

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

The Honorable H.W. Funderburk, Jr., Administrative Law Judge

Case No. 17-ALJ-17-0060-CC
Appellate Case No. 2019-001933

McEntire Produce, Inc. Respondent,

v.

South Carolina Department of Revenue, Appellant.

INITIAL BRIEF OF RESPONDENT

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I. STATEMENT OF ISSUES ON APPEAL

- A. DID THE ADMINISTRATIVE LAW COURT ERR BY GRANTING “THE MACHINE EXEMPTION” AND “THE POLLUTION CONTROL MACHINE EXEMPTION,” BOTH FOUND IN S.C. CODE ANN. § 12-36-2120(17) (SUPP. 2018), TO THE RESPONDENT’S PURCHASES OF ITEMS THAT ARE “MACHINES?”**
- B. DID THE ADMINISTRATIVE LAW COURT ERR BY GRANTING “THE MACHINE EXEMPTION” TO RESPONDENT’S PURCHASES OF MACHINES THAT ARE “USED IN PROCESSING TANGIBLE PERSONAL PROPERTY FOR SALE?”**

II. STATEMENT OF THE CASE

This matter came before the Administrative Law Court (ALC) in accordance with the Administrative Procedures Act, S.C. Code Ann. §§ 1-23-310 et seq. (2005 & Supp. 2015), for a contested case hearing. McEntire Produce, Inc., (“Respondent”) filed a request for a contested case hearing with the ALC on March 7, 2017, in case number 17-ALJ-17-0060-CC to challenge a Department Determination issued by the South Carolina Department of Revenue (“DOR,” “Department,” or “Appellant”) on February 7, 2017. (R. pp. ----; Req. for Contested Case Hr’g; Dep’t Determination pp. 1-10) In the Department Determination, the Department concluded that the Respondent’s purchases of certain supplies and protective clothing were subject to use tax for tax periods October 1, 2012 through September 30, 2015 (the “Audit Period”) and were not exempt from use tax under § 12-36-2120(17) (Supp. 2018). (R. pp. ----; Dep’t Determination pp. 1-10).

On November 14 and 15, 2018, the ALC held a contested case hearing. Thereafter, the ALC issued its Final Order on September 6, 2019, and determined that the majority of the items, including those items identified as protective clothing, for which the Respondent sought exemptions were exempt from use tax under § 12-36-2120(17), hereinafter referred to as the “Machine Exemption.” (R. pp. ----; Order p. 42) (The ALC’s Final Order will be referred to, hereinafter, as the “Order”). The ALC further found that the items designated as protective clothing were also exempt from use tax under a separate provision in § 12-36-2120(17) commonly referred to as the “Pollution Control Machine Exemption” (R. pp. ----; Order p. 42).

On September 19, 2019, the Department filed a Motion for Reconsideration, and/or to Alter or Amend. (R. pp. ----; Mot. to Recons. pp. 1-25). The ALC issued an order on October 16, 2019, denying the Department’s Motion for Reconsideration. (R. pp. ----; Order Denying Mot. to Recons.) The Department appealed the Order and the Order Denying Respondent’s

Motion to Reconsider, Alter or Amend on November 20, 2019. (R. pp. ----; Notice of Appeal).

III. STATEMENT OF FACTS

Respondent was started in South Carolina in 1928 and the facility under audit is the only facility. (R. pp. ----; Tr. p. 16, Line 1, 22-24). It is a seasonal business with 600 employees during the summer and 50 in the winter. (R. pp. ----; Tr. 18, Lines 3-8). Their major customers include McDonalds, Burger King, Subway and Taco Bell (R. pp. ----; Tr. p. 21, Lines 13-17). It purchases produce from farmers in California, Florida, Georgia, South Carolina, Michigan and Ohio. (R. pp. ----; Tr. p. 24, Lines 1-5). For sales, income, and property tax purposes, Respondent is taxed as a manufacturer.

Respondent operates in the specialized and highly-regulated arena of fresh food processing. During the periods at issue, Respondent's production primarily involved lettuce, onions, cabbage, tomatoes, and other vegetables.

Respondent's "processing" includes receiving, storing, washing, cutting, mixing, and then packaging the produce at its facility. Respondent called several witnesses who described its fresh food processing in depth. This production process is critical to reduce or eliminate harmful contaminants because the ultimate customer who eats the fresh produce does not take any preventive steps such as microwaving or cooking the produce to the extent necessary to kill or eliminate any contaminants.

Respondent's process begins prior to the raw agricultural commodity even entering the facility. Respondent contracts with a grower to harvest the product when it is about 80-85 degrees, so the first step in the process is to pull the heat from the produce, so that the temperature of the produce is reduced to below 40 degrees within no more than four hours from the time of harvest. This cooling step is essential to Respondent's process because it slows the respiration rate of the produce, thereby slowing the natural chemical process of

ripening in the fruit and/or vegetable. It also minimizes microbiological growth rate. If the produce is not cooled immediately, then it risks turning brown, soggy, slimy, and inedible. Respondent is required by state and federal regulation, as well as customer requirements, to track the produce as soon as it is loaded into its climate-controlled trucks. Respondent must be able to demonstrate that the temperature on those trucks was between 33 and 40 degrees. Respondent's customers (primarily large restaurant chains) have extensive contractual requirements in this regard.

As soon as the product is unloaded, it enters one of six raw coolers, which also are controlled at 33-40 degrees. Soon thereafter, the produce goes through the Ready to Eat ("RTE") process, where it is sorted, physically inspected, trimmed by hand to remove imperfections or browning, and then conveyed to an industrial cutter that discharges into a flume for washing. Respondent's flume is a stainless steel bath that utilizes a water-based product to rinse and sanitize the product. The produce is washed a number of times before it moves to the next step. After washing, the produce goes through a "de-watering" step, which is essentially an industrial-sized salad spinner. This process of washing and de-watering is done in an effort to remove any pollutants or contaminants which were in the produce at the time of delivery to Respondent.

The low care area is generally reserved for whole produce, for example whole tomatoes, and involves their ripening, sorting, defect removal, and repackaging but no cutting of the produce. The physical cutting of produce releases pollutants, which are present on the produce at the farm level, and allows them to grow, multiply and spread which is the reason for the high care area.

The high care area is reserved for produce that is cut down to a smaller size. In the

high care area, employees are required by state and federal law to wear protective clothing. The employees must also go through a specialized sanitization procedure to limit the introduction of microbes to the high care area. The room is also positive-pressurized to ensure there is an outflow, as opposed to an inflow, of air. That pressurization, as well as filters for both ambient and compressed air touching the produce used to filter the air down to 0.1 microns, help maintain the cleanliness of the environment. The overall purpose of these procedures are to protect the produce from human contact and microbial loads. This protective clothing is required by state and federal law to prevent employees from accidentally bringing pollutants (chiefly E. coli) from their clothing into the high care area.

In the high care area, the produce is de-watered in a centrifugal dryer and moved on a conveyor belt to a scale, weighed and bagged, and then boxed and labeled for shipping. In the area, Respondent is required by state and federal law and customer contractual requirements to meet exacting cleanliness standards to ensure the finished product is both free from harmful microbial growth and meets the stringent standards of its many customers.

Once bagged, boxed, and labeled, the produce is stored for a short period of time in a refrigerated cooler, given the fresh nature of its cut produce, and is then shipped on climate-controlled trucks to its customers. Respondent's customers are primarily large restaurant chains who put the fresh produce on salad bars and into hamburgers, sandwiches, etc. without any additional processing for health purposes, e.g., the produce is not cooked. "[W]e do not have a kill step. We do not have a pasteurization step." R. pp. ----; Tr. p. 35 Lines 13 – 15). Respondent's customers also can track the extent to which the produce was kept in a climate-controlled area. For example, if the produce is stored for a period of time above 40 degrees, then the customer can simply reject the shipment. Further, to the extent the Food and Drug

Administration (or a customer) on audit determined that the produce spent a period of time outside the temperature “safe zone,” Respondent could be subject to reprimand, fines, or even plant closure, based on the severity of the violation. Respondent is annually audited by the FDA in this regard. This means temperature and environmental controls permeate the entire production process, from the time the produce is delivered from the farm until the finished product leaves Respondent’s facility. (R. pp. ----; Order pp. 5-8). The facility has had a Class 100 clean room environment since it opened in 2006 as required by state and federal law. (R.- ----; Tr. 59:21 to 60:13.)

As detailed below, many of the items at dispute in this audit relate to Respondent’s attempt to combat three potentially serious foodborne microbes – *Listeria monocytogenes*, *E. coli* and salmonella. The microbes are described on the CDC website as follows:

1. **Listeria monocytogenes** is a germ that can cause a serious infection called Listeriosis, which presents as flu-like symptoms. People usually become ill with listeriosis after eating contaminated food. The disease primarily affects pregnant women, newborns, older adults, and people with weakened immune systems. Approximately 80% of those with Listeriosis go into the hospital, and as many as 18% of those infected die.
2. **Escherichia coli** (abbreviated as *E. coli*) are bacteria that can cause diarrhea, urinary tract infections, respiratory illness and pneumonia, and other illnesses. *E. coli* are pathogenic, meaning they can cause illness, either diarrhea or illness outside of the intestinal tract. The types of *E. coli* that can cause diarrhea can be transmitted through contaminated water or food, or through contact with animals or persons.
3. **Salmonella** is a bacteria that can cause diarrhea, fever, and abdominal cramps between 12 and 72 hours after infection. The illness usually lasts 4 to 7 days. In some cases, diarrhea may be so severe that the patient needs to be hospitalized. In these patients, the Salmonella infection may spread from the intestines to the blood stream, and then to other body sites. In these cases, Salmonella can cause death unless the person is treated promptly with antibiotics. The elderly, infants, and those with impaired immune systems are more likely to have a severe illness.

All three microbes grow naturally in South Carolina and are present in farms across the

country where Respondent's produce is harvested. The germ and bacteria can breed in produce if the environment is conducive to that growth. Respondent deals with these pollutants in two scenarios: (1) to prevent the spread of contaminants which are in produce delivered to its facilities; and (2) to prevent employees from introducing such pollutants into the facility from their own clothing and shoes. (R. pp. ----; Order pp. 8-9).

