

FINDING OF EMERGENCY

CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION FINANCING AUTHORITY

Title 4, Division 13, Article 2

Finding of Emergency

Pursuant to California Public Resources Code 26009, the regulations being adopted herewith by the California Alternative Energy and Advanced Transportation Financing Authority (the “Authority” or “CAEATFA”) as emergency regulations (“the Emergency Regulations”) are, by legislative mandate, necessary for the immediate preservation of the public peace, health and safety, and general welfare.

Necessity

These Emergency Regulations are necessary to implement, interpret and make specific Public Resources Code Sections 26000, *et. seq.* by amending procedures that will enable the Authority to grant sales and use tax exclusions for qualifying advanced transportation, alternative source, advanced manufacturing, and recycled feedstock applicants as defined in Public Resources Code Section 26011.8 (Eggman, Chapter 768, Statutes of 2015 (AB 199)), which authorizes the Authority to award such sales and use tax exclusions.

Authority and Reference

Authority: Public Resources Code Section 26009. Section 26009 of the Public Resources Code authorizes the Authority to adopt emergency regulations necessary for the immediate preservation of the public peace, health, safety, or general welfare in accordance with Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

Reference: Public Resources Code Section 26011.8; Revenue and Taxation Code Section 6010.8. This regulation will implement and make specific Section 26011.8 of the Public Resources Code.

Informative Digest

Existing law establishes the California Alternative Energy and Advanced Transportation Financing Authority and authorizes the Authority to provide financial assistance, as defined, to Participating Parties, as defined in Public Resources Code Sections 26003(a)(7), for alternative source, advanced transportation, and advanced manufacturing Projects, also known as the Sales and Use Tax Exclusion Program (“Program”). (See Public Resources Code Sections 26003(a) and 26011.8(a), and Revenue and Taxation Code Section 6010.8.) Existing law limits the amount of sales and use tax exclusion (“STE”) that may be granted in each calendar year to \$100 million (Public Resources Code Section 26011.8(h)).

Existing law, AB 199 (Eggman, Chapter 768, Statutes of 2015), as codified in Public Resources Code Sections 26003 and 26011.8, expanded the pre-existing Program, which initially enabled CAEATFA to award a sales and use tax exclusion to manufacturers of alternative source and advanced transportation products under Senate Bill 71 (Padilla, Chapter 10, Statutes of 2010) and then to advanced manufacturing projects under SB 1128 (Padilla, Chapter 677, Statutes of 2012), to include recycled feedstock projects. The proposed regulations will incorporate recycled feedstock projects into the existing Program.

Subsequent to the passage of AB 199, staff conducted public workshops in March and June 2016 to solicit input on the appropriate program design to facilitate the inclusion of recycled feedstock projects and approaches for managing Program oversubscription. The proposed modifications to the regulations further clarify and specify the provisions set forth in statute, and address “lessons learned” from earlier implementation of the Program. The proposed amendments and objectives for each section are below.

The proposed regulations will allow the Authority to continue to offer financial assistance to alternative source, advanced transportation, advanced manufacturing, and recycled feedstock projects. By promoting these types of projects the Authority promotes California-based manufacturing, California-based jobs, the reduction of greenhouse gases, or the reduction in air and water pollution or energy consumption.

Government Code Section 11346.5(a)(3)(D) requires that the notice of emergency rulemaking shall include, “an evaluation of whether the proposed regulation is inconsistent or incompatible with existing state regulations.” The Authority’s legal counsel reviewed the California Code of Regulations and found no existing regulations dealing with this issue. Therefore, CAEATFA believes that the proposed regulation is neither inconsistent nor incompatible with existing state regulations.

§10031 - Definitions

This section is amended to add definitions of terms commonly used throughout the regulations and program documents. The definitions provide detail on various program terms and

requirements, including Biofuel, Competitive Criteria, Corporate headquarters, Qualified Property, Recycled feedstock, Recycled Resource Extraction Project, and Soil amendments.

Necessity. Proposed amendments to the regulations revise the evaluation criteria for Biofuel projects in order to simplify the application process and more accurately score fiscal benefits based on lessons learned. Because Biofuels will be distinguished from other Alternative Sources, the proposed regulations define Biofuels, which will include biodiesel and biogas as defined in Sections 95481(a)(6) and 95481(a)(9) of Division 3 of Title 17 of the California Code of Regulations.

