

STATE OF MICHIGAN
SUPREME COURT

DETROIT EDISON COMPANY,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,
STATE OF MICHIGAN,

Defendant-Appellant.

Supreme Court No. _____

Court of Appeals No. 309732

Court of Claims No. 10-104-MT

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**PLAINTIFF-APPELLEE'S BRIEF IN OPPOSITION TO
APPLICATION FOR LEAVE TO APPEAL**

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COUNTER-STATEMENT OF QUESTIONS PRESENTED FOR REVIEW

1. In 1999, the Michigan Legislature specifically expanded the industrial processing exemption under the Use Tax Act, as provided under MCL 205.94o. Was the Court of Appeals correct in affirming the Court of Claims' decision that found that Plaintiff's machinery and equipment, used in converting or conditioning electricity by changing the form, composition, quality, combination or character of the electricity, qualified for the exemption?

Plaintiff-Appellee answers, "Yes."

Defendant-Appellant answers, "No."

The Court of Claims below answers, "Yes."

The Court of Appeals below answers, "Yes."

2. Is administrative rule, Michigan Admin Code, R 205.115(4) ("Rule 205.115(4)"), enacted prior to the expansion of the industrial processing exemption under the Use Tax Act, and which conflicts with clear and plain meaning of the governing statute as last amended, invalid and unenforceable?

Plaintiff-Appellee answers, "Yes."

Defendant-Appellant answers, "No."

The Court of Claims below answers, "Yes."

The Court of Appeals below answers, "Yes."

3. Is the Defendant precluded from raising a new and novel argument in its Application for Leave to Appeal, when such argument was not been stated in its Answer, included in its motions or briefs, or argued before the lower courts?

Plaintiff-Appellee answers, "Yes."

Defendant-Appellant answers, "No."

The Court of Claims below did not address this issue.

The Court of Appeals below did not address this issue.

I. COUNTER-STATEMENT OF ORDER APPEALED AND REASONS FOR NOT GRANTING REVIEW¹

This case involves the application of the industrial processing exemption to an industrial processor as specifically authorized by the Michigan legislature. Plaintiff-Appellee, Detroit Edison Company ("DTE) has historically been classified as an industrial processor of electricity by the Appellant, Department of Treasury, State of Michigan (the "Department"), and the production of electricity has been recognized as an industrial process for more than 50 years. The Court of Appeals affirmed the well-reasoned decision of the Court of Claims that held, based on the extensive evidence presented by DTE's experts, and supported by the Department's expert, that equipment used to process, convert, condition, control, supervise, inspect, test and monitor the electricity throughout DTE's unified electric system until the electricity met the mandated parameters for sale to customers at the customer's meter qualified for the industrial processing exemption under the Use Tax Act.

In its Application for Leave to Appeal the Department claims that this case "involves issues of significant public interest," concerns "fundamental legal principles of major

¹ The Facts recited herein are primarily support by Affidavits of Mark D. Tomlinson (DTE Principal Tax Advisor) ("Tomlinson Aff"); Thomas D. Phillips (DTE Supervising Engineer Northwest Group) ("Phillips Aff"); James L. Brown (DTE Supervising Engineer) ("Brown Aff"); Brian E. Wheeler (General Attorney - Tax) ("Wheeler Aff"), attached as Exhibits 1, 2, 3 and 4, respectively, to Plaintiff's Brief in Support of Motion for Summary Disposition ("DTE's Brief in Support") along with the Affidavits of Professor Ewald F. Fuchs (Professor Emeritus of Electrical and Computer Engineering at the University of Colorado) ("Professor Fuchs Aff") and Professor Bruce F. Wollenberg (Professor of Electrical and Computer Engineering at the University of Minnesota and Director of the University of Minnesota Center for Electric Energy) ("Professor Wollenberg Aff"); the Deposition Testimony of the Department's expert witness, Clare F. Cook (Retired Professor in the Electrical Engineering Department, Ferris State University) ("Cook Dep") Exhibits 7, 8 and 9 to DTE's Brief in Support; and also the Supplemental Affidavit of Professor Ewald F. Fuchs ("Professor Fuchs Supp Aff") attached as Exhibit 44 to DTE's Brief in Opposition to Defendant's Cross Motion for Summary Disposition.

significance,” is “clearly erroneous,” and “would cause material injustice to the State” and “created an enormous loophole that enables widespread abuse.” Nothing is further from the truth. For the reasons stated below, this case does not meet the standards for review set forth under MCR 7.302(B)(2), (3) or (5).

The Department’s Application for Leave to Appeal also raises a new argument for apportionment of the exemption that is not properly before this Court, and attempts to supplement the record with documents that are irrelevant and inadmissible. Therefore, this Court should deny the Application for Leave to Appeal and affirm the decision of the Court of Appeals.

A. The Court of Appeals Relied Upon and Followed Longstanding Michigan Supreme Court Precedent Allowing DTE’s Industrial Processing Exemption in Full.

The decision below upholds the legislatively created industrial processing exemption. The Court of Appeals decision is plainly correct and does not meet the standard of review under MCR 7.302(B)(5). The Department has always classified DTE as an industrial processor engaged in the manufacturing and processing of electricity. *Builders Steel Supply Co and Consumers Power Co v Dep’t of Revenue*, Michigan State Board of Tax Appeals Docket No. 285, p 3 (1955) (attached as Exhibit 1 hereto) (“It is an admitted fact that the production of electric energy constitutes ‘industrial processing.’”). This Court has repeatedly held that machinery and equipment that process a product to the final form sold to the customer is used in industrial processing. *Edison v Dep’t of Revenue*, 362 Mich 158, 159; 106 NW2d 802 (1961) (industrial processing requires preparing a product for sale to the consumer); *Kress v Dep’t of Revenue*, 322 Mich 590, 593; 34 NW2d 501 (1948) (holding that industrial processing means conditioning the product for later sale); *Bay Bottled Gas Co v Dep’t of Revenue*, 344 Mich 326, 330; 74 NW2d 37 (1955) (industrial processing is processing for the market). The Court of