IV. STANDARD OF REVIEW

In an appeal from the decision of an administrative agency, the Administrative Procedures Act provides the appropriate standard of review. *Olson v. S.C. Dep't of Health & Env'tl. Control*, 379 S.C. 57, 63, 663 S.E.2d 497, 500-501 (Ct. App. 2008); *Turner v. S.C. Dep't of Health & Env'tl. Control*, 377 S.C. 540, 544, 661 S.E.2d 118, 120 (Ct. App. 2008); *Clark v. Aiken County Gov't*, 366 S.C. 102, 107, 620 S.E.2d 99, 101 (Ct. App. 2005). S.C. Code Ann. § 1-23-610(D) (Supp. 2017) provides the applicable standard:

(D) The review of the administrative law judge's order must be confined to the record. The court may not substitute its judgment for the judgment of the administrative law judge as to the weight of the evidence on questions of fact. The court of appeals may affirm the decision or remand the case for further proceedings; or, it may reverse or modify the decision if the substantive rights of the petitioner have been prejudiced because the finding, conclusion, or decision is:

- (a) in violation of constitutional or statutory provisions;
- (b) in excess of the statutory authority of the agency;
- (c) made upon unlawful procedure;
- (d) affected by other error of law;
- (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
- (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

The standard of review for appeals from the Administrative Law Court was recently stated by the Court of Appeals in *A. O. Smith Corp. v. S.C. Department of Health and Environmental Control*, 428 SC 189, 833 S.E.2d 451, 457-58 (2019), as follows:

“A reviewing court may reverse or modify an administrative decision if the findings of fact are not supported by substantial evidence.” *Risher v. S.C. Dep’t of Health & Env’tl. Control*, 393 S.C. 198, 210, 712 S.E.2d 428, 434 (2011). “When the evidence conflicts on an issue, the court’s substantial evidence standard of review defers to the findings of the **fact-finder**.” *Be Mi, Inc. v. S.C. Dep’t of Revenue*, 408 S.C. 290, 297, 758 S.E.2d 737, 740 (Ct. App. 2014). “In determining whether the ALC’s decision was supported by substantial evidence, this court need only find that, upon looking at the entire record on appeal, there is evidence from which reasonable minds could reach the same conclusion that the ALC reached.” *Engaging & Guarding Laurens Cty.’s Env’t (EAGLE)*, 407 S.C. at 342, 755 S.E.2d at 448. “[W]e may not substitute our judgment for that of the [ALC] as to the weight of the evidence on questions of fact unless the [ALC’s] findings are clearly erroneous in view of the reliable, probative and substantial evidence in the whole record.” *Bailey*, 388 S.C. at 5, 693 S.E.2d at 429 (alterations by court) (quoting *Comm’rs of Pub. Works v. S.C. Dep’t of Health & Env’tl. Control*, 372 S.C. 351, 358, 641 S.E.2d 763, 766-67 (Ct. App. 2007)).

“Substantial evidence is ‘evidence which, considering the record as a whole, would allow reasonable minds to reach the conclusion that the administrative agency reached.’” *Se. Res. Recovery, Inc. v. S.C. Dep’t of Health & Env’tl. Control*, 358 S.C. 402, 407, 595 S.E.2d 468, 470 (2004) (quoting *Lark v. Bi-Lo*, 276 S.C. 130, 135, 276 S.E.2d 304, 306 (1981)). “Substantial evidence ... is more than a mere scintilla of evidence.” *Original Blue Ribbon Taxi Corp. v. S.C. Dep’t of Motor Vehicles*, 380 S.C. 600, 605, 670 S.E.2d 674, 676 (Ct. App. 2008). “Substantial evidence is not ... the evidence viewed blindly from one side of the case, but is evidence that, considering the record as a whole, would allow reasonable minds to reach the conclusion the [ALC] reached in order to justify its action.” *Fragosa v Kade Constr, LLC*, 407 S.C. 424, 428, 755 S.E.2d 462, 465 (Ct. App. 2013) (quoting *Taylor v. S.C. Dep’t of Motor Vehicles*, 368 S.C. 33, 36, 627 S.E.2d 751, 752 (Ct. App. 2006)).

See also DIRECTV, Inc. v. S.C. Dep’t of Revenue, 421 S.C. 59, 804 S.E. 2d 633, 638 (2017) and *Bailey v. S.C. Dep’t of Health & Env’tl. Control*, 388 S.C. 1, 693 S.E. 2d 426,429 (2011).

V. ARGUMENT

A. THE ADMINISTRATIVE LAW COURT DID NOT ERR BY GRANTING THE MACHINE EXEMPTION TO RESPONDENT'S PURCHASES.

1. The ALC Did Not Broaden the Meaning of the Term "Machine" as Used in the Machine Exemption.

a. All machines used within the temperature-controlled portion of the facility are exempt as machines used in the manufacturing process.

S.C. Code Ann. § 12-36-2120(17) exempts from sales tax the sale of "machines used in *manufacturing, processing, agricultural packaging*, recycling, compounding, mining, or quarrying tangible personal property for sale" (emphasis added). (As stated above, Respondent is classified as a manufacturer for all state tax purposes. (R. pp.----; Tr. 25, Line 1-4.)) "Machines," according to the exemption, "include the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of the machines and which ... are necessary to the operation of the machines and are customarily so used." § 12-36-2120(17).

In applying these statutes, "[t]he cardinal rule of statutory interpretation is to determine the intent of the legislature." *Jones v. State Farm Mut. Auto. Ins. Co.*, 364 S.C. 222, 230, 612 S.E.2d 719, 723 (2005). Furthermore, "[t]he legislature's intent should be ascertained primarily from the plain language of the statute." *State v. Landis*, 362 S.C. 97, 102, 606 S.E.2d 503, 505 (Ct. App. 2004). "What a legislature says in the text of a statute is considered the best evidence of the legislative intent or will." *Bayle v. S.C. Dep't of Transp.*, 344 S.C. 115, 122, 542 S.E.2d 736, 740 (Ct. App. 2001). "Revenue laws are generally construed in favor of the taxpayer and against the taxing authority." *Clark v. S.C. Tax Comm'n*, 259 S.C. 161, 169, 191 S.E.2d 23, 26 (1972) (internal quotation marks omitted).

Respondent is an agricultural packager. The definition of “agricultural packaging” is found in § 12-6-3360, which provides a jobs tax credit for manufacturers and agricultural packagers meeting certain requirements. Section 12-6-3360(M)(16) defines “agricultural packaging” as

the technology of enclosing or protecting or preserving agricultural products for distribution, storage, sale, and use. Packaging also refers to the process of design, evaluation, and production of packages used for agricultural products. Packaging can be described as a *coordinated system of preparing agricultural goods for transport, warehousing, logistics, sale, and end use.*” (emphasis added).

Here the statute clearly envisions a more expansive concept of “agricultural packaging,” to include the transportation and warehousing both before and after the literal packaging. This definition includes the receipt of raw produce and placement of the produce on cooling racks, as well as the offloading labeling and control of the finished packaging to storage and ultimate delivery to customers. Therefore, the ALC did not err in including those activities within Respondent’s overall manufacturing process.

b. The Court did not Err in Ruling the Purchases at Issue Involved Machinery and Equipment which was “Integral and Necessary” to the Manufacturing Process.

The ALC Order (R. pp. ----; Order p. 22) found:

In this case, the Court finds that given McEntire’s highly regulated business as a fresh produce processor, the machinery and equipment used both before and after the actual production line processing of the fresh produce are integral and necessary not only to the overall manufacturing process, but also to the health and safety functions imbedded within the manufacturing of fresh produce. Without the processes that occur in the climate-controlled low-care areas of the plant, [Respondent] would be unable to safely and efficiently produce a finished product for sale and distribution. These processes contribute continuously and vitally to the plant’s overall production and are also integrated and harmonized into the activities that occur

directly in the production line, as conceived in the Integrated Plant Concept.

The ALC Order also stated (R. pp. ----; Order pp. 25-26) as follows:

In this case, it is evident that temperature and other environmental controls permeate the entire production process, from the time the produce is harvested and delivered from the farms until the finished product leaves the McEntire plant. In fact, testimony from Carter McEntire revealed that with the help of food safety engineers and experts, the plan and much of the equipment inside of it was specially designed and built to correlate with the climate and other environmental controls that are required to reduce the possibility of food contamination. (Trial Tr., p. 60:1-13).

S.C. Regs. § 117-302.5 provides a three-part test to determine whether a machine is “integral and necessary” to the manufacturing process:

- (1) The machine is used at a manufacturing facility. . . . It does not apply to machines used at a facility whose purpose is retailing, wholesaling, distributing, or some other non-manufacturing purposes.
- (2) The machine is used in, and serves as an essential and indispensable component part of the manufacturing process, and is used on an ongoing and continuous basis during the manufacturing process. A machine is not part of the manufacturing process merely because it is integral and necessary to the manufacturer.
- (3) The machine must be substantially “used in manufacturing . . . tangible personal property for sale.” The statute does not require that the machine be used exclusively for manufacturing; however, incidental manufacturing use will not qualify for the exemption. For purposes of the exemption, more than one-third of a machine’s use in manufacturing is substantial.

S.C. Regs. § 117.302.5(B)(1). Only subpart (2) is at issue in this case. Importantly, the Machine Exemption applies so long as 1/3 of the machine’s use is devoted to manufacturing purposes. S.C. Regs. § 117-302.5 provides that in order to be exempt, the machine must be “*substantially* ‘used in manufacturing ... tangible personal property for sale’” (emphasis added). According to that regulation, “[t]he statute does not require that the machine be used

exclusively in manufacturing; however, incidental manufacturing use will not qualify for the exemption. For purposes of the exemption, *more than one-third of a machine's use in manufacturing is substantial.*" § 117-302.5(B)(1)(c). (Emp. added). This means that a piece of machinery like a forklift can serve many purposes within a manufacturing facility and still be eligible for the exemption, so long as the taxpayer can establish that more than 1/3 of its use is for manufacturing.

Generally, states follow one of two distinct lines of authority when determining what qualifies as machinery used in manufacturing: (1) the Integrated Plant Concept or (2) the "Ohio Rule". See generally Hellerstein, *State Taxation*, at § 14.05. The more restrictive Ohio Rule defines "manufacturing" as "essentially a transformation or conversion of material or things into a different state or form from that in which they originally existed." *Nat'l Tube Co. v. Glander*, 105 N.E.2d 648, 650 (Ohio 1952). Only those assets which physically transform raw materials during the manufacturing process into a different form are eligible for the exemption. In other words, "the test is not whether the property is essential to the operation of the plant but whether it is an actual part of the process of manufacture." *Hawes v. Custom Cannery, Inc.*, 173 S.E.2d 40 (Ga. Ct. App. 1970).

On the other hand, the Integrated Plant Concept is less restrictive. As the name implies, machinery shall be eligible for the exemption if it performs an essential or indispensable function in the taxpayer's manufacturing operations, regardless of whether it actually causes a physical change. This test is derived from *Niagara Mohawk Power Corp. v. Wanamaker*, 286 A.D. 446 (N.Y. 1955). In finding that now material handling equipment including both coal handling and ash disposal equipment fell within the exemption (including the cranes and car dumper that unloaded incoming coal; conveyor belts that moved the coal to the boiler; crushers

and sprayers that processed the coal; and slag lines that carried ash from the boiler), the *Niagara* court determined the relevant questions to be:

- (1) Is the disputed item necessary to production?
- (2) How close, physically and causally, is the disputed item to the finished product?
- (3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?

The court found that the crane and car dumper were as essential to production as the generator itself, since a serious breakdown in operation would quickly stop or impair the output of electricity. The court also noted that while some structures may not play as active a role as other parts, “activity is not the test of directness.” Instead, “[t]he important thing is that all parts of the plant contribute, continuously and vitally, to production, and they are all integrated and harmonized.”

