description of the property or device, its calculated value, the pollution control percentage, and for Tier III applications a copy of the Cost Analysis Procedure (CAP) worksheet. Second, TCPS urged that the Predetermined Equipment List (PEL) should be reviewed and updated at least once a year with public input.

Response

In response to TCPS's first comment, the ED's decision on a use determination application is reflected in the use determination itself rather than the letter that is used to transmit it to the chief appraiser of the appraisal district for the county in which the property is located. In order to better clarify the definition of a "use determination," § 17.2(14) has been amended to state that a use determination includes the percent of the property which is determined to qualify as pollution control property. The term "use determination letter" has been defined to include the use determination and the name of the company, the name and location of the facility, and the property description. In addition, for Tier III applications a copy of the Cost Analysis Procedure worksheet will be enclosed. For Tier II and Tier I applications a copy of the program staff's technical review document will be enclosed. The calculated value of the property or device is not contained in the use determination or the use determination letter because calculating the value of the property or device is the responsibility of the appraisal district. TNRCC's responsibility is to determine if the property qualifies as pollution control property and if the property is used only partly as pollution control property to determine the percentage of the property used for pollution control.

Second, TCPS commented that language either should be added to the definition of PEL in § 17.2(7) or in § 17.4 to require that the PEL be reviewed and updated, with public input, on an annual basis.

Response

The commission agrees that the items on the PEL should be periodically reviewed. Program staff is currently in the process of conducting a comprehensive review of the PEL with input from the workgroup. Staff expects to complete this review of the entire list by December 2002. Upon completion of this review, staff will draft a policy for reviewing the PEL for presentation to the commission that will address whether the PEL should be reviewed on an annual basis and how to solicit and incorporate public input into the process. No changes have been made in response to this comment.

ATINGP commented that while the association generally supports the proposed rules, it has some concern about the appeals process. The proposed rules do not identify the point in time at which the ED's determination is considered to be a final administrative action of the agency. ATINGP recommended that § 17.25(b) be amended to provide that in the event an appeal is not timely filed, the ED's determination letter is deemed to be the final action of the agency upon expiration of the 20-day period of appeal; and that § 17.25(d)(2) be amended to provide that in the event that the commission denies the appeal and affirms the ED's use determination that the ED's determination letter becomes the final administrative action of the agency on the date the commission issues its order denying the appeal.

Response

The commission agrees that § 17.25 does not specifically identify the point in time at which the ED's determination is deemed a final administrative action of the agency. Section 17.25(b) has been clarified to state that the ED's use determination shall be final if a proper appeal is not timely filed. Further, § 17.25(d)(3) has been added to clarify that the commission's decision to deny an appeal and uphold the ED's use determination shall constitute the agency action which is final and appealable.

TTARA commented on two issues. First, TTARA commented that the proposed rule fails to reflect the Attorney General's (AG) April 27, 2001 Opinion No. JC-0372, concerning the application of the pollution control equipment as it relates to new versus existing sites. TTARA commented that the definition of "Production Capacity Factor" in § 17.2(10) refers to the original property or process, implying that a new facility may not qualify since there is no original property or process and that § 17.15 refers to a process change when a new facility has a new process, not a changed one. TTARA recommended the following three actions: first, amend § 17.2(10) to read: "Production Capacity Factor A calculated value used to adjust the value of a partial use determination to reflect capacity considerations"; second, change all references to "process change" to "process"; and third, add a statement to the rules that stating that all pollution control equipment, whether used in a new or existing facility is eligible for a pollution control exemption.

Response

The commission agrees with the first two suggestions. The proposed definition of Production Capacity Factor and the use of the phrase "process change" do appear to be in conflict with the Attorney General's opinion and § 17.2(10) and § 17.15 have been revised in response to these suggestions. Section 17.2(10) has been changed to read: "Production Capacity Factor--A calculated value used to adjust the value of a partial use determination to reflect capacity considerations." Section 17.15, as proposed, contained the only usage of the phrase "process change." The word "change" has been deleted. With these specific modifications, the adopted rules contain no language that implies that property installed at a new site will be treated differently than property installed at an existing site. No changes have been made in response to the third recommendation.