Appeals, based on a record containing detailed expert opinions, observations and explanations regarding the nature of electricity, its generation, production, transmission and distribution, found that until electricity is usable by the customer, the product is not in its final form, and, thus, industrial processing has not yet been completed. The Court of Appeals' decision, finding that DTE's equipment used to change the form and composition of electricity, as well as test, monitor and control the electricity, qualifies for the industrial processing exemption, irrespective of its location outside the main manufacturing plant is not surprising, much less erroneous. The Court of Appeals adheres to this Court's holding that it is the activity in which the equipment is engaged that qualifies the equipment for the exemption ("to determine whether the industrial processing exemption applies, it is necessary to consider the activity in which the equipment is engaged and not the character of the equipment-owner's business."). *Elias Bros Rest, Inc v Dep't of Treasury*, 452 Mich 144, 157; 549 NW2d 837 (1996).

The Court of Appeals clearly determined that the equipment was "concurrently used in a unified system for the purposes of both distribution and industrial processing." *Detroit Edison Co v Dep't of Treasury*, __ Mich App __; __ NW2d __ (2014); 2014 WL 92245 (hereinafter "slip opinion" at 11 attached hereto as Exhibit 2), and, as such, the industrial processing exemption contained in MCL 205.94o is applicable. The Court of Appeals' decision is patently correct and supported by longstanding precedent of this Court. Since 1942, this Court has held that equipment used in the industrial process is exempt "notwithstanding the fact that [the equipment] is also put to another use not in industrial processing." *Michigan Allied Dairy Ass'n v State Bd of Tax Administration*, 302 Mich 643, 650; 5 NW2d 516 (1942) (The fact that the containers are used for activities that are not subject to the exemption does not keep them from being exempt for other activities); see also *Milk Producers v Dep't of Treasury*, 242 Mich App

486, 495; 618 NW2d 917 (2000); *White Consolidated Industries Inc v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals, issued April 15, 2003 (Docket No. 238096) (attached hereto as Exhibit 3) (containers used for both transportation and industrial processing activities qualified for the industrial processing exemption; a concurrent taxable use with an exempt use does not remove the protection of the exemption).

There is no “manifest injustice” in the Court of Appeals’ decision, as sales or use tax is paid on the sale of DTE’s electricity to its customer. This Court has held that the policy behind the industrial processing exemption is to prevent “pyramiding of tax.” *Elias Bros, supra*, 452 Mich at 152. That is, if a product is taxable, the machinery and equipment used to produce it should not be. *Id.* Because DTE’s electricity is subject to tax², the machinery and equipment used to prepare it for sale should not be.

Defendant’s Application fails to meet the standard set forth by MCR 7.302(B)(5), thus requiring denial of the Application for Leave to Appeal and affirmance of the Court of Appeals’ decision.

B. The Decision Correctly Applies Statutory Changes Enacted in 1999.

In 1999, the Legislature expanded the Use Tax Act to more broadly exempt equipment used by an industrial processor, such as DTE, in performing industrial processing. The Department was aware of the impact this expanded exemption would have on producers of electricity.³ The Court of Appeals rejected the Department’s position that DTE’s equipment did not qualify for exemption under the statutorily expanded industrial processing exemption. The

² MCL 205.51a.

³ DTE’s Brief in Support, Exhibit 11, Department of Treasury Interoffice Memorandum to Nancy Taylor, Deputy Treasurer and B.D. Copping, Commissioner, from June Summers Haas, Legal and Hearings, dated May 18, 1999, regarding the Treatment of Utilities Companies Under the Expanded Industrial Processing Statute.

Court of Appeals properly found that DTE had met its burden of substantiating that the equipment qualified for statutory exemption.

The Department claims, however, that this case “has significant public interest” by expanding a tax exemption by inference. The Department’s assertion rings hollow and is simply wrong. For instance, the Department has treated electric transformers, like the ones at issue in this case, as eligible for the industrial processing exemption in prior audits over the past 25 years. Wheeler Aff ¶9; Tiesman Dep 23:20; Email from Stan Weber to Dale Vettel, 12/9/2009 (attached as Exhibit 22 to DTE’s Brief in Support). The courts below reviewed the function of the equipment and determined that all the equipment squarely met the activities specifically exempted by the statute. The Court of Appeals correctly affirmed the exemption as plainly written in the statute. The decision merely applies the statutory changes enacted in 1999 and previously acknowledged by the Defendant. Defendant’s Application fails to meet the standards of MCR 7.302(B)(2).

C. The Decision Below Has Limited Application and Correctly Applies the Plain Language of the Industrial Processing Exemption.

This case involves equipment use in the unified electric system in our state. Equipment that is properly used in an exempt manner was found to qualify for exemption. The owners and users of this equipment are a small and limited group. Clearly, MCR 7.302(B)(3)’s standard is not present herein. The Court of Appeals decision correctly affirmed, based on the extensive evidence presented by DTE’s experts, and not rebutted by the Department, that equipment used to process, convert, condition, control, supervise, inspect, test and monitor electricity along DTE’s unified and integrated system (the legislatively mandated standard to achieve the industrial processing exemption in MCL 205.94o) until it reached the mandated parameters to be sold to its customers, qualified for the industrial processing exemption under the Use Tax Act.

The Department claims that this case “concerns fundamental legal principles of major significance” by incorrectly invalidating an administrative rule. The Court of Appeals addressed the Department’s assertion that Mich Admin Code, R 205.115(4) (hereinafter “Rule 205.115(4)”) was incorrectly invalidated by concluding that:

However, ‘interpretive rules are invalid when they conflict with the governing statute.’ *Guardian Indus*, 243 Mich App at 254. Here, R 205.115(4) conflicts with the UTA and the industrial processing exemption as construed by us today; therefore, the provision is invalid and unenforceable. [Slip opinion, p 13.]