In *Springs Industries, Inc. v. Department of Revenue*, 99-ALJ-17-0153-CC (1999), Chief Administrative Law Judge Kittrell acknowledged that Professor Walter Hellerstein, author of the above-cited treatise on state taxation, testified that South Carolina is classified as an “integrated plant theory state.” In an unpublished opinion, the court of appeals affirmed the finding. It noted that although the Department urged the court to “interpret the term ‘machines used in manufacturing’ to include only items that are part of a production line,” this position was “inconsistent with the result in *Hercules Contractors and Engineers, Inc. v. South Carolina Tax Commission*, 280 S.C. 426, 313 S.E.2d 300 (1984)] and the language in [§ 12-36-2120(17)] that only requires a machine to be ‘used in manufacturing,’ rather than ‘used directly in manufacturing,’ as the [Department] suggests.” *S.C. Dep’t of Revenue v. Springs Indus., Inc.*, 2003-UP-029 (Ct. App. 2003). Thus, South Carolina law provides that so long as the equipment in question performs an essential function in the taxpayer’s manufacturing operations, it will qualify for the machine exemption to the sales tax. To reiterate: The Court

of Appeals in *Hercules* held that machinery and its various parts and attachments are exempt if they are “integral and necessary to the operation of the system as a whole.” In determining the entire facility to be exempt, the Court stated that “even its railings, walkways and ladders, which were required by state and federal laws and therefore ‘necessary to the overall function’ of the system were exempt.” *Hercules*, 280 S.C. at 430, 313 S.E.2d at 303.

As a result of the *Hercules* and *Springs Industries* decision, the DOR issued S.C. Rev. Rul. #04-7 and Regulation 117-302.5 to conform with these decisions. S.C. Rev. Rul. #04-7 states:

Previously, the Department adhered to the “Production Line Theory” in determining what machinery was used in manufacturing. Under this theory, items were found to be exempt only if “used directly” in manufacturing process. Based upon the recent court decisions, the “Production Line Theory” will no longer be used. Instead, the court mandated machinery is exempt if such machinery is “integral and necessary” to the manufacturing process. This change is generally less restrictive than the Department’s prior interpretation. As such, some machines that the Department would previously have held subject to the tax are exempt.

The DOR audit held that the machinery and equipment used to move the fresh produce into the manufacturing process were not exempt. There is no dispute that the machinery used in the cutting and processing was exempt.

In this case, as described more fully below, given Respondent’s highly regulated business as a fresh food processor, the tools and equipment used immediately before and after the actual processing of the fresh produce is integral to the overall processing/manufacturing process, as well as the health and safety functions. Without the process that occurs in these climate-controlled areas, it would seriously impair the ability of the taxpayer to efficiently and safely prepare a finished product for sale and distribution. The refrigeration itself, as well as the tools and equipment used therein, contributes, both “continuously and vitally, to

production” and the assembly line production is surely “integrated and harmonized,” as described in the Integrated Plant concept above.

Moreover, federal guidelines mandate all aspects of the refrigeration. According to Section VIII, Part C, Item 3, of the Food and Drug Administration’s Guide to Minimize Microbial Food Safety Hazards of Fresh-cut Fruits and Vegetables, fresh-cut produce is recommended to be stored in areas with a temperature of less than or equal to 41 degrees Fahrenheit. Regulations promulgated pursuant to the Food Safety Modernization Act of 2011, Section 117.93, provide even further requirements, mandating that any “[s]torage and transportation of food must be under conditions that will protect against allergen cross-contact and against biological, chemical (including radiological), and physical contamination of food, as well as against deterioration of the food and the container.” 21 C.F.R. § 117.93.

Additionally, 21 C.F.R. § 110.80(b) provides:

(b) Manufacturing operations. (1) Equipment and utensils and finished food containers shall be maintained in an acceptable condition through appropriate cleaning and sanitizing, as necessary. Insofar as necessary, equipment shall be taken apart for thorough cleaning.

(2) *All food manufacturing, including packaging and storage, shall be conducted under such conditions and controls as are necessary to minimize the potential for the growth of microorganisms, or for the contamination of food.* One way to comply with this requirement is careful monitoring of physical factors such as time, temperature, humidity, aw, pH, pressure, flow rate, and manufacturing operations such as freezing, dehydration, heat processing, acidification, and refrigeration to ensure that mechanical breakdowns, time delays, temperature fluctuations, and other factors do not contribute to the decomposition or contamination of food.

(3) Food that can support the rapid growth of undesirable microorganisms, particularly those of public health significance, shall be held in a manner that prevents the food from becoming adulterated within the meaning of the act. Compliance with this

requirement may be accomplished by any effective means, including:

- (i) Maintaining refrigerated foods at 45 deg. F (7.2 deg. C) or below as appropriate for the particular food involved. (emphasis added.).

This regulation applies to Respondent and is mandatory. (R. pp----; Tr. 25, Lines 19-25). Since keeping the temperature of this product at or below 41 degrees must be done to prevent contamination of our product, and must be stored (by Congressional Act) in certain areas of plant to prevent cross-contamination (storage racks are the only viable option) then it is considered continuous, on-going and integral to the manufacturing process and therefore exempt. Even once the product is loaded onto Respondent's trucks, the 41-degree requirement must be met until it is ready to be sold inside a restaurant. Temperature recorders are required for refrigerated trucks to ensure that the product never went above this requirement at any time while in transit. In addition to federal law, customer contractual requirements are equally as stringent.

The DOR Policy witness, Corey Smith, testified that equipment required by state or federal law would be part of the manufacturing process. (T. p. ----, Tr. 285:10-25.)

Based on the foregoing, the Court did not err in expanding the exemption beyond those items used only in the cutting process. The highly specialized and highly-regulated nature of the food processing industry mandates a more expansive view of the manufacturing process to include activities both before and after the literal processing of the produce. Purchases of these items used in the manufacturing process are exempt from tax under the Machine Exemption.

2. Respondent's Proposed Definition of "Machine" is Contrary to its Published Regulations and Guidance.

The thrust of the DOR's case is that the many various items which the ALC held were exempt, especially protective clothing, were not "machines." The DOR states that to be a

“machine” the item must be a “mechanical device” or a “combination of mechanical powers, parts, attachments or devices,” e.g., Appellant’s Brief at p. 14. However, contrary to this narrow definition, regulations promulgated by the Department and the Department’s own published guidance have consistently taken an expanded view of what constitutes a “mechanical device” or “combination of mechanical powers, parts, attachments or devices” going back at least thirty years. For many of these items, the property itself does not obtain its “mechanical” nature until viewed in the entirety of the manufacturing operation.

a. Department Regulations

The regulations defining “machine” greatly expand the definition beyond traditional notions of the term. S.C. Regs. § 117-302 lists the following as machines. Clearly, they are not a “mechanical device” or a “collection of mechanical powers, parts [or] attachments:”

- “odorants purchased by gas companies” (§ 117-302.1(b)(a))
- “chemicals such as soda ash, alum, chlorine, etc., used in treating water for sale” (§ 117-302.1(b)(b))
- “refrigerants used by manufacturers to produce ice for sale” (§ 117-302.1(b)(c))
- “plates attached by a manufacturer to his product for identification” (§ 117-302.1(b)(e))
- “chemicals, greases, oils, lubricants and coolants” (§ 117-302.5(B)(5)(a))
- “chemicals used to clean the exterior or interior of an exempt machine” (§ 117-302.5(B)(5)(a)(iii))
- “chemicals used to prevent corrosion” (§ 117-302.5(B)(5)(a)(iv))
- “Traveling water screens” (§ 117-302.5(C)(2))
- “Tanks” (§ 117-302.5(C)(8))
- “Patterns” (§ 117-302.5(C)(9))
- “Boiler Tubes” (§ 117-302.5(C)(15))
- “insulation for pipe coverings, tank coverings, and boiler insulation” (§ 117-302.5(C)(30))
- “Parts or attachments to machines” (§ 117-302.5(B)(2)).

Based on the foregoing, the Department’s proposed definition in this case is contrary to its own promulgated regulations.

b. Department's Published Guidance

Petitioner has also expanded the definition of "machine" in a number of published rulings and decisions. For example, in S.C. Tax Commission Decision 92-19, the former Tax Commission held that stack liners and ash pond pipes and pumps were exempt as they operated exclusively in the abatement of pollution caused by the production of electricity. In S.C. Rev. Rul. # 89-7, the DOR opined that a settling basin for a wastewater treatment facility was exempt as one part of a single entity used to abate pollution and therefore purchases of materials such as concrete and steel to build the facility were likewise exempt.

At issue in S.C. Private Letter Ruling (PLR) # 90-3 was whether concrete, reinforced steel bars and a metallic pool liner were exempt under the pollution control exemption when used to construct a gamma irradiator vault. The vault was designed and licensed for the purpose of containing gamma radiation. The vault had six foot thick walls with a specialized design to trap radiation. The vault was designed to withstand a direct airplane hit and catastrophic earthquake. The vault itself served no purpose other than to trap radiation, and it performed no processing. The ruling held under such facts that the concrete, steel, and liner used to construct the vault were exempt.

In S.C. Tax Commission Decision 89-82 (June 26, 1989), the taxpayer provided radioactive waste management services consisting of processing, transporting and disposing of nuclear waste generated by nuclear power plants. At issue was the sales taxation of liners. The liners served three functions: (1) they were first transported to the power plant site where radioactive waste was placed inside them; (2) the liners then processed the waste into a more stable form, thus reducing the likelihood of nuclear accidents; and (3) the liners were then transported to disposal sites where they became permanent storage containers for holding waste. The Tax Commission Division staff initially held the liners were subject to sales taxes.

The Commission disagreed and found that the liners were exempt notwithstanding their storage function stating:

In reaching this decision, we first note that the *liners are machines*. The term 'machine' has been defined to include 'every mechanical device or combination of mechanical power and devices to perform some function and produce a certain effect or result.' *Hercules Con. & Engineers v. South Carolina Tax Com'n.*, 280 S.C. 426, 313 S.E. 2d 300 (S.C. App. 1984). The evidence presented showed that the liners were more than mere storage tanks. They contained internal devices that processed radioactive waste into a less volatile state. This falls squarely within the definition of a 'machine.' The fact that the liners were subsequently used for storage does not detract from their function as machines. As noted in *Hercules* at page 308, a machine may have an alternate use but it still remains a machine.

There is also adequate evidence indicating the liners abated pollution. Such evidence demonstrated that the processing undergone in the liners was a necessary step in the treatment of radioactive waste produced by power plants. In point of fact, *nuclear utilities would not be licensed or allowed to operate without this means* of processing nuclear waste. Moreover, the testimony and documentary evidence establishing these points are sufficient to meet the certification requirements of Regulation 117-173. (Emphasis added)

(Similarly, food processing plants are not allowed to operate without protective clothing.)

Most recently, in S.C. Rev. Rul. 13-3, the Department found that the component parts used to construct a manufacturing machine qualified as a "machine" for purposes of the exemption.

If chemicals, stackliners, ash pond pipes, concrete and steel and metallic pool liner used to construct a gamma irradiator vault, liners used in radioactive waste management services, storage containers with no moving parts, and the component parts of these products constitute "machines," then certainly Petitioner's attempt to impose a strict "mechanical" requirement is contrary to its own guidance.