Proposed amendments to the regulations will also add a system of ranking applications in situations where STE requests exceed the available remaining annual program cap. This ranking will be based on competitive criteria, as now defined in regulations. One of the competitive criteria used to rank applications will be the presence of a California Headquarters. As such, a clear definition of corporate headquarters is needed in the regulations.

The passage of AB 199 expanded the Program to include manufacturers that utilize equipment that primarily processes Recycled feedstock or uses Recycled feedstock to create another product or Soil amendment. The definition of Qualified Property has been updated to reflect this expansion of the Program. Additionally, the proposed regulations refer to Section 26011.8(b)(2) of the Public Resources Code in order to provide a definition of Recycled feedstock in regulations and refer to Section 26011.8(b)(3) of the Public Resources Code in order to provide a definition of Soil Amendments in regulations.

Proposed amendments to the regulations create evaluation criteria for projects that convert Recycled feedstock into materials that are used in a subsequent manufacturing process. These are defined as Recycled Resource Extraction Projects. The proposed regulations also clarify that projects currently eligible under Alternative Source, Advanced Transportation, or Advanced Manufacturing are not included in this definition.

§10032(a) – Timing of Application Submissions

This section adds a per-project STE limit of \$20 million per-calendar year and provides a process for awarding additional STE to qualified capped projects if the Authority has STE available at the last board meeting of the calendar year. The proposed regulations also establish an application ranking process based on specific, objective criteria for determining the priority of processing applications in the event the program receives STE award requests exceeding the statutory \$100 million STE cap.

Necessity. Statute limits the program to awarding \$100 million in STE each calendar year, but current program regulations do not limit the amount of STE that can be requested in a single application. Additionally, current program regulations establish a first-come-first served process for reviewing applications. In light of the Program's historic oversubscription, questions have been raised as to whether this method of allocating awards provides the greatest possible

benefit to the state. Imposing a project cap and instituting a competitive process based on objective criteria when the Program is oversubscribed will ensure a more equitable dispersion of awards and maximize the effectiveness of the Program in achieving its goals, while providing a mechanism to provide an award greater than \$20 million should such funds be available at the end of the year.

Applications will still be considered first-come, first-served, to best meet the needs of business cycles. At the time of oversubscription – when the total amount that would be approved by the Authority at a given board meeting exceeds the \$100 million statutory cap – all applications to be considered in the same month will be ranked based on four basic criteria: (1) unemployment rate in the county of the facility, (2) presence of corporate headquarters in California, (3) status as a small business, (4) and being new to the Program. Each criterion shall be worth between one and five points, and the application with the greatest point score shall be advanced first. In the event of a tie, the project with the smaller STE request will advance first. If the amounts of each request are identical, the order will be determined by the order in which the applications were received by CAEATFA. Additional applications will be advanced in the order of their rank, as the Program cap allows. The application that exceeds the Program cap will be the last application to be considered, with the portion of the award in excess of the cap being awarded from the next calendar year. All subsequent applications will be placed on a waiting list and considered in the following calendar year.

§10032(c)(4)(B) – Facility Information

This section is amended to require information on the type of Recycled Resource Extraction Project, if applicable. The proposed regulations also require Biofuel projects to provide the fraction of Biofuel produced that will offset external fuel purchases. This section is also amended to require Biofuel applicants to provide information on the taxability of the end of supply chain product for purposes of generating sales taxes – a key measure used to evaluate the fiscal benefits of a project. Applicants no longer will need to provide the estimated annual corporate or income taxes paid by the company on its profits.

Necessity. Requiring information on the type of Recycled Resource Extraction Project is necessary to incorporate the newly eligible Recycled feedstock projects added to the Program under AB 199.

Past Program experience has shown that many Biofuel applicants use their own Biofuel produced by the project for internal purposes, such as fueling trucks or generating electricity; therefore this fraction of Biofuel is not being purchased and not generating sales tax, which is used to calculate a project's fiscal benefits. The proposed regulations are necessary to obtain the required information on the fraction of Biofuel produced that will offset external fuel purchases and whether the facility will produce a product that is taxable for purposes of generating sales taxes in order to more accurately determine the amount of sales tax generated by the Biofuel project when calculating the project's fiscal benefits.