As clearly shown by the experts, when processing electricity, a finished product does not exist until the electricity passes through the customer’s meter. Professor Fuchs Aff ¶34; Professor Wollenberg Aff ¶¶36, 43; Cook Dep 77:8-14. The Department’s own expert agrees that the final retail product delivered to a typical retail customer in Michigan is at 120 to 240 volts, stating, “. . . typically that voltage, coming in on those transmission lines is higher; not the 120/240 voltage so you have to put a transformer there to transform that voltage for residential usage.” Cook Dep 76:10-13. Application of the Court of Appeals decision is limited to interpreting the industrial processing exemption for providers of electricity. The decision below correctly applies the plain language of the industrial processing exemption. The Defendant’s Application fails to meet the standard set by MCR 7.302(B)(3).

D. Apportionment Was Not Raised or Preserved Below and May Not Be Addressed.

The Department raises a new and heretofore unheard argument in its Application for Leave to Appeal, by contending, for the first time, that DTE failed to prove the percentage of exemption that it is entitled to or would be statutorily applicable. This argument is untimely, and should be rejected by the Court, as a party is prevented from raising new claims and issues on appeal. Nor may a party change its legal theory between the trial and subsequent appeal.

Additionally, the newly raised “apportionment” argument is patently wrong and unsupported by the specific language of MCL 205.94o.⁴

For these reasons and those discussed more comprehensively below, this Court should deny the Department’s request for leave to appeal.

II. Counter-Statement of Facts and Legal Background

A. DTE’s Business Operations and What is Electricity.

DTE is an integrated utility company generating, transmitting and delivering electricity to approximately 2.1 million residential, commercial and industrial customers in Southeast Michigan. DTE’s generation, transmission and distribution of electricity is regulated by numerous federal and state governmental agencies, with the primary agency being the Michigan Public Service Commission (“MPSC”).⁵ Brown Aff ¶13. Electricity operations are inherently dangerous and, therefore, strict standards must be followed so as to provide a safe, reliable, high-quality product.

Electricity is composed of an organized flow of electrons endowed with voltage, Professor Fuchs Aff ¶¶17-18, and consists of voltage and current. *Id.* at ¶17; Cook Dep 85:3-4; Phillips Aff ¶45. In producing electricity, DTE produces current to change the character of the

⁴ MCL 205.94o(2) limits the exemption *only* for equipment that *alternates between exempt and non-exempt use, not for concurrent exempt and non-exempt use*. Revenue Administrative Bulletin 2000-4 provides an example: “An industrial processor uses a forklift truck 60% of the time in its plant moving in-process parts from one press to another press; this usage is exempt under industrial processing. The forklift is used the remaining 40% of the time in taxable activities such as shipping and receiving. The forklift truck would qualify for a 60% industrial processing exemption on the cost of the truck.” Revenue Administrative Bulletin 2000-4, Example 1.

⁵DTE’s MPSC-approved rates charged to customers have historically been designed to allow for the recovery of costs, plus an authorized rate of return on investments. Brown Aff ¶24. The costs of DTE’s equipment were used by the MPSC in setting DTE’s rate base. *Id.* at ¶31.

electrons, which changes the voltage, current and the frequency of electricity. Professor Fuchs Aff ¶¶22-23; Phillips Aff ¶¶49.

B. How Electricity is Manufactured.

The production of electricity requires an integrated, interrelated and interconnected system that includes generation plants, substations, transmission lines, distribution systems, transformers and meters which is spread out over a large geographic area (hereinafter “Electric System”).⁶ Phillips Aff ¶¶14-15; see also Attachment A to Phillips Aff; Professor Fuchs Aff ¶24. Professor Wollenberg Aff ¶24.

At the generation plant, a generator equips free electrons with voltage, and the electrons become endowed (i.e., with voltage) within an electric circuit. Professor Fuchs Supp Aff ¶10. The electron must be continually processed by the equipment in the Electric System to reach the customer’s meter in an endowed state. *Id.* at ¶15. The voltage level of the electricity at the generator ranges from 15,000 to 25,000 volts. Phillips Aff ¶72. This voltage is far too high for DTE’s customers to use. Professor Fuchs Aff ¶25; Professor Wollenberg Aff ¶22; Phillips Aff ¶76. Most customers use electricity at the 120/240 volt level—for them, this is the “finished product.” Professor Fuchs Aff ¶34; Phillips Aff ¶57. Thus, the electric power exiting a generation plant is only partially “manufactured” and cannot be sold at retail because homes, businesses and factories are not able to accept or use the electricity at the voltage levels that are produced at the terminals of a generator. Professor Fuchs Aff ¶34; Professor Wollenberg Aff ¶22; Phillips Aff ¶80; Cook Dep 77:8-14. The same electricity processing activity that occurs at

⁶This concept of a single system is adopted by MPSC. In Mich Admin Code, R 460.3102(e), the MPSC defines “electric plant” as “all real estate, fixtures or property that is owned, controlled, operated or managed in connection with or to facilitate the production, transmission and delivery of electric energy.”

the generation plant continues to occur throughout the Electric System, until it reaches the customer's meter. Professor Fuchs Aff ¶24.

From the generation plant, the electricity's voltage must be stepped up and then stepped down with the use of transformers and other equipment to make it useful to DTE's customers and to meet MPSC regulations. Phillips Aff ¶¶78, 79; Brown Aff ¶68; Professor Wollenberg Aff ¶27; Professor Fuchs Aff ¶¶34-35. Without a connection to the transformers and the other voltage processing, power quality, safety and power monitoring equipment within the transmission and distribution portion⁷ of the Electric System, these endowed electrons cannot flow safely from the generation plant to the customer's meter and the electricity cannot be delivered in usable form. Professor Fuchs Aff ¶34. Through the use of transformers and the other equipment in the Electric System, the voltage and current (consisting of organized electrons) is transformed, changed and processed. *Id.* at ¶¶33-34. The electricity continues to be processed, converted, conditioned, controlled, supervised, inspected, tested and monitored as it moves through the Electric System to reach its final form that is usable to customers. Phillips Aff ¶¶88-90.⁸

C. The Equipment at Issue.

At issue is equipment used in the Electric System after the start of production of electricity at the generation plant until the furnishing of the finished product to the customer at the meter. DTE provided seven uncontested affidavits, including experts, who attested to the

⁷ A complete description of the equipment at issue is in DTE's Brief in Support pp 11 to 13.