3. Substantial Evidence Supports the ALC's Conclusions that the Purchases at Issue are Exemption under the Machine Exemption.

a. Recordkeeping Items Used for Tracking Produce are "Machines" and, as such, Qualify for the Machine Exemption.

The ALC found that bar code scanners, black ink aerosol cans, and mobile computer stands, all of which the Respondent uses to track the produce as required by law, were exempt from use tax. (R. pp. ----; Order p. 26). The Respondent's bar code scanners are hand-held devices that the Respondent uses to trace the produce backwards one-step to the grower-shipper and forward one-step to the customer's distribution center. (R. pp. ----; Hr'g Tr. pp. 64:22-65:2). This trace-back system is required by federal law. (R. pp. ----; Hr'g Tr. p. 64:24). The Respondent scans raw produce when it enters the facility, when the raw produce goes into processing, when it then goes into the finished goods area, and lastly when the produce goes from the finished goods section onto the refrigerated delivery trucks. (R. pp. ----; Hr'g Tr. p. 65:2-9, R. pp. ----; Order p. 11).

The Respondent also uses black ink aerosol cans as part of this tracking process. (R. pp. ----; Hr'g Tr. pp. 79:25-80:1-4). Specifically, the ink goes across a jet ink sprayer to spray a "use-through code" and a "lot code" onto a finished case of produce in the pack-out and repack areas of the Respondent's facility. (R. pp. ----; Hr'g Tr. p. 79:10-16). In basic terms, the black ink aerosol cans label finished cases. (R. pp. ----; Hr'g Tr. p. 79:2-7). "The Lot Codes assist in the FDA trace-back process." (R. pp. ----; Order p. 11).

The Respondent uses a computer program to track its produce through the processing stages. (R. pp. ----; Hr'g Tr. pp. 95:24-96:1). The Respondent places computers on mobile computer stands in various parts of the facility so the employees can more easily track the process as the produce moves through the facility. (R. pp. ----; Hr'g Tr. p. 96:1-9). "The mobile

computer stands are used by quality technicians, food safety technicians, and production operators to assist in the scanning and tracking of produce as it moves through the facility. While the stands themselves are not explicitly required by law, the critical care checkpoints at which the stands are used are required.” (R. pp. ----; Order p. 11.)

These machines are a federal requirement so that the produce can be tracked (1) back to the farm, and (2) forward to the customer in the event contamination is subsequently found in the produce. Mr. McEntire testified that the need for a trace-back arises when a food-borne illness results in sickness or death and the FDA needs to determine the source of the illness. (R. pp. ----; Hr’g Tr. p. 65:12-17; p. 79:23 to 80:15). Clearly these are “protecting or preserving agricultural products for distribution, storage, sale and use,” and a part of a “coordinated system of preparing agricultural goods for transporting, warehousing, logistics, sale and end use.” § 12-6-3360(M)(16).

In Reg. 117-302.1(e) the DOR states that “plates attached by the manufacturer to his product for identification purposes” is covered by the machine exclusion. Presumably the vast majority of such plates are not required by federal law (for food safety purposes.) The Regulation also exempts “Recording instruments attached to manufacturing machines.” Reg. 117-302.5(C)(25).

b. Floor Drain Covers are “Machines” and, as such, Qualify for the Machine Exemption.

The ALC determined that the floor drain covers the Respondent purchases and uses within its plant are exempt from use tax under the Machine Exemption. (R. pp. ----; Order p. 28). McEntire testified that “We have a very extensive stainless steel floor drain system that goes throughout the high care area. It is an expensive floor drain system because it’s custom made.” (R. ----; Tr. 98:8 -11.) The floor drain system is so extensive because the water is

strained all the way down to filtered water level and reused to rinse produce. (R. ----; Tr. 98:8-24.) Respondent installs stainless steel floor drain covers inside the high-care area of its facility to keep debris and product from entering the floor drain system. (R. pp. ----; HR'g Tr. p. 98:11-15). The Respondent uses the floor drain system to recapture spilled water so it may reuse the water to wash the produce. (R. pp. ----; Hr'g Tr. 98:15-24). Stainless steel floor drain covers are used in the high-care area and serve as both a filter and a drain in Respondent's recycling of fresh water. These higher quality drains must be used because waste material was previously entering the closed water system and causing adulteration of the water. Respondent uses about 300,000 gallons of water per day and recycles about half of that. (R. pp. ----; Tr. 184:16-19). When water is sprayed onto the produce in the cutting process, runoff goes onto the floor and mixes with debris. Through the drain system, the water is separated from the debris and some flows back to the plant where it is recycled while the rest goes to the city sewer system. (R. pp. ----; Order p. 14).

George Lovelace, head of Food Safety at McEntire, testified that the DHEC Water Permit required Respondent to filter the water before it was discharged back into the City water system. (R. pp. ----; Tr. p. 184:11 to 185:4.) These expensive floor drain covers were an integral part of recycling water used directly in the processing process. As such they meet the traditional definition of machine and were part of a coordinated system of preparing agricultural goods for transporting and warehousing.

In Revenue Ruling #04-7, the DOR held that traveling water screens used to filter water from a river or lake were exempt. The Revenue Ruling also states that machines used to remove sawdust from saws in a sawmill are exempt. *Id.* at 8.

c. The Conveyances at Issue (Fork Lifts, Pallet Jacks and Lubricants) are Machines Used in Processing Tangible Personal Property for Sale.

The Respondent uses forklifts (along with their respective parts and batteries), pallet jacks, and hand trucks to move heavy produce (600 to 2,000 pounds) from place to place and to certain lines of production within the facility. (R. pp. ----; Hr'g Tr. p. 67:12 - 68:1-2, 77:13-25; 113:9-12). McEntire testified that 80% of the forklifts were used directly in the food processing. (R. pp. ----; Tr. 69:6-10).

Aside from transporting produce from place to place within the facility, the Respondent also uses the forklifts to dump produce onto the conveyor system, which moves the raw produce into the high-care area for processing. (R. pp. ----; Hr'g Tr. pp, 69:3-5, 111:19-112:15).

The ALC Order (R. pp. ----; Order p.12) describes these as follows:

(9)Hand Trucks and Pallet Jacks, and Oil Lubricant Used Therein

The majority use of hand trucks and pallet jacks is attributed to moving sliced tomatoes and sack onions from the cold storage area to the high-care area to feed the in-line for the cutting process. As a food manufacturer, [Respondent] is required to use food grade oil and grease to maintain both.

(10)Forklift Rental, Forklift Batteries, Forklift Parts, Forklift Repair Parts

Forklifts are used throughout the facility, except in the high-care area. While some may be used outside of the actual building structure, 90% are used within the facility. The forklifts used in the facility move the produce from place to place. Specifically, they are used to move 800 – 1,600 lb. bags of raw produce onto the conveyor belt at the beginning of the cutting area.

The ALC found that these various conveyances and their respective batteries, parts, and oils and lubricants are exempt from use tax under the Machine Exemption. (R. pp. ----;

Order p. 24). The ALC Order states that “Testimony also revealed that the majority of the use of **Hand Trucks, Pallet Jacks, and Oil Lubricant used Therein (9)** could be attributed to moving sliced tomatoes and sack onions from the low-care areas to the cutting room/high-care area to feed the in-line for the cutting machine. As a processor of fresh produce, Respondent is required to use food grade oil and grease to maintain these items. As machines that feed the first processing machine and as material handling machinery used to transport in-process material from one process stage to another within the integrated plant, the Court finds that these items also fall within the parameters of the Machine Exemption.” (*Id.*) In addition they were obviously part of a “coordinated system of preparing agricultural goods for transporting, warehouse, logistic, sale and end use.” § 12-6-3360(M)(16). In Revenue Ruling #04-7, pp. 9-10, the Department states that “warehouse machines (e.g., forklifts) that, in addition to being used in loading, unloading, storing and transporting raw materials from the warehouse to the manufacturing area, or transporting finished products from the manufacturing area to the warehouse, are also used substantially to feed raw material into or onto the first processing machine in the manufacturing process area are exempt as machines used in manufacturing” (emphasis in original).

The Revenue Ruling also noted that wheeled conveyances, known as print screen trucks, which were used to move print screens from the holding area to the print machines were exempt. Neither DOR witness testified these items were not exempt.

d. The Items used for Storage/Temperature Control are Machines Used in Processing Tangible Personal Property for Sale.

Respondent uses two primary types of warehouse racks: a flow-through rack and a pushback rack system. (R. pp. -----; Hr’g Tr. p. 69:15-21). It uses flow-through racks in the storage coolers where palletized raw produce flows through from one side of the cooler to the

other. (R. pp. ----; Hr’g Tr. p. 69:16-18). It uses the pushback rack system where the Respondent places raw produce or finished produce onto a carriage that is pushed back several spaces or up and out. (R. pp. ----; Hr’g Tr. p. 69:18-24). These racks help with efficiency, keeping the produce separated, and maintaining the temperature of the produce during storage. (R. pp. ----; Hr’g Tr. pp. 69:24 -70:2). “So what happens to the lettuce before it enters the cutting room it is stood in a rack system and that rack system is specifically designed to keep the product separated enough to allow air to flow across the storage container....” (R. pp. ----; Tr. 53:11-14.) “The rack system enables us to maintain that [proper] temperature.” (R. pp. -- --; Tr. 71:1-6.) The ALC Order (R. pp. ----; Order p. 12) describes them as follows: “These racks are specifically designed to assist in cooling and maintaining the required temperature of the produce during processing to avoid spoilation and prevent contamination. Since pallets cannot be stacked on top of each other due to cooling limitations, these racks are galvanized to withstand the cold, wet and humid atmosphere inside of the facility and to allow cold air to flow through the rack system and over the individual items of produce so that the temperature does not exceed 40 degrees. Because a temperature of 41 degrees or over means that [Respondent] effectively has no product, maintaining the required temperature is essential to [Respondent]’s manufacturing process.”

In *Department of Revenue v. State Contracting & Stone Co., Inc.* 599 S.W.2d 166 (KY. Ct. App. 1977), the Court held that Storage bins were exempt from use tax where bins contained blending units which concluded manufacturing process of asphalt.

Hellerstein, State Taxation ¶ 14.05[2][d] states:

“A number of other state courts and administrative tribunals have adopted the New York court’s integrated plant approach to the delineation of machinery or equipment directly used in manufacturing...”

Under that [integrated plant] view, the Missouri court has held that a manufacturer of charcoal briquettes was exempt from sales tax on its purchase of conveyors and storage bins used to (1) remove the railroad cars starch used in the manufacturing of the briquettes; (2) store the starch in storage bins; and (3) convey it to the processing area.

The Respondent uses pallet flow brakes on the racks in the raw cooler areas. (R. pp. -- --; Order p. 12; Hr'g Tr. p. 72:18-22). Specifically, the pallet flow brakes slow down the speed of the pallets as they travel down the flow-through pallet system. (R. pp. ----; Hr'g Tr. p. 72:12-13). The ALC Order (R. pp. ----; Order p. 12) notes:

(8) Pallet Flow Brakes

The pallet flow brakes are used on the racks, which hold thousands of pounds of raw produce and finished product. The racks, which transport the produce into the cutting area, are potentially dangerous without the brakes as the pallets can fall off racks and injure employees. The brakes allow the 1,600 lb. pallets to rotate and flow through the facility at a safe rate. During the audit period, the pallet flow brakes were used in all three tomato coolers and in the raw cooler area.