The proposed regulations eliminate the requirement that applicants provide the estimated annual corporate or income taxes paid by the company on its profits because the estimated facility sales, applicant-provided inputs on costs of goods sold, and specific assumptions established by the Executive Director based on information from the California Franchise Tax Board and other relevant sources, may be used to estimate income tax liability.

§10032(c)(4)(C) – Qualified Property Information

This section is amended to remove the \$10,000 limit for individual pieces of equipment and the \$100,000 cumulative cost limit, instead allowing applicants to group reasonably related Qualified Property items on their Qualified Property lists. This section is also amended to incorporate Recycled Resource Extraction Projects.

Necessity. Program experience has shown that separating out projected Qualified Property based on a \$10,000 individual and \$100,000 cumulative cost basis can be difficult and sometimes unreliable. Applicants will still be allowed to group Qualified Property as long as they are reasonably related. This will allow staff to review and inquire about the types of Qualified Property necessary to complete the project prior to approval by the Authority. Additionally, all applicants are required to fill out a revised list of Qualified Property purchases at the end of the project, which is easier and more accurate. As long as applicants group Qualified Property in the application according to reasonably related categories, staff can do its due diligence, while relying on the back-end analysis and reporting to capture more detailed purchasing information.

Requiring the estimated percent of time Qualified Property will be utilized in a Recycled Resource Extraction Project is necessary to ensure these projects meet the statutory requirement established in Public Resources Code section 26011.8(b)(1), where tangible personal property must be used at least 50.0 percent of the time to process recycled feedstock.

§10032(c)(4)(D) – Product Information

This section has been amended to no longer require that applicants provide the North American Industry Classification System (NAICS) code of the Applicant's industry or the estimated amount of total facility sales. The proposed regulation also requires information on the estimated average annual amount of recycled material to be produced and specifies that only Alternative Source and Advanced Transportation applicants must provide information on the Estimated Useful Lifespan of the product, on whether the product is a subcomponent, and the total value of the end-of-supply-chain Green Component. The proposed regulations also now require applicants to provide the estimated percent of the total end of supply chain product sales in California.

Necessity. In an effort to streamline the application process, the proposed amendments remove the requirement that applicants provide a NAICS code because Staff does not use NAICS codes to categorize applications but rather project type, which is more informative for

tracking purposes as opposed to applicant-provided NAICS code. Additionally, the proposed regulations remove the requirement that applicants provide estimated total facility sales because applicants already provide the estimated number of units produced and sales price, which may be used to estimate facility sales.

Specifying that only Alternative Source and Advanced Transportation applicants must provide information on the Estimated Useful Lifespan of the product, on whether the product is a subcomponent, and the total value of the end-of-supply-chain Green Component is necessary to clarify that Advanced Manufacturing and Recycled Resource Extraction applicants do not need to provide this information because their project scores do not rely on those inputs.

Requiring the estimated percent of total end of supply chain product sales in California is necessary to calculate the attributable share of fiscal and environmental benefits that can be credited towards the manufacture of a component or subcomponent and the benefits generated specifically within California.

§10032(c)(4)(E)(vi) – Environmental Benefits for Recycled Resource Extraction Projects

This section requires Recycled Resource Extraction Projects to provide a description of the environmental benefits, and the marginal increase in total amount of materials recycled due to the sales and use tax exclusion.

Necessity. This section is necessary to provide CAEATFA with the information required from Recycled Resource Extraction Projects, which are newly eligible under AB 199, to calculate a project's environmental benefits. Environmental benefits will be measured based on increases in the total amount of recycled materials produced. Applicants will provide the appropriate recycled material, and the estimated GHG benefits of recycling those materials will be calculated based on the US Environmental Protection Agency's ("EPA") Waste Reduction Model ("WARM model") (or other relevant sources of information). Where the California Air Resources Board ("CARB") has made modifications or developed an alternative to the WARM model, the CARB measurements will be used. GHG reductions will then be monetized based on economic estimates of the cost of each additional ton of GHG emissions (according to the process already utilized by CAEATFA to estimate the value of GHG reductions). Only projects that increase the amount of recycled materials produced and generate sufficient environmental benefits will be eligible.