⁸ Due to the inherently dangerous nature of electricity, failure to adhere to regulatory standards can result in damage to appliances and equipment, destruction of homes and businesses, risk of fire and electrocution, and even death to DTE customers and employees. Professor Wollenberg Aff ¶20; Professor Fuchs Aff ¶31; Phillips Aff ¶¶60-62; Brown Aff ¶¶39-41; Cook Dep 99:25 to 100:10. These standards apply to all segments of DTE's production operations, from the generation plant to the customer's location. Brown Aff ¶42.

fact that electricity continues to be processed, controlled, and monitored throughout the transmission and distribution. See Affidavits listed on p 1, *supra*. Each of these uncontested affidavits clearly reflects that DTE's activities satisfy the legislative standard for the industrial processing exemption contained in MCL 205.94o. Additionally, DTE provided substantial testimony and documentation regarding the use, function and activities performed by such equipment. See Phillips Aff ¶36 and Attachment C thereto. The characteristics and quality of the electricity continues to change up to the final 120/240 volt conversions at or near the customer's meter. *Id.* This position is corroborated by the testimony of experts from both parties. Professor Wollenberg Aff ¶¶31-34; Cook Dep 77:8-25.

D. The Department's Prior Audits.

DTE has been audited on numerous occasions by the Department. Wheeler Aff ¶5. For more than 25 years, the Department has consistently treated DTE as an industrial processor. *Id.* at ¶¶7-9; DTE's Brief in Support Exhibits 19 and 20 thereto. The Department admits that electricity production is an industrial process. Deposition Testimony of Stan Weber ("Weber Dep") 17:18 to 18:4 (Exhibit 10 to DTE's Brief in Support); Deposition Testimony of Glenn White ("White Dep") 35:18 to 36:4 (Exhibit 16 to DTE's Brief in Support); Wheeler Aff ¶8; Department's Responses to DTE's First Request for Admission to Defendant, Response No. 4 (Exhibit 49 to DTE's Brief in Opposition to Department's Motion for Summary Disposition ("DTE's Reply")).

In the course of these previous audits, the Department has allowed the industrial processing exemption for transformers used in DTE's Electric System, regardless of location. Deposition Testimony of Jean Tiesman (hereinafter "Tiesman Dep") 24:16-20 (Exhibit 9 to DTE's Brief in Support); Weber Dep 12:18-19; 5/18/99 Haas memo (Exhibit 11 to DTE's Brief in Support); Deposition Testimony of Dale Vettel, Tax Policy Bureau Director ("Vettel Dep")

11:6-23 (Exhibit 12 to DTE's Brief in Support) ("transformers treated as exempt as a matter of routine"). In addition, the Department has allowed a partial exemption for other equipment located at a substation. Wheeler Aff ¶12. Then, after enactment of 1999 PA 117, which clearly and unambiguously expanded the industrial processing exemption to DTE's unified Electric System, the Department refused to comply with the provisions of the statute, instead relying on an outdated and conflicting administrative rule promulgated in 1979, Rule 205.115(4).

E. The Department's Assessment.

The Department conducted a use tax audit of DTE for the period January 1, 2003 through September 30, 2006. The Department allowed the industrial processing exemption from use tax for certain equipment purchased by DTE for use in its unified Electric System, but denied the industrial processing exemption for other electricity processing and testing equipment based solely on the equipment's location outside the generation plant. Tomlinson Aff ¶¶13, 20. The Department's auditor stated that the sole reason the Department denied an exemption for certain equipment was because this equipment was not located at a generation plant, even though the equipment is used in an identical manner to other equipment which the auditor found to qualify for the industrial processing exemption at a generation plant. Deposition of Yolanda Stokes 9:20 to 10:10 (Exhibit 15 to DTE's Brief in Support).

F. Decision of Court of Claims Below.

The Court of Claims below issued an Opinion and Order holding that the equipment used by DTE in its electric operations prior to the electricity reaching its usable finished form at the customer's meter clearly qualified for the expanded statutorily enacted industrial processing exemption. The Court found that electricity production does not cease until the electricity reaches the customer's meter and, therefore, all of the equipment from the generation plant,

through the transmission and distribution to the customer's meter, was entitled to the industrial processing exemption. The Court ruled that, under the undisputed facts, it is clear that electricity continues to be processed by the equipment up until the point where it reaches the customer's meter, because the voltage and current levels are drastically changed multiple times at various locations, the last being at or near the customer's meter, and between these locations, the voltage and current levels are constantly being adjusted to keep them constant. The Court noted that the Department provided nothing that contradicted the evidence presented by DTE as to the amount of the exemption claimed, the equipment at issue, the function of the equipment within the unified Electric System or when the electricity is a final product available for use by its customers in a safe and nonhazardous manner, as mandated by multiple state and federal regulatory requirements.

G. Decision of Court of Appeals.

The Court of Appeals correctly affirmed the Court of Claims, rejecting the Department's contention that the equipment was not used in an exempt manner, and holding that Rule 205.115(4) conflicted with the governing statute and is both invalid and unenforceable. Slip opinion p 11, 13. Further, the Court of Appeals opined that the sole affidavit submitted by the Department was essentially conclusory in form and was insufficient to create a question of fact. *Id.* at 10.