The Respondent also uses stacking containers for storage in the “work in progress” section of the facility to store processed produce until the Respondent can combine it with other processed produce. (R. pp. ----; Order p. 12). For example, the Respondent combines cabbage and carrots to make coleslaw. (R. pp. ----; Hr'g Tr. pp. 92:24-2; Order p. 12). The Respondent uses the stacking containers to keep cut carrots until the cabbage is processed and ready to be combined to be made into coleslaw. (R. pp. ----; Order p. 12). “The combining of these component pieces into a bag to be sealed, labeled, and palletized completes the manufacturing process with respect to the mixed product.” (*Id.*)

The Respondent used blower fans in both the high and low-care areas to move refrigerated air in order to maintain the mandated temperature level and to also filter any airborne contaminants. (R. pp. ----; Hr'g Tr. p. 109:9-23). The blower fans are used to maintain

the temperature and they have a filtration system designed to remove pollution or contaminants that are in the area. (R. pp. ----; Tr. p. 109:9 to 110:20). The ALC states in its Order that:

(11)Blower Fan

Because the temperature in the facility must be maintained between 33-40 degrees, blower fans are used to circulate refrigerated air throughout the facility in both the high-care and low-care areas. Without the blower fans, [Respondent] could not maintain the required temperature in the facility. Additionally, blower fans are used to prevent unfiltered air from entering the high-care area where air is filtered to an exact standard to maintain an elevated level of sanitation. (R. pp. ----; Order p. 13).

In Reg. 117-302.3, the Regulation states “This exemption [for fuel] applies to fuel used to control plant atmosphere as to temperature and/or moisture content, in the quality control of tangible personal property being manufactured or processed for sale.” The Regulation also finds as exempt: “Machines used to condition air (including humidification systems) for quality control during the manufacturing process of tangible personal property made from natural fibers and synthetic materials.” S.C. Regs. § 117-302.5(C)(24). Neither DOR witness testified that items were not exempt.

e. The Water Tanks are Machines Used in Processing Tangible Personal Property for Sale.

The Respondent has large water tanks both inside and outside the facility (R. pp. ----; Hr’g Tr. p. 117:13 – 14). The outside tank stores chilled water and mixes sanitation chemicals before the water is delivered to the high-care area to wash the produce. (R. pp. ----; Hr’g Tr. pp. 117:21 – 118:7). The inside tanks are in the high-care area; they recirculate some of the runoff water so that it can be used again in the processing of produce. (R. pp. ----; Hr’g Tr. p. 117:8-9, 118:21-24; Order p. 14). McEntire testified, “So water tanks are used throughout the facility but particularly in the high care area where we wash produce.” (R. pp. ----, Tr. 73:17-

20). The water is “used to wash and sanitize the produce.” (*Id.*)

The ALC found these water tanks exempt from use tax. (R. pp. ----; Order p. 27). The ALC order noted that “These tanks are essential to sanitize the produce and to prevent the spread of food contaminants or pollution during the cutting process by reducing the pathogens that may flow between the cutting machines, the produce and the run-off water. As such, [Respondent]’s storage water tanks minimize the potential for the growth of microorganisms, prevent the contamination of food, and are integral and necessary to the processing of fresh produce and fall with the Machine Exemption.” (*Id.*)

In Revenue Ruling #04-7, the DOR summarized the *Springs* decision to hold that washing was an exempt function. The Revenue Ruling states at p. 7:

In *Springs Industries, Inc. v. SCDOR*, 99-ALJ-17-0153-CC, the court held that the washing of a textile print screen was done specifically for the purpose of manufacturing a final product, that without washing the print screen would be rendered useless thereby preventing further manufacturing of the final product, and that the print screens could not be continually used without the screen washing machine. In addition, the print screen washing machine was located close to the production line machinery. As such, the court further held that the print screen washing machine was integral and necessary to the manufacturing process, was not a maintenance or repair machine, and was, therefore, exempt...”

S.C. Regs. § 117-302.5(C)(8) holds that “Tanks which are a part of the chain of processing operations” are exempt. Neither DOR witness testified that these items were not exempt. *See Monroe v. Livingston*, 251 S.C. 214, 161 S.E. 2d 243 (1968) (machines used for “spraying, cleaning, candling, grading and packaging the eggs” were exempt.)

f. The Floor Treatment Chemicals and Cleaning Machines (Foamers) are Machines used in Processing Tangible Personal Property for Sale.

McEntire testified: “We have an entire shift of sanitation where our sanitation

technicians use this machine to take cleaning chemicals and both foam and sanitize the processing equipment.” (R. pp. ----; Tr. p. 88:18-22.) He testified this was required by federal law. (R. pp. ----; Tr. p. 88:23 to 89:1.)

floor treatment chemicals inhibits growth of dangerous microbes, and the brooms and squeegees are used specifically in those areas to inhibit such growth. Appellant agreed 70% of the floor treatment chemicals and other products were used in the manufacturing process, but contended that 30% was not. (R. pp. ----; Tr. pg 84:19 to 85:4). Respondent testified that the vast majority of the floor treatment chemicals, brooms, and squeegees were used in the manufacturing process—specifically in the high care area. (R. pp. ----; Tr. p. 83:6-13).

The Respondent utilizes cleaning machines, called foamers, to foam and sanitize the processing equipment in the high care area (R. pp.----; Tr. p. 88:14-22). Federal law requires cleaning to be done by foamers. (R. pp. ----; Tr. P. 88:23 – 89:1). The Respondent also uses floor treatment chemicals to sanitize the floor in the high care area. (R. pp. ----; Tr. p. 83:8-13.). The ALC Order described these as follows:

17. Floor Treatment Chemicals

The floor treatment chemicals are used primarily in the high-care area to sanitize the floor. The Department previously agreed that an exemption was available for the 70% of the treatment chemicals that were used in the high-care area during the manufacturing process but did not allow the exemption for the remaining 30%.

19. Cleaning Machines

Every night, a specific sanitation shift utilizes the cleaning machines, called “foamers,” to sanitize the machines and surfaces used in the high-care area. [Respondent]’s witness testified that these machines are required by the FDA and that 80% of their use occurs in the high-care area.

The ALC (R. pp. ----; Order pp. 27 - 8) determined these items were exempt for the

following reason:

Cleaning Machines (19) and Floor Treatment Chemicals (17) are both used in the cutting room/high-care area to sanitize the machines and surfaces directly involved in the production line. [Respondent] testified that 80% of the cleaning machines or “foamers” are required by the FDA to sanitize surfaces in the cutting room nightly. Therefore, those machines are used on an ongoing and continuous basis and fall under the exemption as integral and necessary to the manufacturing process. The Department previously conceded that the 70% of the floor treatment chemicals used in the high-care area were integral and necessary to the manufacturing process and, thereby, exempt. In concluding that the manufacturing process occurs in other areas of the plant outside of the high-care area, the Court finds that of the remaining 30% of the floor treatment chemicals disallowed by the Department, any percentage used to clean the actual plant, as opposed to the administrative/office area, should also fall within the Machine Exemption as integral and necessary to the manufacturing process.

In Revenue Ruling #04-7, the DOR held that pressure washing machines and ultrasonic cleaning machines used to clean machines were exempt. Neither DOR witness testified that the cleaning chemicals or machines were not exempt.

g. The Maintenance Tools at Issue are Used on an Ongoing and Continuous Basis, and Thus Qualify for the Machine Exemption.

The ALC Order (R. pp. ----; Order p. 13) found that “[Respondent] uses maintenance tools to maintain, repair, install, and uninstall equipment. In the cold, damp environment of the facility, machinery wears out so quickly that [Respondent] has thirty (30) fulltime employees working continuously to repair and maintain equipment.”

Moreover, according to Mr. McEntire, utility carts used within the manufacturing area require special care due to the sensitive nature of the high care environment. The ALC Order (R. pp. ----; Order p. 23) stated that “Because the processing of fresh produce is regulated by climate control and other environmental controls, the cold and damp conditions inside the plan

cause machinery to constantly require maintenance and repairs. Thus, general **Maintenance Tools (12)** that are used to maintain, repair, install and uninstall exempt machines inside of the plant are used on an ongoing, continuous basis and therefore fall within the Machine Exemption.”

Neither DOR witness testified these items were not exempt. *See In re LaFarge Midwest/Martin Tractor Co., Inc.* 271 P.3d 732 (Kan. 2012) (Taxpayer was entitled to sales tax exemption for the repair and replacement parts and accessories it purchased for loaders and haulers used at its cement plant.) *See also Idaho State Tax Com'n v. Haener Bros., Inc.*, 121 Idaho 741, 828 p.2d 304 (1992) (repair parts and equipment used to make repairs to heavy construction equipment that was primarily and directly used in production process was exempt from tax, since repair of manufacturing and production equipment was one segment of continuing and integrated production process).

h. The Generator Rentals the Respondent Uses in its Facility are Used on an Ongoing and Continuous Basis, and Thus Qualify for the Machine Exemption.

Tomatoes arrive at the Respondent’s facility in various color stages, and different customers have different color requirements. (R. pp. ----; Hr’g Tr. pp. 75:16, 21-25, 76:1-2). When necessary, the Respondent rents ethylene generators to speed up the ripening process and change the color of the tomatoes to a certain color stage, per a customer’s request. (R. pp. ----; Hr’g Tr. p. 75:17-25). The Respondent rents these generators when the repack manager determines that a generator is needed based on color of the available crop of tomatoes. (R. pp. ----; Hr’g Tr. p. 116:1318). The generators are not needed year-round. (R. pp. ----; Hr’g Tr. p. 116:12).

The Department argues that Respondent must use the generators on an “ongoing and continuous basis” for the generators to be considered integral and necessary to the processing

of fresh produce and that renting and using a generator to ripen tomatoes “when necessary” or “as needed” is not using them on an “ongoing and continuous basis.” The DOR argues that there are times when crops of tomatoes come into the Respondent’s facility that are already at the desired color and the generators are not needed, or that the natural ripening that occurs in the low-care area is sufficient for the ripening of a particular crop. (R. pp. ----; Order p. 6) and therefore these generators are not used on an “ongoing and continuous basis.”

The ALC determined that the Respondent’s rental of these generators are exempt from use tax. (R. pp. ----; Order p. 24). Specifically, the ALC determined that, because tomato crops are variable, and the Respondent rents generators on a seasonal basis, then the rental of generators on an as-needed, seasonal basis to process a variable crop makes the Respondent’s use of the generators “ongoing and continuous.” (R. pp. ----; Order p. 24). Neither DOR witness testified that the generators were not exempt.

B. THE ALC DID NOT ERR IN FINDING PURCHASES OF PROTECTIVE EQUIPMENT QUALIFIED FOR BOTH THE MACHINE EXEMPTION AND THE POLLUTION CONTROL EXEMPTION.

