

POPP, GRAY & HUTCHESON, LLP

The Property Tax Firm of Texas



PROPERTY TAX SCOREBOARD:

Commerce Clause Questions Unanswered At U.S. Texas Supreme Court

On March 12th, the Texas Supreme Court denied the petitions for review in both *Peoples Gas, Light & Coke Co. v. Harrison Central Appraisal Dist.*, and *Midland Central Appraisal Dist. v. BP America Production Co.*

Two weeks earlier on March 1, 2010, the United States Supreme Court denied Missouri Gas Energy's petition for certiorari of the Oklahoma Supreme Court's decision in *In re Assessment of Personal Property Taxes Against Missouri Gas Energy*. The denial was without any comment by the Court.

The entire analysis memo on the decision can be read at <http://www.property-tax.com/articles/TXSCDeniesPeoples.pdf>. For further information, please contact Raymond Gray, raymond@property-tax.com

EXPERT OPINION

Appeals To TCEQ Regarding The Exception Of Refinery Hydrotreaters

Keeping up with the issues at the TCEQ has become a real challenge. In the past, there were few appeals, and those usually involved isolated or project specific issues. That has all changed. In 2007, major issues at the TCEQ began to surface. Initially, Valero and several other taxpayers filed for 100% exemptions on their hydrotreater projects. Immediately following these applications, the 80th Legislature amended Sec. 11.31 of the Texas Tax Code by adding three new subsections. The most controversial of the additions was Section 11.31(k), which was the new, nonexclusive, list of the 18 categories of property that would eventually make up Part B of the Equipment and Categories List.

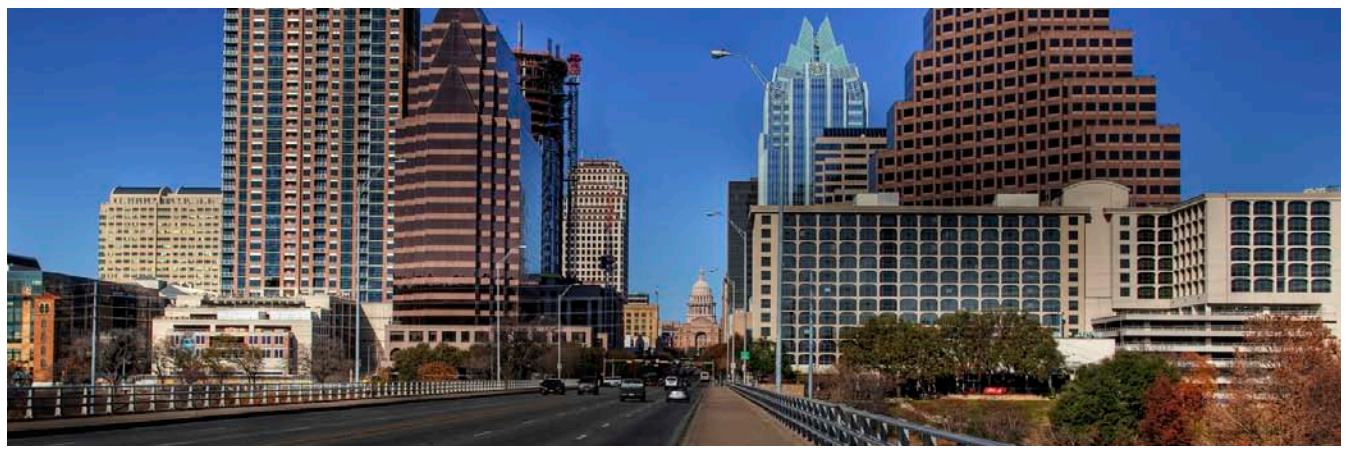
In an effort to clarify what it had done in the 80th Legislative Session, and in light of the controversy over the HRSR and hydrotreater applications, the 81st Legislature again amended 11.31 of the Texas Tax Code by adding two new sections in 2009.

The new sections require that all applications be reviewed using equal and uniform methods and that a permanent advisory committee be established. The new law applies only to applications filed after January 1, 2009.

After several years of briefing, meetings, site visits to the refineries, and hearing continuances, the Valero 2007 hydrotreater negative use determination appeals were presented to the Commissioners in January 2010. The Executive Director (ED), Valero, and appraisal districts (CADs) affected by the applications were all allowed to provide briefs and provide oral argument to the Commissioners, addressing the following:

Are hydrotreaters mandated by a rule or law?