The Court of Appeals also held that the Department effectively failed to challenge DTE's position under MCL 205.940(6)(b) that the equipment used to inspect, test and control the quality of electricity as it flows through the transmission and distribution system clearly fits within the statutorily expanded industrial processing exemption. *Id.* at 11. The Court of Appeals

found it “indisputable that electricity is not a finished good ready for sale until it reaches the meters of DTE’s customers.” *Id.* at 10.

III. STANDARD OF REVIEW, RULES OF CONSTRUCTION, AND BURDEN OF PROOF

A. Standard of Review and Legal Standards for A Motion for Summary Disposition.

The Court of Claims granted DTE’s Motion for Summary Disposition pursuant to MCR 2.116(C)(10). Such decisions are reviewed *de novo*. An appellate court “reviews the grant or denial of summary disposition *de novo* to determine if the moving party is entitled to judgment as a matter of law.” *Maiden v Rozwood*, 461 Mich 109, 118; 597 NW2d 817 (1999). This case involves a question of statutory construction and questions of statutory construction are questions of law that this Court also reviews *de novo*. *Halloran v Bhan*, 470 Mich 572, 576; 683 NW2d 129 (2004).

In evaluating a motion for summary disposition brought under MCR 2.116(C)(10), a reviewing court considers affidavits, pleadings, depositions, admissions, and other evidence submitted by the parties, MCR 2.116(G)(5), in the light most favorable to the party opposing the motion. *Coblentz v Novi*, 475 Mich 558, 567-568; 719 NW2d 73 (2006). Where the proffered evidence fails to establish a genuine issue regarding any material fact, the moving party is entitled to judgment as a matter of law. *Id.*; see also MCR 2.116(C)(10) and MCR 2.116(G)(4).

B. Legal Standard and Rules of Statutory Construction.

Questions of statutory construction are reviewed *de novo*. *Feyz v Mercy Mem Hosp*, 475 Mich 663, 672; 719 NW2d 1 (2006). When the Legislature has unambiguously conveyed its intent in a statute, the statute speaks for itself and judicial construction is not permitted. *Koontz v Ameritech Services, Inc*, 466 Mich 304, 312; 645 NW2d 34 (2002). If an ambiguity exists in a tax statute, such an ambiguity must be resolved in favor of the taxpayer. *Michigan Bell Tel Co v*

Dep't of Treasury, 445 Mich 470, 477; 518 NW2d 808 (1994). In addition: (1) tax statutes are to be liberally construed in favor of the taxpayer; (2) ambiguities and doubtful language are to be construed in favor of the taxpayer; and (3) tax officials have the burden to identify express language authorizing the tax sought to be imposed.⁹

IV. ARGUMENT

A. The Court of Appeals Correctly Concluded That the Equipment Outside the DTE Generation Plant Qualifies For the Industrial Processing Exemption.

1. The Industrial Processing Exemption Applies to Equipment Used to Convert and Condition Electricity by Changing the Form, Composition, Quality or Character of the Electricity As Well As to Equipment That Performs the Industrial Processing Activities of Inspection, Quality Control, And Testing to Determine if the Product or Process Conforms to Specified Parameters Prior to Finished Goods Inventory Storage.

In Michigan, the Use Tax Act exempts equipment used by an industrial processor, such as DTE, in performing industrial processing. MCL 205.94o(1)(a) provides that:

The tax levied under this act does not apply to property sold to the following after March 30, 1999 . . .

- (a) An industrial processor for use or consumption in industrial processing.

The term "industrial processing" is defined in subsection 94o(7)(a):

Industrial processing means *the activity of converting or conditioning* tangible personal property by changing the *form, composition, quality, combination, or character* of the property for ultimate sale at retail or for use in the manufacturing of a product

⁹*Ford Motor Co v State Tax Comm*, 400 Mich 499, 506; 255 NW2d 608 (1977) (point 1); *Ecorse Screw Machine Prods Co v Michigan Corp & Securities Comm*, 378 Mich 415, 418; 145 NW2d 46 (1966) (point 2); *Garavaglia v Dep't of Revenue*, 338 Mich 467, 470-71; 61 NW2d 612 (1953) (points 1, 2 and 3); *Ready-Power Co v Dearborn*, 336 Mich 519, 525; 58 NW2d 904 (1953) (points 1 and 2); *Standard Oil Co v Michigan*, 283 Mich 85, 88-89; 276 NW 908 (1937) (points 1, 2 & 3); *In re Dodge Bros Inc*, 241 Mich 665, 669; 217 NW 777 (1928) (points 1, 2 & 3); *Detroit v Norman Allan & Co*, 107 Mich App 186, 191; 309 NW2d 198 (1981) (points 1 & 2).

to be ultimately sold at retail. *Industrial processing* begins when tangible personal property begins movement from raw materials storage to begin industrial processing and *ends when finished goods first come to rest in finished goods inventory storage.* [Emphasis added.]

An “industrial processor” is defined in MCL 205.94o(7)(b) as:

a person who *performs the activity of converting or conditioning* tangible personal property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. [Emphasis added.]

To qualify for the exemption, the property must be used in industrial processing either by or on behalf of an industrial processor.

As supported by the testimony of the experts, the process of generation, transmission and distribution of electricity is an integrated process that cannot be bifurcated into parts. The industrial processing exemption applies to all equipment used in industrial processing activities. *Granger Land Dev Co v Dep't of Treasury*, 286 Mich App 601; 780 NW2d 611 (2009). Accordingly, once DTE begins the industrial process of the production of electricity, all equipment used in the industrial process is exempt until a final product is achieved. As the Court of Appeals correctly concluded:

The Department does not cite any documentary evidence that counters the position of DTE's experts that the machinery and equipment are used to inspect, test, and control the quality of the electricity.

We conclude that DTE's machinery and equipment located outside of its generation plants are used in the activity of converting and conditioning electricity by changing the quality, form, character, and/or composition of the electricity for ultimate sale at retail up until the time the electricity reaches its customers' meters, *at which point it becomes a finished good.* [Slip opinion, p 10, emphasis added.]