The ALC found that purchases of “protective clothing”¹ qualified under both the Machine Exemption and the Pollution Control Exemption, which exempts which exempts machines “necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section.” They are also exempt as part of the agricultural packaging exemption.

Thus, Respondent, a manufacturer of fresh produce, is exempt from taxes on machines

¹ The ALC defined “protective clothing” as “Coveralls, Eyewear, Gloves, Aprons, and Hairnets.” (R. p. ---; Order p. 26).

which are necessary to comply with the order of a state or United States agency to prevent or abate pollution that is precipitated by other manufacturing machines used in the process of cutting and bagging fresh produce. From this, four elements must be met: (1) a machine that (2) prevents or abates pollution (3) caused by machines used in the manufacturing process and is (4) necessary to comply with the order of an agency.

1. Protective Clothing Qualifies as a “Machine” for Purposes of the Machine Exemption and Pollution Control Exemption.

Significantly, neither the DOR Proposed Assessment (R. ____) nor the DOR’s Department Determination (R. ____) alleged that protective clothing was not a “machine.” Both documents alleged only that E Coli., Salmonella or Listeria were not “pollution.” Petitioner raised the machine argument for the first time at trial.

At first blush, protective clothing does not seem to fit the definition of machinery and equipment (any more than the ladders, walkways, and scaffolding in the *Hercules* case, or chemicals in a machine. *See* S.C. Regs. § 117-302.5(B)(5)). The Department itself acknowledges, however, that protective clothing fits within the machinery and equipment ambit. The Department’s published guidance provides that “[p]rotective clothing worn by an employee working in the area in which the manufacturing process occurs does not qualify as a machine and is not exempt from the tax as a machine used in manufacturing tangible personal property for sale under Section 12-36-2120(17).” However, that guidance is intended to apply to protect the worker’s own clothing from dirt, paint, oils, etc. which are given off in the manufacturing process. On the other hand, the clothing worn by Respondent’s workers serves a substantively different purpose. Respondent’s protective gear protects *the produce* from the worker (for the purpose of protecting the ultimate consumer). The protective gear puts a barrier between the end product – i.e., the chopped vegetable – and the workers entering the high care

area. The protective gear is absolutely vital and is required by state and federal law as detailed above to maintain the physical environment necessary to produce Respondent's finished product in a safe and unadulterated manner.

The distinction between protective clothing for workers versus protective clothing for manufactured products is discussed in Massachusetts² and Connecticut³ sales tax bulletins. The Massachusetts bulletin notes that "the term 'protective use' does not refer to clothing designed primarily to protect the product being manufactured, e.g., 'clean room' clothing or hats and gloves worn by workers in the food service industry..." Similarly, the Connecticut bulletin notes that "*safety apparel* does not include clothing and equipment intended to protect the product being worked upon, such as clean room clothing or gloves and hairnets worn by food service industry workers." (See also *Chrome Deposit v. Ind. Dep't of State Revenue*, 557 N.E. 2d 1110 (Tax Ct. Indiana 1990), (clothing worn to "prevent contamination of the product during production" qualified under the state's machine exemption, as it was "acquired for direct use in the direct manufacturing of other tangible personal property"). Both states acknowledge that clothing and gear protecting the product being manufactured or processed is distinguishable from more common apparel which protects the wearer.

The Court of Appeals in *Hercules* held that railways, walkways and ladders were exempt under the machine exemption as they were required by state and federal law and thus were necessary, to the overall function of the system. The same applies to Respondent's protective clothing. The gear creates a physical barrier that maintains the integrity and purity

² Massachusetts Directive 99-3: Sales and Use Tax Treatment of Protective Clothing, available at <https://www.mass.gov/directive/directive-99-3-sales-and-use-tax-treatment-of-protective-clothing>

³ Connecticut PS 2004(4): Sales and Use Tax Exemption for Safety Apparel, available at <https://portal.ct.gov/DRS/Publications/Policy-Statements/2004/PS-20044-Sales-and-Use-Tax-Exemption-for-Safety-Apparel>.

of Respondent's manufacturing process, is required by state and federal law and thus as described above, must be considered an integral part of that process.

The Department repeatedly argues that protective clothing are not "machines." While there is no DOR Policy Document on whether protective clothing constitutes a machine for the pollution control exemption, as noted *supra* pp. 11-13, the Department has issued guidance expanding the definition of "machine" to products such as liners, bins, scaffolding, chemicals, tanks, another other products which only assume their "mechanical" nature once viewed in context of the entire manufacturing operation.

The uncontroverted evidence in this matter demonstrates that the protective clothing are mechanical devices that act to prevent or mitigate contamination. The contamination comes from the machines essential to the production of the fresh produce, namely the cutting machines.

2. The Protective Clothing Prevents or Abates E. Coli, Salmonella, and Listeria, which are "Pollution."

a. Respondent Established the Contaminants are "Pollution."

The major thrust of the Department Determination was that food contamination and diseases are not "pollution." The Department Determination states that "food contamination does not constitute air, water or noise pollution. Moreover, it is questionable whether food contamination constitutes pollution in general." (Respondent contends that E. Coli, Listeria and Salmonella – which causes food contamination – are pollution.) While the Department Determination is presumptively correct, the DOR auditor testified that she didn't know what the definition of "pollution" was under the statute, (R. pp. ----, 372:12-14) and didn't know enough about E. Coli, Listeria or Salmonella to determine whether they constituted "pollution." (This was the auditor's first audit of a fresh foods manufacturing facility.) (R. pp. ----, Tr. p.

334:11-13.) Both of the DOR witnesses, however, agreed with the Black's Law and dictionary definitions of "pollution." (Smith, R. pp. ----; Tr. pp. 294:17-23, to 295:17; Mitchell, R. pp. ---; Tr. p. 372:22 to 328:10.)

Interestingly, the Auditor testified that if she had been given at the audit "the name of the State or federal agency requiring it [protective clothing required by the FDA] and the type of pollution [E coli, Salmonella, Listeria]" she would have granted the exemption. (R. pp. ---; Tr. pp. 317:20 to 318:5.) She further testified she was not aware at the time of the audit that state and federal law required protective clothing. (R. pp. ----; Tr. p. 334:3-5.)

However, Corey Smith, the DOR witness from the Policy Section, agreed that pollution is something that is a hazard, and that something that would kill you would typically be considered pollution, as well as contamination that would cause miscarriage, or send someone to the hospital. He also testified that E Coli. "can be a source of pollution." (R. pp----; Tr. pp. 290:20 to 291:24.)

Section 12-36-2120(17) does not define the word "pollution." "Pollution" is defined by The Law Dictionary as, "[t]he presence of *harmful substances (either physical or gaseous)*, noise or energy (radiation) within a certain area, that *causes harm* to the surroundings, altering the natural environment around which it has been excreted."⁴ Black's Law Dictionary, Eleventh Edition, defines "pollution" as "[t]he harmful addition of a substance or thing into an environment; esp., the introduction of man-made products, esp. waste products, into a natural area." Other dictionary definitions are similar. For example, Wikipedia defines "pollution" as "the introduction of *contaminants* into the natural environment that cause adverse change." Wikipedia, <https://en.wikipedia.org/wiki/Pollution> (emphasis added). Dictionary.com defines

⁴ The Law Dictionary, Featuring Black's Law Dictionary Free Online Legal Dictionary 2d Edition, <https://thelawdictionary.org/pollution> (emphasis added).

“pollution” as “1. the act of polluting or the state of being polluted, 2. the introduction of *harmful substances or products* into the environment.” <http://www.dictionary.com/browse/pollution> (emphasis added). The DOR auditor agreed at trial with these definitions. The ALC Order described the testimony of Dr. David Gombas, McEntire’s expert witness in the area of food safety and protective closing as follows:

Dr. Gombas defines “pollution” as any contaminant that may be injurious to the intended consumer. In the context of food safety, Dr. Gombas testified that the terms “pollution” and “contaminant” are used interchangeably and that “protective clothing is a necessary protection against contamination or pollution...in any fresh cut or fresh produce handling facility; likewise, any ready-to-eat food processing facility.” (Trial Tr., p. 231:21-232:1) ... Moreover, when asked whether the major foodborne illnesses associated with fresh produce (Salmonella, E. coli, and Listeria) constitute “pollution” as defined by Black’s Law Dictionary, Wikipedia and dictionary.com, Dr. Gombas answered in the affirmative and confirmed that all three of the harmful substances meet the various definitions of pollution. (R. pp. ----; Order p. 10.)

When determining “pollution,” it is important to consider not only the harmful microbes at issue (i.e., Listeria, E. coli, salmonella), but also the host/carrier of those microbes. These microbes are typically transmitted through human and animal feces. This means the microbes are being transported when fecal matter lands on or around the produce, and then travels on the produce to the processing facility. Fecal matter can also be transported into the facility on the shoes and feet of employees, particularly those with pets or who live in rural areas with deer and other wild animals. All of Respondent’s control efforts are focused on the prevention or abatement of fecal pollution into the water or air. The Environmental Protection Agency recognizes the significant threat of fecal pollution:

Fecal pollution of water from a health point of view is the contamination of water with disease-causing organisms (pathogens) that may inhabit the gastrointestinal tract of mammals, but with particular attention to human fecal sources

as the most relevant source of human illnesses globally. Ingestion of water contaminated with feces is responsible for a variety of diseases important to humans via what is known as the fecal-oral route of transmission. Food, air, soil, and all types of surfaces can also be important in the transmission of fecal pathogens, and thereby implicated in disease outbreaks...In 1998, it was estimated that 2.2 million deaths were associated with diarrhea each year, a good percentage of them due to fecal pollution of water, with the vast majority of victims being children in poor countries (WHO, 2000). This should not be a surprise as it has been estimated that more than 1 billion people worldwide lack access to safe drinking water, and more than 2 billion lack sanitation. Sadly, very little progress has been made in the last 20 years to ameliorate these problems, particularly due to the rapidly increasing global population. *On the contrary, problems associated with fecal pollution of water are likely to worsen in coming decades*, as more people are moving to coastal areas, most people now live in urban centers, many of which have out of control growth rates, and demands for animal meat products are increasing due to current trends in dietary regimes. *Considering that per capita water availability and quantity are diminishing worldwide, it is reasonable to assume that fecal pollution of water is one of the most important and difficult challenges for future generations.* (emphasis added).⁵

Moreover, there is a large amount of case law throughout the United States which categorizes contamination of food as a pollutant with respect to a commercial insurance policy where the term “pollutant” is specifically defined in the *exclusion section* of such policies. The Court of Appeals of Wisconsin held that the term “ ‘contaminants’ as used in [the] pollution exclusion of [a] commercial property insurance policy, included bacteria, and thus the insurance policy excluded coverage *for any losses resulting from bacterial outbreak at insured’s food processing facility.*” *Landshire Fast Foods of Milwaukee, Inc. v. Employers Mut. Cas. Co.*, 269 Wis.2d 775, 783, 676 N.W.2d 528, 532 (Ct. App. 2004) (emphasis added). In this case, Landshire, a food preparer, delivered sandwiches containing listeria to its