Valero argued that the hydrotreaters were mandated by Federal Rule, 40 CFR 80, which required Valero to install the hydrotreaters in order to meet the new low sulfur diesel and gasoline requirements. Valero stated that it had no choice if it intended to continue to sell finished products into the domestic automobile market. The ED conceded the point and agreed that Valero really had no other options. When specifically asked by Chairman Shaw if the ED believed Valero had a choice, the ED responded "no."



EXPERT OPINION CONT.

Appeals To TCEQ Regarding The Exception Of Refinery Hydrotreaters

The CADs argued that Valero made a business decision to participate in the low sulfur gasoline and diesel market. The CADs pointed to Marathon, in Texas City, as an example of a refinery that chose not to make the investment to meet the new sulfur requirements.

Chairman Shaw pointed out that some refinery would have to install the equipment somewhere in order to meet the new requirements. The commissioners all appeared to agree that installing the hydrotreaters was a requirement of the new EPA low sulfur gasoline and diesel rules.

Is Valero a manufacturer or producer of pollution control equipment?

Valero argued that their product is gasoline. Valero also stated that gasoline could never qualify as a pollution control product even under the most liberal definition of the term.

The ED and CADs argued that the cleaner gasoline is actually a pollution control product. For instance, cleaner gasoline helps the catalytic converter work efficiently and last longer in automobiles.

The Commissioners concluded that gasoline is not a pollution control product. Chairman Shaw stated that if Valero made an additive for gasoline, that he might consider that a pollution control product, but gasoline is not a pollution control product.

Hydrotreaters are production equipment.

Valero admitted that some hydrotreaters located at refineries are production equipment. Refiners have used hydrotreaters for many years to pre-treat intermediate streams prior to the stream being introduced into a reformer or fluid catalytic cracking unit. Pre-treating these intermediate streams prevents catalyst contamination as well as providing other benefits to the process. However, the hydrotreaters in Valero's applications are not used as part of the process. The sole

purpose of the hydrotreaters included in the 2007 applications is to remove sulfur in order to meet the new EPA requirements. Valero made the case that if the new rule were suspended today; Valero would cease operation of the new hydrotreaters.

The ED agreed that certain pieces of equipment that make up the hydrotreaters may not be production equipment, but the ED does believe that at least some parts of the units are used as production equipment.

The Commissioners wanted more information from the engineers and appeared to be unable to make a determination based on the information presented.

Exempting the Hydrotreaters will result in financial devastation for the taxing units.

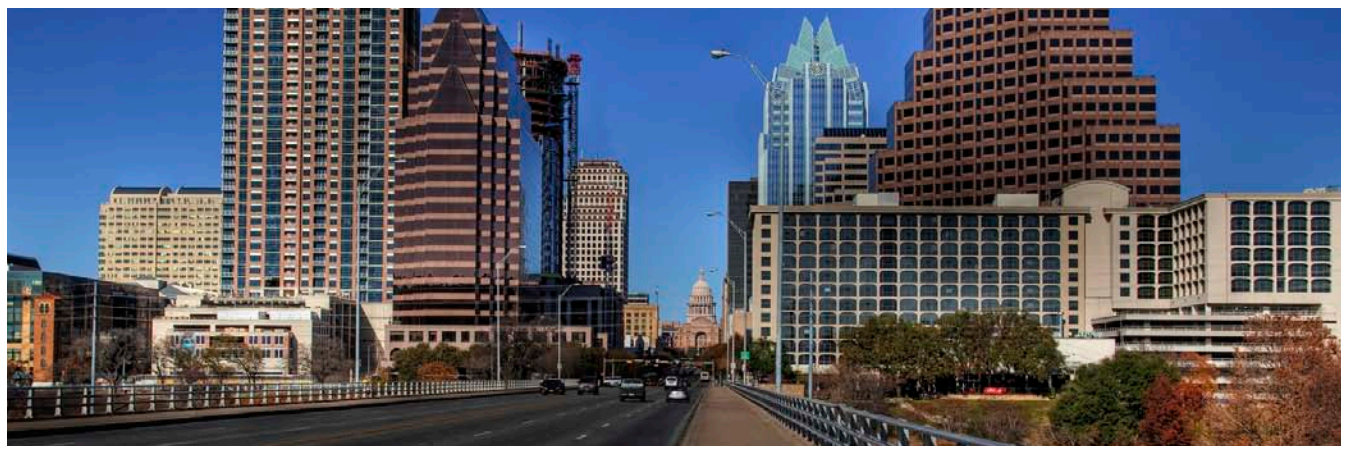
Valero pointed out that the jurisdictions were on notice that the exemptions had been filed and were under appeal and that the taxes had been paid under protest. Valero did agree to consider not pursuing refunds for past years.