The Department was aware that in addition to transformers, the other equipment within the unified Electric System would also qualify for exemption under the expanded definition of

industrial processing enacted in 1999 PA 117, which became MCL 205.94o. Memo from Stan Weber to Mark Meyer, dated February 27, 2008 (Exhibit 45 to DTE's Reply). The Department has admitted that the industrial processing exemption is "*not dependent upon who the industrial processor is, but on the nature of the use of the property by the industrial processor.*" Defendant's Admission, Response No. 28 (emphasis added), Exhibit 49 to DTE's Reply. There is absolutely no evidence in the record to dispute the findings of the Court of Claims and the Court of Appeals that DTE's production of electricity is an integrated industrial process in which industrial processing activities occur throughout until the electricity reaches, and passes through, the customer's meter.

2. The Court of Appeals Correctly Ruled for Two Independent Reasons That the Uncontroverted Evidence Plainly Establishes That Electricity Manufacturing is Not Complete Until the Finished Retail Product is Produced at the Customer's Meter.

The plain language of the Use Tax Act defines when industrial processing begins and ends. Under MCL 205.94o(7)(a) "industrial processing . . . ends when *finished goods* first *come to rest* in finished goods inventory storage." (Emphasis added). Thus, the very definition of industrial processing requires that there be a "finished good" before industrial processing ends, and such "finished good" requires that the product be in its final form, usable by, and ready for, sale to the customer. *Id.* Vettel Dep 57:18-20 ("electricity . . . cannot be stored . . . and therefore there is no application of finished goods inventory storage to electricity). The Court of Appeals correctly concluded "shipping and distribution," within the meaning of MCL 205.94o(6)(b), cannot occur before industrial processing of electricity ends when it achieves a final form usable by, and ready for, sale to the customer.

All of the expert witnesses in this case, along with the Department's former Tax Policy Bureau Director, agree that electricity is not a finished retail product until the electricity is at 120

or 240 volts, which for residential customers means electricity delivered at the meter at their homes or residences. Professor Wollenberg Aff ¶42; Professor Fuchs Aff ¶40; Cook Dep 34:21-23; 39:15 to 40:6-9; 76:10-13; 84:9-11. Vettel Dep 56:12-15. There is no final product until the electricity passes through the customer's meter in a form that is usable by the customer. DTE's Brief in Support pp 23-26; Professor Fuchs Aff ¶¶25, 41; Professor Wollenberg Aff ¶¶36, 43); Phillips Aff ¶116; Cook Dep 40:3-12. Due to the inherently dangerous nature of electricity, failure to adhere to the state and federal regulatory standards that are applicable to the unified Electric System can result in damage to appliances and equipment, destruction of homes and businesses, risk of fire and electrocution, and even death to DTE customers and employees. Professor Wollenberg Aff ¶20; Professor Fuchs Aff ¶31; Phillips Aff ¶¶60-62; Cook Dep 99:25 to 100:10.

The Court of Appeals specifically concluded

The terms "form, composition, quality, combination, or character," MCL 205.94o(7)(a), are sufficiently broad and expansive so as to encompass voltage and current changes in electricity as it travels through the transmission and distribution system. We are in accord with the analysis of the Court of Claims. Additionally *we find it indisputable that electricity is not a finished good ready for sale until it reaches the meters of DTE's customers.* The expert testimony and affidavits clearly indicated that electricity is not in usable form for customers, and is in fact a danger or hazard to customers, until it completes its passage through the transmission and distribution system. [Slip opinion, p 10, emphasis added].

Additionally, the Court of Appeals stated:

Furthermore, as discussed earlier, the Department has effectively failed to challenge DTE's position under MCL 205.94o(3)(d) that the machinery and equipment in dispute are used to inspect, test, and control the quality of electricity as it flows through the transmission and distribution system. Under MCL 205.94o(3)(d), these functions or activities are defined as constituting industrial processing. *And again, we conclude that electricity is not a*

finished good until it reaches the meters of DTE's customers. [Id. at 11, emphasis added].

The Court of Appeals also found that:

Here, in light of our holding above, we have a situation in which machinery and equipment are concurrently used in a unified system for purposes of both distribution *and* industrial processing. In such a situation, the caselaw is clear that the "industrial processing" exemption applies to the machinery and equipment *in full*. In *Mich Allied Dairy Ass'n v State Bd of Tax Admin*, 302 Mich 643, 649-651; 5 NW2d 516 (1942), our Supreme Court affirmed the circuit court's allowance of a full exemption with respect to milk bottles and cans that were used for distribution *and* for the industrial processing of milk:

The question is raised whether the exemption should apply inasmuch as the milk bottles and cans are also used as delivery containers, the latter use not being industrial processing. Without considering the practical disadvantages of using one set of bottles and cans for refrigeration and another for delivery, we believe that the one use of bottles and cans in industrial processing makes them exempt from the general sales and use taxes, *notwithstanding the fact that they are also put to another use not in industrial processing.*

Where an article has more than one use, one or more (but not all) of which are within the agricultural producing or industrial processing exemptions, the legislature could have provided that the portion of the value of the article representing its non-exempt uses should bear the tax, but it has not done so. . . .[*Id.* at 11-12.]

And finally, the Court of Appeals concluded:

[C]oncurrent taxable use with an exempt use does not remove the protection of exemption. *Mich Milk Producers Ass'n v Dep't of Treasury*, 242 Mich App 486, 495; 618 NW2d 917 (2000). When equipment is used from the outset in industrial processing as well as otherwise, the full exemption is to be allowed, and apportionment is not permitted "when the equipment involved is put to mixed use, but in a unified process." *Mich Bell*

Telephone Co v Dep't of Treasury, 229 Mich App 200, 211-212; 581 NW2d 770 (1998). Accordingly, DTE is entitled to the claimed 'industrial processing' exemption in full, despite the fact that the machinery and equipment in dispute are used, in part, for a nonexempt purpose, i.e., distribution, given that the machinery and equipment are concurrently being used to also industrially process electricity, all as part of a unified process or system. [*Id.* at 12.]