⁵ Santo-Domingo, J.W. and N. Ashbolt, *Fecal Pollution of Water*, Cutler J. Cleveland (ed.) Encyclopedia of Earth, National Council for Science and the Environment (2008), *extract available at* https://cfpub.epa.gov/si/si_public_record_Report.cfm?Lab=NERL&dirEntryId=196784.

client, Great Lakes Naval Training Station commissary. *Id.* at 778, 676 N.W.2d at 529. Once the contamination was discovered, Great Lakes returned all of the contaminated food to Landshire. *Id.* Landshire determined that the food contamination occurred on a meat slicer at their facility. *Id.* at 779, 676 N.W.2d at 529. After this contaminated food incident, Landshire “submitted claims for loss of income, loss of product, sanitizing expenses, and costs related to investigating the source of the bacteria” to their insurance company. *Id.* at 779, 676 N.W.2d at 530. Landshire’s insurance policy contained what is commonly referred to as a pollution exclusion. *Id.* at 782, 676 N.W.2d at 531. Landshire’s insurance policy specifically stated, “[w]e will *not pay for loss or damage* caused directly or indirectly by any of the following Discharge, dispersal, seepage, migration, release or escape of ‘**pollutants**’ unless the discharge, dispersal, seepage, migration, release or escape is itself caused by”. *Id.* (emphasis added). Furthermore, the policy defined pollutants as “any solid, liquid, gaseous or thermal irritant or **contaminant**, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.” *Id.* (emphasis added). The parties in this case disputed the actual scope of the term “contaminant,” and specifically whether listeria was a “contaminant.” *Id.* at 782-83, 676 N.W.2d at 531. To answer this question, the court looked to *Richland Valley Products, Inc. v. St. Paul Fire & Cas. Co.*, which held that:

[C]ontamination ‘connotes a condition of impurity resulting from mixture or contact with a foreign substance,’ that that it means ‘to make inferior or impure by mixture; and impairment of impurity; loss of purity resulting from mixture or contact,’ a definition the court found consistent with common understand and WEBSTERS NEW INTERNATIONAL DICTIONARY. . .

201 Wis.2d 161,169-70, 548 N.W.2d 127, 169 (Ct. App. 1996 (quoting *American Casualty Co. of Reading, P.A. v. Myrick*, 304 F.2d 179, 183 (5th Cir. 1962)) (emphasis in original). The court ultimately held that the term “contaminant” in an insurance contract such as the one in

dispute in the case is not susceptible to multiple interpretations. *Landshire*, 269 Wis.2d at 785, 676 N.W.2d at 533. Therefore, the food contamination caused by listeria was a *pollutant* and was thus excludable from an insurance claim by Landshire. *Id.*

South Carolina case law is nearly identical to the states discussed above. For example, in *Helena Chemical Co. v. Allianz Underwriters Ins. Co.*, the Supreme Court of South Carolina held that the pollution exclusion in the plaintiff's policy barred its claims. 357 S.C. 631, 641, 594 S.E.2d 455, 460 (2004). In *Helena*, the Court noted that almost all insurance policies contain an identical pollution exclusion policy. *Id.* The Court went on to state that "pollution arising from ordinary business operations is not covered. *But* if the damage were caused by a 'sudden and accidental' discharge, release, or escape of pollutants, *then the insurers must provide coverage.*" *Id.* (emphasis added). Because the Court held that "the *contamination* at the various sites was caused by Helena's routine business operations and was, therefore, not unexpected and accidental," plaintiff fell under the pollution exclusion. *Id.* at 642, 594 S.E.2d at 460.

Here, with Respondent's case, even though S.C. Code Ann. § 12-36-2120 *does not* contain a definition of "pollutant," insurance policies throughout the entire country repeatedly and continuously consider contaminants such as bacteria on foods to be a "pollutant" due to its "contaminating" nature. *See also Nova Cas. Co. v. Waserstein*, 424 F.Supp 1325, 1334 (S. D. Fla. 2006) (holding that "living organisms," "microbial populations," "airborne and microbial contaminants," and "indoor allergens" are contaminants and are excluded from coverage under the insurance policies pollution exclusion). Based upon the foregoing, the ALC concluded that *E. coli*, *Listeria*, and *Salmonella* constitute "pollution." In addition, the use of Respondent's safety attire protects against pollution through the contamination of food.

b. Respondent Established the Protective Clothing Prevents or Abates Pollution.

In Respondent's industry, the contaminants described above are most commonly transmitted via the transfer of feces.⁶ Contamination could potentially come into the facility in one of two ways: (1) inside the produce and/or (2) from employees. Employees can bring *E. coli*, *Listeria* and *Salmonella* principally from fecal matter and dirt on their shoes and on their hands. Contamination gets on hands/feet from pathogens from employees who walk on/in the dirt, fecal matter from wild animals (deer, raccoons, etc.), and fecal matter and dirt from household pets. (R. pp. ----; Tr. p. 241:10 – 12); 242:5 – 13.) In addition to required hand washing and cleanliness, protective clothing severely minimizes the transfer of such a pollutant from employees to Respondent's produce.

Respondent's witnesses went into great detail to describe the manufacturing process. In short, when the fresh produce is picked and enters the trucks for transport, it may have one of the contaminants described above either inside or on the surface of the produce. When the produce is cut during the manufacturing process, either by hand or with its mechanized choppers, those contaminants can be released into the air or water, and can essentially transfer to an exposed surface, where it can subsequently contaminate other produce as well as reproduce. (This is described by the FDA as cross-contamination). Additionally, when those pollutants are exposed during the cutting process, Respondent's water sprayers and flume systems can cause the pollutants to aerosolize – that is, be transferred into tiny droplets of water that are dispersed into the air. (R. pp. ----; Tr. p. 241:21 to 242:12.) The spread of the pollutants also occurs when the produce is dried – both the blowers and the produce dryers (think large

⁶ See also *Bacteria and Viruses*, available at <https://www.foodsafety.gov/poisoning/causes/bacteriaviruses/ecoli/index.html>.

salad-spinners) cause potentially polluted water to aerosolize. Use of the uniforms, cleaning chemicals, and other precautions during the manufacturing process helps to ensure that the pollution, which is exacerbated and disturbed from its state while on the produce, does not spread, generally referred to as cross-contamination or cross-contact.

Of interest is S.C. Private Letter Ruling (PLR) # 95-8. The taxpayer was an environmental consulting firm that contracted with manufacturing companies to remediate contaminated soil and water beneath and surrounding the manufacturer's facilities. The contaminated areas were a direct result of chemical releases from machines used in manufacturing tangible personal property for sale. The taxpayer designed and installed dual vacuum extraction systems to contain and recover contaminants from soil and ground water. The systems were constructed from pumps, tanks, piping, and vacuum extraction devices to remove water and vapor from the ground. By removing the water and vapor, contaminants were removed from the ground so they could be disposed of properly. In addition, the now-clean water could, if needed, be used as a coolant in the manufacturing plant. The taxpayer made all purchases of the component parts that were used to construct these systems.

The PLR held that such purchases fell under the pollution control exemption, stating:

The [pollution control exemption] regulation does not restrict the exemption to machines that prevent pollution or that reduce the amount of pollution released into the environment. *The clear language of the regulation also allows the exemption for machines used to reduce the amount of pollution already in the environment.* In other words, machines used to "clean up" pollution "caused . . . by the operation of other machines that are used in the mining, quarrying, compounding, processing, or manufacturing of tangible personal property" for sale qualify for the exemption under Code Section 12-36-2120(17). (Emp. added).

The protective clothing at issue is vital to Respondent's control and containment of the pollutants described above. Most importantly, the protective clothing serves as a barrier

between the high care area – where those pollutants are exposed and dispersed in the air and water – and the outside. Witnesses for Respondent testified as to the rigorous processes for entering and exiting the high care area. All are designed to ensure that none of the dangerous microbes leave that area. Without the control, Respondent could spread those microbes outside the facility. By requiring full dress-down when exiting the clean room, Respondent is able to contain the pollutants that may have been released from the produce during the manufacturing process.

The protective clothing serves the additional purpose of ensuring those pollutants are not introduced into the clean room environment by Respondent's employees. Respondent's manufacturing process results in significant spray-back, as cutters chop the produce, sprayers and wash flumes wash down the produce, and blowers and spinners dry the produce. Through this process, a significant amount of water becomes airborne. (R. pp. ----; Tr. p. 147:21 to 148:20; P. 150:1 – 21; P. 165:3 – 21.) Pollutants brought into the room from an unsanitary employee could be released into the air or introduced to water used in Respondent's manufacturing process. For this reason, the protective clothing is changed and washed daily.

c. The Respondent Established that the Machines within its Facility Cause or Threaten to Cause Pollution of Air, Water, or Noise.

Since Respondent has demonstrated that the protective clothing protects against “pollution,” it must also establish that the pollution for which it protects against consists of air, water, or noise. According to the World Health Organization:

Foodborne illnesses are usually infectious or toxic in nature and caused by bacteria, viruses, parasites or chemical substances entering the body through *contaminated food or water*.

Foodborne pathogens can cause severe diarrhea or debilitating infections including meningitis.

Chemical contamination can lead to acute poisoning or long-term diseases, such as cancer. Foodborne diseases may lead to long-lasting disability and death. Examples of unsafe food include uncooked foods of animal origin, *fruits and vegetables* contaminated with feces, and raw shellfish containing marine bio toxins.⁷

Such contaminated food, if not disposed of properly, can contaminate the water supply. Respondent is the manufacturer in a very large and diverse supply chain. Once product leaves Respondent's facility, within a short period of time, due to the spoilage nature of produce, it is disseminated to thousands of businesses throughout the Southeast. If Respondent did not prevent the pollution as described above, the ultimate and immediate affects to the water supply of communities throughout the Southeastern United States could be substantial if such pathogen contaminated food is not disposed of properly.

Furthermore, Respondent uses three-hundred thousand (300,000) gallons of water per day at its facility, and discharges at least 150,000 gallons into the municipal sewer system daily. (R. pp. ----; Tr. 184:16-19). Water is the means by which the Respondent is able to deliver its sanitizing agents to the produce and the facility. Approximately half of that water is recycled, and the other half of the water makes its way through the local sewage system. Respondent's use of safety materials directly prevents pollution which could contaminate the water supply at Respondent's facility and subsequently enter the counties water supply and/or rivers. After a recent *Listeria* outbreak in Arizona, the Food and Drug Administration determined that that the root cause was water found in a nearby stream.⁸ After an extensive

⁷ Food Safety-Key Facts, World Health Organization, *available at* <http://www.who.int/news-room/fact-sheets/detail/food-safety> (emphasis added).

