

**CALIFORNIA ALTERNATIVE ENERGY AND
ADVANCED TRANSPORTATION FINANCING AUTHORITY**

Request to Approve Project for Sales and Use Tax Exclusion (STE)¹

**Haas Automation, Inc.
Application No. 14-SM024**

Tuesday, March 17, 2015

Prepared By: *Ashley Bonnett*

SUMMARY

Applicant – Haas Automation, Inc.

Location – Oxnard, Ventura County

Industry – Computer Numerical Control Machine Manufacturing

Project – New Manufacturing Facility and Retrofit of Existing Manufacturing Facility
(Advanced Manufacturing)

Value of Qualified Property – \$81,426,200

Estimated Sales and Use Tax Exclusion Amount² – \$6,856,086

Application Score –

Fiscal Benefits Points:	5,568
<u>Environmental Benefits Points:</u>	<u>95</u>
Net Benefits Score:	5,663
<u>Additional Benefits Points:</u>	<u>105</u>
Total Score:	5,768

Staff Recommendation – Conditional approval, pursuant to conditions outlined under Recommendation

¹ All capitalized terms not defined in this document are defined in the Program’s statute and regulations.
² This amount is calculated based on the average statewide sales tax rate of 8.42%.

THE APPLICANT

Haas Automation, Inc. (“Haas” or the “Applicant”), a wholly owned subsidiary of Haas Holdings, Inc., was founded in 1983, and, according to the Applicant, is currently the largest machine tool builder in the western world. At its one-million-square-foot facility located in Oxnard, the Applicant manufactures four major Computer Numerical Control (“CNC”) product lines: vertical machining centers, horizontal machining centers, lathes and rotary tables, and large five-axis and specialty machines.

The major shareholders (10.0% or greater) of Haas Holdings, Inc. are:
Gene Haas (100%)

The corporate officers of Haas Automation, Inc. are:
Gene Haas, President
Kurt Zierhut, Secretary
Robert Murray, Treasurer

THE PROJECT

The Applicant plans to upgrade its current CNC machinery tool manufacturing facilities located in Oxnard and to build an additional manufacturing facility next to one of its existing facilities, incorporating state of the art mechanics, controls, and information systems, which the Applicant represents will radically increase productive capacity (the “Project”). The manufacturing process will utilize advanced semi-conductors in the CNC machinery and Flexible Manufacturing Systems (FMS), providing advance scheduling systems and full automation to eliminate human errors in setting up machine schedules and product loading. The Applicant represents that the Project’s utilization of innovative cutting strategies, cutting tools, and methods of securing and positioning workpieces will be able to achieve accuracies beyond what is normally considered possible on a milling or turning machine. The Applicant also makes use of additive manufacturing during research and development to create prototypes of the machine tools to be manufactured.

The Applicant represents that the FMS machining, automated loading and information technology integration, as well as the fact that many of the machines will be twice as fast as those they replace, will significantly increase the rate of productivity while minimizing the facilities’ environmental impact. Specifically, the Applicant anticipates reducing power consumption, water use, and hazardous waste. For example, the Applicant anticipates decreasing water use by approximately 50% because the new equipment will nearly eliminate machine lubrication contamination and will reduce chip accumulation in coolant tanks through the use of chip removal systems, allowing for longer coolant change intervals.

ANTICIPATED COSTS OF QUALIFIED PROPERTY

The anticipated Qualified Property purchases are listed below:

Flexible Manufacturing Systems	\$ 35,568,000
Horizontal Pallet Pool Systems	22,451,700
Bridge Style Milling Machines	18,810,000
Multi-function Lathes	3,000,000
Communication and IT Infrastructure	976,500
Vertical Machining Centers	620,000
Total	<u>\$ 81,426,200</u>

Note: The Qualified Property purchases reported in the Application and shown here in staff's report are estimated costs. At the termination of the master regulatory agreement a finalized project equipment list will be prepared detailing the value of the Project equipment acquired and detailing the actual tax benefit realized pursuant to Revenue and Tax Code Section 6010.8. Variance from the costs shown in the Application and in this report may occur prior to the closing due to increased costs of certain components (of the Project) over original estimates, and other reasons. In addition, such costs may vary after closing due also to increased costs, as well as common design and equipment modifications during construction, differences in equipment due to future changes in law or regulation, or for other reasons.

TIMELINE

The Applicant represents that its decision to expand its manufacturing operations in California will be influenced by the outcome of CAEATFA's Sales and Use Tax Exclusion Program. The Applicant represents that, if Haas does decide to proceed with expansion plans in California, the design and permitting process will begin immediately and will continue for about six months, at which point construction and then equipment installation would commence. The Applicant anticipates beginning production about 18 months after initial project start-up.

PROJECT EVALUATION

NET BENEFITS

The total cost of the Qualified Property purchases is anticipated to be \$81,426,200 and the total net benefits are valued at \$31,318,132 for the Project. The Project received a Total Score of 5,768 points, which exceeds the required 1,000 point threshold and a total Environmental Benefits Score of 95 points, which exceeds the 20 point threshold.

- A. Fiscal Benefits (5,568 points).** The net present value of the total fiscal benefits over the lifetime of the Qualified Property is derived from the Applicant's sales taxes, personal income taxes paid by the firm's employees, firm taxes on profits, property taxes and other indirect fiscal benefits of the Applicant which amounts to \$38,174,218 resulting in a Fiscal Benefits score of 5,568 points for the Project.