This Court has repeatedly held that equipment that processes a product into the final form sold to the customer is used in industrial processing. *Edison v Dep't of Revenue*, 362 Mich at 159; *Kress*, 322 Mich at 593; *Bay Bottled Gas*, 344 Mich at 330. Under the plain language of the statute and precedential case law, until electricity is usable by the customer, the product is not in its final form, and, thus, industrial processing has not yet been completed. DTE has provided substantial support for the use, function and activities performed by such equipment. DTE's Brief in Support pp 26-32; Phillips Aff ¶36 and Attachment C thereto. This evidence of industrial processing was compelling and uncontroverted and is corroborated by the testimony of DTE's experts, as well as the Department's expert. Professor Wollenberg Aff ¶¶31-34; Cook Dep 77:8-25.

The Court of Appeals noted that the sole affidavit submitted by the Department to rebut the vast evidence by DTE's experts was conclusory in form and insufficient to create a question of fact. Slip opinion, p 10. The Department now offers additional conclusory, irrelevant and inadmissible evidence in support of its position. See Exhibits C, E, F, G, and J to the Department's Application for Leave to Appeal. None of this purported evidence rebuts DTE's experts' testimony that the equipment at issue changes the form, composition, quality, combination or character of the electricity qualifying the equipment for the exemption. Additionally, none of this purported evidence rebuts the finding of the Court of Appeals that the equipment was also used to inspect, test, and control the electricity in order to monitor and

maintain the electricity to the required regulatory standards. Slip opinion, p 11. As noted by the Court of Appeals:

DTE presented extensive expert documentary evidence indicating that the machinery and equipment at issue are used not only to change the form and character of electricity, but to inspect, test, and control the electricity in order to determine whether it conforms to specified parameters at a time before the electricity becomes a finished good. The documentary evidence reflected that DTE is required to engage in such monitoring to be in compliance with rules and regulations of the Michigan Public Service Commission (MPSC) and federal agencies. . . . *The Department does not cite any documentary evidence that counters the position of DTE's experts that the machinery and equipment are used to inspect, test, and control the quality of the electricity.* [Slip opinion, p 10, emphasis added].

Under MRE 402, this irrelevant evidence is not admissible.

3. The Court of Appeals' Decision Applies the Plain Language of the Statute.

The production of electricity is unique in that, unlike the manufacturing of car parts or furniture, there is no inventory storage for electricity as might be the case with other products. This is why the courts have recognized that the production of electricity is an ongoing, continuous, geographically dispersed process, with the production of electricity commencing at the generation plant and until it passes through the customer's meter. *Builders Steel Supply Co, supra* at p 3. The decision of the Court of Appeals applies only to those that provide electricity. The users of this equipment are a limited industry group in the state.

The "material injustice" that would be created upon a reversal of this decision would be tax pyramiding, and its impact on electric affordability on every Michigan resident. If the decision is overturned, tax pyramiding would ensue, which is against public policy, results in unlawful double taxation, and flies in the face of the standard set by this Court. This Court has recognized that tax pyramiding is against public interest and should be avoided. *Elias Bros, 452*

Mich at 152. The industrial processing exemption exists in Michigan and many other states that impose sales and use taxes so as to prevent this pyramiding of taxes. As this Court has stated “*If the end product is taxed, the components used or consumed in its production are not taxed so that the product is not subject to double taxation.*” *Id.* (Emphasis added.)

Thus, the industrial processing exemption is, in part, the product of a targeted legislative effort to avoid double taxation of the end product offered for retail sale. As the sale of electricity at retail is subject to sales or use tax, and the price charged for the electricity reflects the costs incurred for the generation, transmission and distribution of the electricity, to impose sales or use tax on the equipment used to process electricity into the final product sold to the consumer would result in unlawful double taxation.

In addition, if the decision is overturned, there would be an increase in the cost of energy to all Michigan residents and businesses. All Michigan residents pay sales tax upon the total amount charged for the provision of electricity. *Id.* The inclusion within DTE’s rate base of additional sales or use tax resulting from the reversal of the Court of Appeals’ decision, would directly result in an increase in the cost of energy to Michigan residents and businesses. This contradicts the state’s policy to strive for electric affordability, particularly in light of current economic times and the intent to support Michigan businesses. Utilities provide a necessary product and have an obligation to serve customers, which includes keeping the cost of their product within the means of all. Utilities already face significant challenges to not spend more than Michigan residents can afford to buy a product they need to light and power their homes and appliances.

B. The Court Properly Invalidated an Administrative Rule That Conflicts With the Updated Governing Statute.

Both the Court of Claims and the Court of Appeals held that the Department's reliance on Rule 205.115(4) is unwarranted because it was superseded by the 1999 legislation. In enacting 1999 PA 117 some twenty years after the administrative rule was last amended, the Legislature moved the industrial processing statutory provisions from subsection 94(g) to section 94o, incorporating much of the language that is found in Michigan Admin Code, R 205.90 (hereinafter "Rule 205.90"). The Legislature, however, incorporated little, if any, of the language found in Rule 205.115, even though Rule 205.90 is specifically referenced therein. The courts below concluded that this was a conscious choice by the Legislature. See, e.g., *Beckman Production Services, Inc v Dep't of Treasury*, 202 Mich App 342, 345; 508 NW2d 178 (1993), as the Legislature is charged with knowledge of existing laws on the same subject. *Inter Cooperative Council v Dep't of Treasury*, 257 Mich App 219, 227; 668 NW2d 181 (2003).