As to TTARA's second issue, it commented that limiting the use of the Production Capacity Factor (PCF) in the CAP to cases where there is an increase in production understates the partial percentage for installation of an equipment/process that has a smaller production capacity than the previous equipment/process. TTARA recommends that footnote 1 in § 17.17(b) be eliminated.

Response

The commission agrees that not adjusting for a decrease in capacity may result in a reduced use determination. However, the commission disagrees that the adjustment should be made to Capital Cost New (CCN) by using the PCF. The more appropriate method for handling a decrease in production capacity is to adjust Capital Cost Old (CCO) to reflect the lower production capacity. Footnotes 3.1, 3.2, and 3.3, in § 17.17(b) provide three methods for calculating CCO. The methods described in 3.1 and 3.3 calculate CCO based on CCO being comparable to CCN. These two methods account for a decrease in production capacity. The method in footnote 3.2 as proposed did not account for a decrease in production capacity. Accordingly, footnote 3.2 has been modified to read: "If the conditions in variable 3.1 of § 17.17(b) do not apply and the company is replacing an existing unit, then the company shall convert the original cost of the unit to today's dollars by using a published industry specific standard. If the production capacity of the new equipment or process is lower than the production capacity of the old equipment or process, then CCO is divided by the PCF in order to reduce CCO to reflect the same production capacity as CCN." Adjusting the production capacity of CCO to reflect the lower production capacity of CCN provides the same benefit as adjusting CCN to reflect the lower production capacity of CCO.

RVS commented that the CAP assumes that capital cost/capacity relationships are linear and that the use of this assumption will likely understate the amount of the exemption to the disadvantage of the taxpayer. RVS commented that while a PCF is necessary to adjust for size differences between the existing and replacement equipment, a scale factor or size exponent should be added as a component since the capital cost of equipment of different capacities often varies exponentially rather than linearly due to economies of scale. The proposed scale factor is the "six-tenths factor."

Response

The commission agrees that the relationship between capital cost for equipment of varying production capacities in some cases is not linear. However, the commission does not agree that the "six-tenths factor" should be added to the CAP. Before the CAP was approved by the commission, staff reviewed several Tier III applications where the "six-tenths factor" was included in the calculation. In all cases the applicants were unable to justify the use of the scale factor and it was not included in the final calculation. The CAP was developed by staff and revised by the workgroup. Several factors, including the "six-tenths factor" were reviewed for inclusion in the equation. The workgroup decided not to include a scale factor. The information provided by RVS does not provide justification for changing the rule. No changes have been made in response to this comment.

RVS also commented that it disagrees with the method used for determining the Net Present Value of the Byproduct (BP). RVS provided an alternative method for calculating byproduct. RVS proposed allowing income tax to be subtracted from the value of the byproduct to arrive at a truer cash flow number and that a weighted average cost of capital (WACC) be used as the discount rate rather than the Prime-Lending Rate (PLR).

Response

The commission does not agree with either of RSV's proposed revisions to the method used for determining Net Present Value of Byproduct. The byproduct calculation was developed by staff and revised by the workgroup. Several factors, including income tax were reviewed for inclusion in the equation. The workgroup decided that because the CAP was developed to look at capital values operating expenses and net income were not appropriate items for inclusion.

Further, the commission disagrees that the use of the WACC will provide a more accurate byproduct value. The PLR was chosen because of its wide availability. The WACC is not widely available. RVS provided examples to illustrate the increase in the byproduct value which would occur if its two proposals are implemented. After removing income taxes from the equation the example using WACC provides only a 2% increase in byproduct value over the example using the PLR. No changes have been made in response to this comment.

STATUTORY AUTHORITY

The amendments and new sections are adopted under Texas Water Code (TWC), § 5.102, which authorizes the commission to perform any acts authorized by TWC or other law which are necessary and convenient to the exercise of its jurisdiction and powers and § 5.103, which authorizes the commission to adopt rules necessary to carry out its powers and duties under TWC. The amendments and new sections are also adopted under TTC, § 11.31, which authorizes an exemption from taxation of all or part of real and personal property that is used wholly or partly as a facility, device, or method for the control of air, water, or land pollution.

EXHIBIT F

Prop 2 Decision Flow Chart

Applicants must use this flow chart for each piece of equipment or process. In order for a piece of equipment or process to be eligible for a positive use determination the item must generate 'yes' answers to the questions asked in boxes 3 and 5.