The ED remained fairly neutral with regards to this argument.

This was one of the CAD's primary arguments. Charts with potential refund calculations, using the Valero exemption applications as well as contemplated new exemption applications were used to illustrate the potential financial impact the exemptions may have on local taxing jurisdictions.

The Commissioners understood the potential financial impact, but assumed that the jurisdictions were prudent and had placed the tax revenue associated with these units in escrow, since Valero had paid the taxes under protest. **What is the origin of "Benefit at the site"?**

Valero responded to Chairman Shaw's question by pointing out that the TCEQ rules require there to be a "benefit at the site", but there is no definition of "site" in the rules. Valero contends that, on some level, the local



EXPERT OPINION CONT.

Appeals To TCEQ Regarding The Exception Of Refinery Hydrotreaters

community benefits from the cleaner fuel. Valero also argued that “at the site” would include locations beyond the fence line of the property.

The ED responded by pointing out that “at the site” has been part of the TCEQ rules since 2002. All applications since then have had to pass this test. In order to be fair and equal, these applications must also pass the “at the site” test.

Chairman Shaw noted that the requirement was in the TCEQ rules, but still questioned the legal origin of “at the site”. Chairman Shaw pointed out that he could not find the requirement in Section 11.31 of the Tax Code. The ED referred to the delegation of the rule making authority to the TCEQ in Sec. 11.31. Based on that authority, the TCEQ promulgated rules which included a requirement that the pollution control benefit be established “at the site” as noted in 30 TAC 17.15. The ED also pointed to Sec. 11.31 which states that all applications should be treated fairly and equitably. Chairman Shaw understood the ED’s position and noted that the rules indeed did require a benefit “at the site” and that in order to be fair and equitable, these applications must also meet these criteria. The commissioners appeared puzzled regarding the definition of “at the site”. They concluded that “at the site” must mean “beyond the fence line of the property” but they could not fully define how far beyond the fence one should look when trying to meet the requirements of the rule.

Do the hydrotreaters provide a “benefit at the site” as mandated by the rule?

Valero argued that the hydrotreaters do provide a benefit at the site because they produce clean gasoline that is used by local motorists. The lower tailpipe emissions certainly provide some level of a “benefit at the site”. The ED made the argument that the hydrotreaters actually produce additional pollution “at the site”. The heaters and any fugitive emissions would increase the NOx, CO, and other pollutants “at the site”. The minimal amount of benefit from burning cleaner gasoline

in the area would be offset by the additional pollution from the unit.

The Commissioners asked the TCEQ engineering staff if the TCEQ has ever weighed the benefit of one type of pollutant, such as sulfur dioxide, against the increase of other types of pollution, in this case nitrous oxide, to determine a partial percentage exemption. The ED acknowledged that there were many other prior similar instances where the reduction of one mandated pollutant had the effect of increasing another pollutant. The ED did not know of a situation in which the pollutants had been netted to arrive at a partial exemption.

On January 25th, 2010, the TCEQ Commission signed an order remanding all ten of the Valero hydrotreater appeals back to the ED for further review. The order established that 1) The EPA requirement to remove sulfur from the fuel is an environmental regulation and portions of Valero’s hydrotreaters and related equipment were installed to meet that low-sulfur requirement; and 2) Valero’s hydrotreating equipment may provide a partial environmental benefit at the site in satisfaction of the Commission’s rules.

Based on the order, and the Commissioner’s comments at the hearing, we now have clearer definitions for “production equipment” and “producer of pollution control equipment”. By the end of the appeal process, we should have a better definition of “at the site”, and how these definitions will impact the industry at large.

*Trey Novosad
Director, Complex Appeals
Popp Gray & Hutcheson, LLP
Phone: 512-473-2661
Email: trey.novosad@property-tax.com*

*Correction from February Newsletter:
In our last issue we erroneously stated that the Harrison CAD appraisal contract had been awarded to Wardlaw appraisal when it was actually awarded to Thos. Y Pickett. We apologize for any inconvenience this mistake might have caused*