As the Court of Appeals noted, interpretive rules are invalid and unenforceable when they conflict with the governing statute. Slip opinion, p 13. In *Michner Plating Co v Dep't of Treasury*, 12 MTTR 18 (Docket No. 273340, May 23, 2002), attached as Exhibit 51 to DTE's Reply, the petitioner relied on the definition of "industrial processing" found in Rule 205.90 in support of its claim that certain chemicals it used were exempt from use tax. The petitioner also relied on Revenue Administrative Bulletin 2000-4 (hereinafter "RAB 2000-4") in support of its exemption claim. Ironically, the Department asserted that

[T]hat rule, effective in 1962 and amended in 1972, predated the controlling statute Thus, the Department notes, [Rule 205.90] does not apply in the instant case; the statute taking precedence over the administrative rule. The Department asserts that even if [Rule 205.90] had been promulgated subsequent to the relevant statute, the rule would, nevertheless, have been invalid inasmuch as it would have improperly

expanded the statutory exemption.” [*Michner Plating*, 12 MTTR at 9, internal citations omitted.]

Because Rule 205.115(4) predated both the pre- and post-1999 amendment versions of the Use Tax Act, it is inapplicable and has no reasonable relationship to the statutory purpose of the industrial processing exemption. Case law issued before the post-1999 amendment to the Use Tax Act that is inconsistent with, or limits, the industrial processing exemption must give way to the plain language of the statute. *Sington v Chrysler Corp*, 467 Mich 144, 155 n 9; 648 NW2d 624 (2002). The Court of Appeals noted that the interpretive rule must similarly give way to the governing statute. *Guardian Indus Corp v Dep't of Treasury*, 243 Mich App 243, 254; 621 NW2d 450 (2000).

Furthermore, consistent with the 1999 Use Tax Act, the Department's longstanding policy is that transformers, substations and much of the equipment at issue is exempt under the industrial processing exemption. Vettel Dep 11:4-8; Tiesman Dep 24:16-20; Memo from Stan Weber to Mark Meyer, dated February 27, 2008 (“Transformers and transformer parts are specifically exempted by 1979 AACS, R 205.115 and have been allowed as exempt in the audit”)(Exhibit 45 to DTE's Brief in Opposition to Department's Motion for Summary Disposition); Memo from Mike Eschelbach to Glenn R. White, dated March 27, 2007 (“Such equipment and supplies could include poles, wire lines and substation equipment. . . . (Transformers and transformer parts are specifically exempted by 1979 AACS, R 205.115 and have been allowed as exempt in the audit”); Email from Dewayne Miller to William Hubbert, dated August 24, 2001 (Exhibit 43 to DTE's Brief in Support) (“Dale Vettel has informed me that all transformers (and not just the ones at substations) would be exempt”).

C. The Department Has Not Raised or Preserved any Argument That DTE's Exemption Should be Apportioned.

The Department belatedly raises an argument that DTE has not supported a discrete percentage of exempt use required under Rule 40.¹⁰ This issue is improperly brought before this court because it was not properly raised either as an affirmative defense or at the trial court level. See *Bageris v Brandon Twp*, 264 Mich App 156, n 2; 691 NW2d 459 (2004). Michigan follows the "raise or waive" rule of appellate review. A litigant must preserve an issue for appellate review by raising it in the trial court at a time when their opponents may respond to them factually. *Therrian v Gen Laboratories, Inc*, 372 Mich 487, 490; 127 NW2d 319 (1964) (holding that were defendant failed to raise issues at trial court, such issues are not available to it on appeal); *Three Lakes Ass'n v Whiting*, 75 Mich App 564, 581; 255 NW2d 686 (1977) ("Plaintiff may not shift ground on appeal and bring forward new theories"); *Napier v Jacobs*, 429 Mich 222, 225; 414 NW2d 862 (1987). A party may not remain silent in trial court and attempt to prevail upon appeal on an issue that was not called to the court's attention. *Kinney v Folkerts*, 84 Mich 616, 625; 48 NW 283 (1891) ("on appeal a case will not be reviewed on a theory different from that on which it was tried.").

DTE introduced evidence that the equipment is used concurrently 100% of the time for industrial processing, as well as the proper amount of the exemption to which they were entitled. Tomlinson Aff ¶ 20. At that point, the burden shifted to the Department to introduce evidence disputing the amount of exemption that DTE was entitled to and showing a genuine issue of material fact. See MCR 2.116(G)(4); *Smith v Globe Life Ins Co*, 460 Mich 446, 454; 597 NW2d 28 (1999). The Department did not introduce any such evidence and has waived further argument. Rather, the Department consistently argued only that the industrial processing

¹⁰ Mich Admin Code, R 205.90(8).

exemption did not apply at all. See Department's Brief in Support of Motion for Summary Disposition p 11; Department's Opposition to DTE's Motion for Summary Disposition pp 14-19. Indeed, even upon appeal, the Department did not raise the apportionment issue or contest the amount of exemption DTE claimed.

However, the Department now contends, for the very first time, that DTE must prove the percentage of time its equipment is engaged in an exempt function. This argument is untimely, and should be rejected by the court. Additionally, even if properly raised, the Department is incorrect in its application of Michigan law. This Court has long held that equipment used in a step in the industrial process is exempt "notwithstanding the fact that the equipment is also put to another use not in industrial processing." *Michigan Allied Dairy*, 302 Mich 650; *White Consolidated Industries, supra*.¹¹ The fact that the equipment also facilitates movement of the electricity is not disqualifying because the equipment concurrently converts, conditions, changes the quality, form, character, and/or composition of the electricity, as well as tests, monitors and controls the electricity as part of the process to produce a finished product ready for sales to DTE's customers.¹²

¹¹ See footnote 4, *supra*. At all times, the equipment is used in industrial processing activities.

¹² Professor Fuchs Aff ¶¶ 24, 35-36; Professor Wollenberg Aff ¶¶ 24-27; Phillips Aff ¶¶14-15, 88-90; see also Attachment A to Phillips Aff; Brown Aff ¶68.

V. CONCLUSION

For the reasons set forth above, the Court of Appeals properly held that DTE was entitled to judgment as a matter of law. The Department's Application for Leave to Appeal should be denied.

Respectfully submitted,

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By: 

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