§10032(c)(4)(F)(ii) – Alternative Source and Advanced Transportation Process Improvements

The proposed regulations remove questions in the application related to estimated manufacturing or production process improvements by Alternative Source and Transportation applicants.

Necessity. Current regulations allow Alternative Source and Advanced Transportation applicants to potentially earn supplemental points for substantial improvements in use of

energy or water, or in avoided pollution or waste relative to comparable production processes if the applicant is able to provide substantial third party evidence. Any points awarded are not applied to fiscal or environmental benefits scores, but may be used to increase the total points earned, thus potentially allowing the applicant to meet the minimum scoring threshold of 1,000 points required for staff recommendation if the project's fiscal and environmental benefits are insufficient to meet that threshold. To date, no applicant has used the process improvement points to meet the minimum scoring threshold; therefore, the proposed regulations remove this section from the application.

§10033(b)(1) – Eligibility

This section has been amended to add tangible personal property otherwise subject to sales where at least 50.0 percent of the use of the Qualified Property is to process Recycled feedstock, and adds processing Recycled feedstock as an eligible use in the definition of “used substantially.”

Necessity. These amendments are necessary to incorporate Recycled Resource Extraction Projects as eligible projects, as established under AB 199.

§10033(c)(1)(G)(i) – Calculating Fiscal Benefits

This section specifies that the estimated increase in sales taxes for a Biofuel applicant will be reduced accordingly if the Biofuel applicant uses a fraction of the Biofuel to operate its facility and does not produce a product that generates sales tax revenue. The proposed regulations also now provide that the estimated annual tax liability will be based on information provided by the California Franchise Tax Board and other applicant-provided data.

Necessity. Past Program experience has shown that many Biofuel applicants use their own Biofuel produced by the project; therefore this fraction of Biofuel is not being purchased and is not generating sales tax, which is used to calculate a project's fiscal benefits. The proposed amendments are necessary to establish how the estimated increase in sales taxes will be calculated to account for the fraction of Biofuel that does not produce sales tax revenue.

The proposed regulations eliminate the requirement that applicants provide the estimated annual corporate or income taxes paid by the company on its profits because they may be estimated based on other applicant-provided information and assumptions established by the California Franchised Tax Board. Amendments in this section are necessary to clarify that the estimated annual corporate or income taxes will not be based on an estimate directly provided by the applicant and to establish the methodology for calculating the estimated annual corporate or income taxes.

§10033(c)(3) – Environmental Benefits

Current regulations measure the environmental benefits of all Alternative Source projects based on the energy generation potential of the project, which results in a reduction in the amount of non-alternative source power that otherwise would be needed. Applicants must calculate and provide the energy generation capacity of the products produced by the project, and a dollar value of the pollution that is avoided per megawatt-hour of electricity generation is assigned based on available research and analysis.

This section is amended to establish a new methodology for calculating the environmental benefits of Biofuel projects that is distinct from other Alternative Source or Advanced Transportation projects. Under the proposed regulations, the environmental benefits of Biofuel projects will be calculated based on the type of biofuel produced and the units of energy produced, using CARB estimates and other relevant sources to calculate the net difference in GHG emissions between the various Biofuels and the corresponding fossil fuel that the fuel is replacing and assigning a dollar value to the reduction in pollution based on available research and analysis

This section also establishes a methodology for calculating the environmental benefits for Recycled Resource Extraction Projects. Environmental benefits will be measured based on increases in the total amount of recycled materials produced. Applicants will provide the appropriate recycled material, and the estimated GHG benefits of recycling those materials will be calculated based on the EPA WARM model (or other relevant sources of information). Where CARB has made modifications or developed an alternative to the WARM model, the CARB measurements will be used. GHG reductions will then be monetized based on economic estimates of the cost of each additional ton of GHG emissions (according to the process already utilized by CAEATFA to estimate the value of GHG reductions). Only projects that increase the amount of recycled materials produced and generate sufficient environmental benefits will be eligible.