⁸ See Cynthia Hubert, *Heading to the American River this Week? Here's where E. Coli Levels are High*, Sacramento Bee, *available at* <https://www.sacbee.com/news/article214295669.html>; Sandee LaMotte, *Deadly E. Coli Outbreak in Lettuce Traced to Contaminated Water*, *available at* <https://www.cnn.com/2018/06/29/health/e-coli-romaine-lettuce-outbreak-cause/index.html>; AP, *Source of Romaine Lettuce E. Coli Outbreak Identified*, *available at* <https://www.cbsnews.com/news/source-of-romaine-lettuce-e-coli-outbreak-identified/>; Maggie Fox, *Dirty Canal Water May Have Tainted Romaine Lettuce with E. Coli*, *available at* <https://www.nbcnews.com/>

investigation, the Food and Drug Administration concluded that:

[t]hree samples of irrigation canal water collected by the team were found to contain E. coli O157:H7 with the same rare molecular fingerprint (using whole genome sequencing (WGS)) as the strain that produced human illnesses (the outbreak strain). These samples were collected from an approximate 3.5-mile stretch of an irrigation canal in the Wellton area of Yuma County that delivers water to several of the farms identified in the traceback investigation as shipping romaine lettuce that was potentially contaminated with the outbreak strain. *This recent news story demonstrates the threat of pollution to area waterways is a significant issue that affects the entire community.*⁹

In response to Respondent's argument, the Order (R. pp. ----; Order pp. 30-31) found: "When the produce is cut during the manufacturing process, either by hand or with the cutting machine, those contaminants spread directly onto the cutting equipment and can transfer onto other items of produce. The contaminants may also be transferred onto any other exposed surface where they can subsequently contaminate other produce, as well as reproduce. Additionally, when those same harmful pathogens are exposed during the cutting process, [Respondent]'s water sprayers and flume systems can cause the pollutants to aerosolize – that is, be transferred into tiny droplets of water that are dispersed into the air. Furthermore, the spread of pollutants also occurs when the produce is dried – both the blowers and the produce dryers, which operate like large salad-spinners, cause potentially polluted water to be sprayed around the high-care area in such a manner that the back-spray settles on the protective gear worn by employees and onto other exposed surfaces. These various forms of transfer are described by the FDA and the Respondent's expert witness in this case as "cross-

health/health-news/dirty-canal-water-may-have-tainted-romaine-lettuce-e-coli-n887606; Julia Jacobs, *Officials Identify a Source in the Romaine Lettuce E. Coli Outbreak*, available at <https://www.nytimes.com/2018/07/01/us/romaine-lettuce-e-coli-nyt.html>

⁹ See October 24, 2018 Memorandum to the File on the Environmental Assessment; Yuma 2018 E. coli O157:H7 Outbreak Associated with Romaine Lettuce, available at <https://www.fda.gov/ucm/groups/fdagov-public/@fdagov-afda-orgs/documents/document/ucm624633.pdf>.

contamination.”

The ALC determined that food contamination constitutes pollution of air and water because the bacteria that contaminates the food “could contaminate the air inside the facility and the water supply both at the plant and in the municipal water system and/or rivers.” (R. pp. ---; Order p. 35). These conclusions were supported by the substantial evidence presented at the hearing.

d. The Protective Clothing is Required to Comply with Federal and State Regulations.

In this case, the purchases at issue are required by the both federal and state regulation and statutes. Prior ALC case law has established that federal agency regulations satisfy this requirement. *See Duke Energy Corp. v. Dep’t of Revenue*, Docket No. 12-ALJ-17-0031-CC (filed April 28, 2017) (exemption applied to canister system used to comply with regulations of the U.S. Nuclear Regulatory Commission, an “independent United States agency”).

The FDA has established extensive regulations to combat “environmental pathogens,” which are those pathogens:

capable of surviving and persisting within the manufacturing, processing, packing, or holding environment such that food may be contaminated and may result in foodborne illness if that food is consumed without treatment to significantly minimize the environmental pathogen.

Examples of environmental pathogens for the purposes of this part include *Listeria monocytogenes* and *Salmonella spp.* but do not include the spores of pathogenic sporeforming bacteria.

21 CFR § 117.3 (emphasis added). The following summarizes the state and federal agency requirements requiring the use of the gear at issue, all of which apply to Respondent.

e. FDA GMP Regulations

Specifically, 21 C.F.R. § 110.10 requires plant management to take all reasonable

measures and precautions regarding the maintenance of a clean facility, including the following:

(b) *Cleanliness*. All persons working in direct contact with food, food-contact surfaces, and food-packaging materials **shall** conform to hygienic practices while on duty to the extent necessary to protect against contamination of food. The methods for maintaining cleanliness include, but are not limited to:

(1) Wearing outer garments suitable to the operation in a manner that protects against the contamination of food, food-contact surfaces.

...

(3) Washing hands thoroughly (and sanitizing if necessary to protect against contamination with undesirable microorganisms) in an adequate hand-washing facility before starting work, after each absence from the work station, and at any other time when the hands may have become soiled or contaminated.

...

(5) Maintaining gloves, if they are used in food handling, in an intact, clean, and sanitary condition. The gloves should be of an impermeable material.

(6) Wearing, where appropriate, in an effective manner, hair nets, headbands, caps, beard covers, or other effective hair restraints.

Furthermore, 21 C.F.R. § 117.10(b), describes the measures and precautions that firms such as Respondent must exercise in order to:

conform to hygienic practices while on duty to the *extent necessary* to protect *against* allergen cross-contact and against *contamination of food*. The methods for maintaining cleanliness include: (1) [*w*]earing outer garments suitable to the operation in a manner that protects against allergen cross contact and against the *contamination* of food, food contact surfaces, or food-packaged materials. . . (5) [*m*]aintaining gloves, if they are used in *food handling*, in an intact, clean and sanitary condition, (6) [*w*]earing, where appropriate, in an effective manner, *hair nets, headbands, caps, beard covers*, or other effective hair restraints. . . (9) [*t*]aking any other necessary precautions to protect against allergen cross-contact and against contamination of food, food contact surfaces, or food-packaging materials with microorganisms or foreign substances. . .”(emphasis added).

Additionally, 21 C.F.R. § 117.80(a)(1) states that Respondent's operations must comply with the following sanitation principles:

(2) [a]ppropriate quality control operations must be employed to ensure that food is *suitable* for human consumption and that food-packaging materials are safe and suitable...(c)(2) [a]ll food manufacturing, processing, packing, and holding must be conducted under such conditions and controls as are necessary to *minimize* the potential for the growth of *microorganisms*, *allergen cross-contact*, *contamination of food*, and deterioration of food...(5) [w]ork-in-process and rework *must be handled* in a manner that protects against allergen cross-contact, *contamination*, and *growth of undesirable microorganisms*...(10) [s]teps such as washing, peeling, trimming, cutting, sorting, inspecting, mashing, dewatering, cooling, shredding, extruding, drying, whipping, defatting, and forming must be performed *so as to protect* against allergen *cross-contact* and *against contamination*. Food must be protected from contaminants that may drip, drain, or be drawn into the food.

Finally, according to § 117.37, "adequate sanitary facilities and accommodations include:

(a) Water supply. The water supply must be adequate for the operations intended and must be derived from an adequate source. Any water that contacts food, food-contact surfaces, or food-packaging materials must be safe and of adequate sanitary quality. Running water at a suitable temperature, and under pressure as needed, must be provided in all areas where required for the processing of food, for the cleaning of equipment, utensils, and food-packaging materials, or for employee sanitary facilities.(emphasis added).

McEntire is subject to all these regulatory requirements. (e.g., R. pp.----; P. 176:24-5).
Based on the foregoing, federal law explicitly requires all clothing at issue in this case, and there was no testimony from the DOR to the contrary.

f. DHEC Statutes and Regulations

According to S.C. Code Ann. § 39-25-180(H):

Good manufacturing practice regulations and their amendments now or hereafter adopted pursuant to the authority of the federal Food, Drug, and Cosmetic Act are the good manufacturing regulations of this State. However, the commissioner may adopt a regulation that prescribes conditions under which good manufacturing processes may be used in this State whether or not in accordance with regulations promulgated pursuant to the federal act.

DHEC has accordingly adopted the Part 110 and Part 117 guidelines stated above which require protective clothing. Moreover, DHEC also has promulgated Regulation 61-25, which also provides rules and regulations for entities engaged in food production. Produce manufacturers like Respondent comply with such regulations.

These regulations require the use of protective clothing to reduce or eliminate opportunities for cross-contamination, and place responsibility for use on food protection managers. *See* S.C. Regs. §§ 61-25, 2-103.11 (person in charge “shall ensure that ... (L) employees are preventing cross-contamination of ready-to-eat food with bare hands by properly using suitable utensils such as deli tissue, spatulas, tongs, single-use gloves, or dispensing equipment”). Section 3-301.11(B) prohibits food employees from contacting exposed, ready-to-eat food with bare hands, and requires use of gloves. Under S.C. Regs. § 2-402.11(B), food employees must wear hair restraints, including hats, hair covering and nets, beard restraints, and clothing that covers body hair. Those restraints must be both designed and worn to effectively keep hair from contacting exposed food, clean equipment, utensils, and linens. *Id.* Accordingly, state law requires all the clothing at issue in this matter. (R. pp. ----; Tr. 26, Lines 3-13; Tr. 206:6 – 8; 244:12 – 16.)

VI. CONCLUSION

Based on the foregoing, Respondent respectfully requests this Court affirm the ALC’s Order, which properly applied the Machine Exemption and Pollution Control Exemption to

the purchases at issue, finding its application of the law and conclusions supported by substantial evidence.

Respectfully Submitted,

March 23, 2020



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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

The Honorable H.W. Funderburk, Jr., Administrative Law Judge

Case No. 17-ALJ-17-0060-CC
Appellate Case No. 2019-001933

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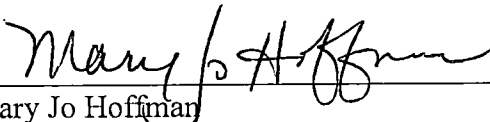
McEntire Produce, Inc.Respondent,

v.

South Carolina Department of Revenue,Appellant.

PROOF OF SERVICE

I, Mary Jo Hoffman, hereby certify that I have caused to be mailed a copy of McEntire Produce Inc.'s Initial Brief and Designation of Matter to be Included in the Record on Appeal regarding the above-referenced case, by depositing the same in the United States Mail, postage prepaid, on March 23, 2020, addressed to the Court of Appeals, 1205 Pendleton Street, Columbia, SC 29201 and to the attorneys of record, Elisabeth Shields, South Carolina Department of Revenue, PO Box 12265, Columbia, SC 29211-9979.



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Member

March 23, 2020

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The Honorable Jenny Abbott Kitchings
Clerk, South Carolina Court of Appeals
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Columbia, South Carolina 29201

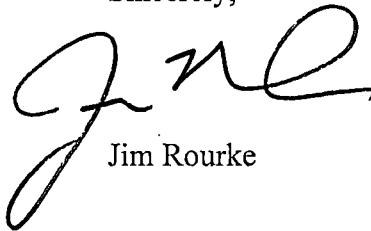
Re: McEntire Produce, Inc. vs. South Carolina Department of Revenue
Appellate Case No. 2019-001933

Dear Ms. Kitchings:

Enclosed for filing please find the original and one (1) copy of Respondent's Initial Brief and Designation of Matter to be Included in the Record of Appeal, along with Proof of Service. Please return a clocked copy to me in the enclosed self-addressed, postage paid envelope.

By way of copy, I am serving counsel of record with the same. Thank you for your assistance.

Sincerely,



Jim Rourke

JR/mw

Enclosure

cc: Elisabeth W. Shields, Esquire

- Charleston
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