Increases in recycling due to the STE will be estimated by taking applicant-provided information about total production costs, tons of materials processed, and amount of recycled materials to be produced and calculating the change in production costs due to the STE, the resulting increase in recycling due to the incentive effect of the STE based on supply and demand characteristics of the relevant recycling market, the reduction in GHG emissions from the EPA WARM model (or CARB), and the economic benefit from the reduction in GHGs.

Necessity. The proposed amendments are necessary to establish a new methodology for calculating the environmental benefits for Biofuel applicants, which will simplify the application process while still accurately scoring the environmental benefits based on assumptions already established by the CARB.

The proposed amendments are also necessary to establish a methodology for calculating the environmental benefits for Recycled Resource Extraction Projects, which are newly eligible under AB 199.

§10033(c)(4) – Calculation of Points

This section adds a reference to Recycled Resource Extraction applications in the methodology for calculating environmental benefits points.

Necessity. These amendments are necessary to incorporate Recycled feedstock projects as eligible projects, as established under AB 199, and to specify the methodology by which the environmental benefits points will be calculated.

§10033(c)(5)(E) – Process Improvement Score

This section has been amended to remove the scoring related to estimated manufacturing or production process improvements by Alternative Source and Transportation applicants.

Necessity. Current regulations allow Alternative Source and Advanced Transportation applicants to potentially earn supplemental points for substantial improvements in use of energy or water, or in avoided pollution or waste relative to comparable production processes if the applicant is able to provide substantial third party evidence. Any points awarded are not applied to fiscal or environmental benefits scores, but may be used to increase the total points earned, thus potentially allowing the applicant to meet the minimum scoring threshold required for staff recommendation if the project’s fiscal and environmental benefits are insufficient to meet that threshold. To date, no applicant has used the process improvement points to meet the minimum scoring threshold; therefore, the proposed regulations remove this section from the application scoring.

§10033(c)(5)(G)(i)d – Out-of-state Environmental Benefits Score

The proposed amendment excludes Biofuels from being considered in the calculation of the total value of out-of-state non-greenhouse gas pollution benefits due to electricity generated from alternative sources. This evaluation methodology is specific to Alternative Source applicants.

Necessity. Under the proposed regulations, a separate evaluation methodology for Biofuels is proposed – distinct from the evaluation methodology used for Alternative Source applicants. The proposed amendment is necessary to clarify that when calculating the out-of-state environmental benefits score for Alternative Source applicants, Biofuels shall be excluded since Biofuels are evaluated using a different methodology.

§10032(c)(6)-(7) – Total Score

The proposed amendments reduce the environmental benefits score threshold required for Alternative Source and Advanced Transportation applicants to receive a recommendation for a sales and use tax exclusion award from greater than 100 points to greater than 20 points, and establishes the environmental benefits score threshold to greater than 20 points for Recycled Resource Extraction Projects. The regulations have also been amended to specify an applicant may be recommended for an award if the scoring thresholds are met, rather than will be recommended for an award, and to make a grammatical correction clarifying that there is more than one point threshold value.

Necessity. Current regulations specify that Alternative Source and Advanced Transportation applicants who receive an environmental benefit score of greater than 100 points and Advanced Manufacturing applicants who receive an environmental benefit score of greater than 20 points will be recommended for sales and use tax exclusion, given that they also score greater than 1,000 total points. The different threshold requirements are due to the fact that Advanced Manufacturing projects generally generate fewer environmental benefits through manufacturing process improvements than Alternative Source and Advanced Transportation projects do through products that directly generate environmental benefits. In reviewing sample applications, staff noted that eligible AB 199 projects create environmental benefits that meet various quantifiable standards and may not, due to the nature of the projects, generate more than 100 environmental benefits points. The proposed regulation is necessary to better and more equitably accommodate the variety of projects statutorily eligible under the Program by evaluating all types of projects using the same scoring threshold.

Additionally, the proposed amendment allowing staff to not recommend an application for approval despite meeting the scoring threshold is necessary to provide staff the discretion to recommend a negative recommendation in which there are non-quantifiable factors outside of the fiscal and environmental benefits generated by a project that may disqualify a project from receiving a financial award, such as legal issues.

§10035(b)(1) – Purchase Requirement

This section has been amended to require applicants make at least 15% of their Qualified Property purchases within one year of approval by the Authority.

Necessity. In light of the program's statutory cap of awarding \$100 million in STE each calendar year, and the Program's historic oversubscription, the proposed regulation is necessary to ensure that projects that apply are truly ready and will move forward. Previous program experience has shown that some applicants apply prematurely, using up some of the Program's limited cap, and never use the sales and use tax exclusion award, and therefore never produce the anticipated benefits to the state while also receiving an award that would otherwise go to another project. By requiring applicants to purchase at least 15% of the project's Qualified Property within one year, violation of which would be subject to termination of the award, the proposed regulation helps maximize the Program's benefit to the state by encouraging projects that will actually move forward. 15% was selected as the purchase requirement based on

previous program experience with a 25% purchase requirement and stakeholder input that requested a lower percentage given the consequence for failing to meet the purchase requirement.

§10035(b)(8) - Suspension

This section allows the Executive Director to suspend a sales and use tax exclusion award if the Applicant violates statute, regulations, or the terms of the Regulatory Agreement.

Necessity. Approved applicants are required to adhere to terms and conditions laid out in statute, regulations, and the terms of the Master Agreement. Failure to comply with any of these may currently result in punitive measures, such as termination of the award. The proposed regulation is necessary to create an additional tool to help ensure compliance with Program requirements, without resorting to more drastic measures for curable violations.

§10036(a)(4) – Application Fee

This section specifies that the application fee can be refunded if the application is not reviewed because of Program oversubscription.

Necessity. Statute limits the program to awarding \$100 million in STE each calendar year, but current regulations do not specify that an application fee is refundable if the Authority does not review an application because of oversubscription. This regulation is necessary to make clear that the Authority will refund an application fee if the application is not reviewed due to Program oversubscription where the Authority may receive more applications than can be considered by the Authority Board.

§10036(c) - Fees

This section adds a \$500 fee for any applicant that requests a modification of its existing Master Agreement requiring approval by the Authority and a .00005 (one two hundredth of one percent) of the total Qualified Property amount fee for any applicant that requests a modification to its Master Agreement or authorizing resolution that requires a revised application to be considered by the Authority, subject to a \$500 minimum and a \$2,000 maximum.

Necessity. The current fee structure is intended to offset the costs associated with the review of applications (application fee) and the ongoing administrative needs of the Program (administrative fee). These fees do not cover the additional expense of bringing an approved applicant back before the Board for modifications to an existing Master Agreement. Proposed modifications are necessary to address this issue by offsetting the standard costs for staff and materials necessary to bring a resolution before the Board and to review a revised application. A \$500 fee was based on the amount of hours required to modify a master agreement requiring approval by the Authority. This fee is not a sliding scale because the amount of work does not

vary based on the size of the application. The fee of .00005 (one two hundredth of one percent) of the total Qualified Property amount fee for any applicant that requests a modification to its Master Agreement or authorizing resolution that requires a revised application to be considered by the Authority, subject to a \$500 minimum and a \$2,000 maximum is based on the amount of hours required to review such requests, which varies based on the amount of Qualified Property requested in the application as the complexity of the application tends to increase the larger the STE request.

**Other Matters Prescribed by Statutes Applicable
to the Specific State Agency or to any
Specific Regulation or Class of Regulations**

No other matters are prescribed by statute applicable to the Authority or to any specific regulation or class of regulation pursuant to Section 11346.1(b) or 11346.5(a)(4) of the Government Code pertaining to the Emergency Regulation or to the Authority.

Mandate on Local Agencies or School Districts

The Executive Director of the Authority has determined that the Emergency Regulations do not impose a mandate on local agencies or school districts (pursuant to Government Code Section 11346.5(a)(5)).

Fiscal Impact

The Executive Director of the Authority has determined that the Emergency Regulations do not impose any additional mandated cost or savings requiring reimbursement under Section 17500 et. seq. of the Government Code, or any other non-discretionary cost or savings to any local agency or any cost or savings in federal funding to the State. Pursuant to the State Administrative Manual Sections 6601-6616, a Fiscal Impact Statement (Form 399) is submitted without the signature of a Project Budget Manager at the Department of Finance, as there are no fiscal impact disclosures required. There will be no cost or savings to any State Agency or effect on Federal funding to the State.