B. Environmental Benefits (95 points). The Project will result in an Environmental Benefits Score of 95 points. The Applicant received points in the following categories:

1. **Environmental Sustainability Plan (20 of 20 points)**. The Applicant will implement an environmental sustainability plan for its Project that will result in the documentation of all waste and emission volumes, and the reduction of energy and water consumption and hazardous waste through the utilization of best available technologies for emission reduction equipment and record keeping.
2. **Energy Consumption (15 of 30 points)**. The Applicant's manufacturing process will result in a 15% reduction in energy consumption relative to the industry standard manufacturing process.
3. **Water Use (30 of 30 points)**. The Applicant's manufacturing process will result in a 50% reduction in water use relative to the industry standard manufacturing process.
4. **Hazardous Waste (30 of 30 points)**. The Applicant's manufacturing process will result in a 70% reduction in hazardous waste produced relative to the industry standard manufacturing process.

C. Additional Benefits (105 points). Applicants may earn additional points for their Total Score. The applicant submitted information and received 105 additional points.

1. **Permanent Jobs (55 of 75 points)**. The Applicant's Project will support a total of 1,235 permanent jobs at its Facility. CAEATFA estimates that approximately 51 of these jobs will be attributable to a marginal increase in jobs created due to the approved STE resulting in a Permanent Jobs Score of 55 points for the Project.
2. **Construction Jobs (0 of 75 points)**. The Applicant's did not identify any construction jobs at its Facility.
3. **Research and Development Facilities (25 of 25 points)**. The Applicant has verified that it has a facility located in California that performs research and development functions related to CNC machine manufacturing.
4. **Workforce Partnerships (25 of 25 points)**. The Applicant has a partnership with various educational institutions, such as Rio Mesa High School, Ventura College, California State University – Northridge, and Cal Poly – San Luis

Obispo, providing nearly \$10 million worth of machine tools at no cost for the purpose of assisting in the training of potential future workers.

STATUS OF PERMITS/OTHER REQUIRED APPROVALS

The Applicant represents that, if Haas does decide to proceed with expansion plans in California, the design and permitting process will begin immediately, and that the required permits for the Project, including electrical, foundation, and cranes, if required, will be obtained within fifteen months thereafter.

CAEATFA FEES

In accordance with CAEATFA Regulations,³ the Applicant has paid CAEATFA an Application Fee of \$10,000 and will pay CAEATFA an Administrative Fee of up to \$325,704.80.

LEGAL QUESTIONNAIRE

In response to the application's Legal Status Questionnaire, the Applicant disclosed that Gene Haas, sole shareholder and President of Haas Automation, Inc., entered a plea of guilty in 2007 for conspiracy to impede and obstruct the Internal Revenue Service (IRS) in its lawful collection of income taxes (18 U.S.C. § 371) pursuant to a plea agreement. The Applicant represents that the charges related to accounting irregularities designed to distort Haas Automation, Inc.'s cost-of-goods-sold in order to reduce the income tax payable by Mr. Haas.

According to a press release from the U.S. Department of Justice, Mr. Haas pleaded guilty to conspiring to defraud the IRS through a scheme orchestrated by Mr. Haas in 2000 and 2001 in which false expenses were put on the Applicant's books in order to reduce Mr. Haas' personal income tax liability. The indictment states that Mr. Haas, along with co-conspirators, created false purchase orders and receiving documents to provide the appearance that the Applicant was purchasing goods. These false purchase amounts were deducted as cost-of-goods-sold on the Applicant's financial records, thereby reducing the reportable net income of the Applicant and Mr. Haas as sole shareholder. The payments for the false purchases were then refunded and deposited into bank accounts other than the Applicant's, including Mr. Haas' personal bank account. Under the plea agreement, Mr. Haas was sentenced to 24 months in prison, of which he served 16 months, was placed on 6 months of supervised released, and was required to pay a fine and all outstanding taxes, plus penalties and interest, a total in excess of \$70 million according to the Department of Justice press release.

Staff has reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. As part of its due diligence, Staff requested additional information on both the legal disclosure and changes that the Applicant had subsequently made. The Applicant

³ California Code of Regulations Title 4, Division 13, Section 10036.

responded to Staff’s initial request for further information by providing this broad and general description of the changes implemented to prevent tax fraud within the Applicant’s organization:

At the time the fraudulent transactions took place we had a single accounting manager who was able to operate alone and without oversight, making fraud difficult to detect. [A replacement controller was brought on] in December 2003 and soon thereafter spearheaded an initiative to clean up the books and our procedures. The company has since bolstered the finance department, including the hiring of a CFO, Financial Analyst and an entire costing department. Where we used to have one person who could control all aspects of a transaction, we now have several. We have set up a system of internal controls, including establishing an appropriate segregation of duties (e.g. requiring that the wiring of money requires two individuals to approve) to reduce the likelihood that fraud could be committed without discovery. In addition, we have upgraded our accounting system to SAP, which offers robust internal control capabilities. Since that time we have been audited by both the IRS and the Franchise Tax Board; no instances of fraud were uncovered by either audit.

Staff requested further details and documentation of the compliance policies and procedures that the Applicant represents have been implemented; however, the Applicant declined Staff’s request for further specific and meaningful information on the responses contained in the Legal Status portion of the Application.

POLICY CONSIDERATIONS AND DISCUSSION

The Applicant’s proposed Project generally would be recommended for approval because it meets the Program’s eligibility criteria and exceeds the scoring requirements; however, in light of the matter of the legal disclosure – and its direct relation to the type of financial assistance provided under the Program – in addition to the Applicant’s lack of full cooperation with providing additional information for Staff to conduct its due diligence, Staff believes additional assurance to protect public resources, the integrity of the Program and ensure the public interest is required. Further discussion of considerations and identifying a balance in policy goals is below.

Based solely on the proposed Project, the Applicant presents a strong case for approval due to the estimated benefits of the Project and its alignment with the goals of the program and statute, to expand opportunities for advanced manufacturing in our State. This program was designed to assist key types of manufacturing projects and job growth in our State, despite California’s recent economic recovery, the manufacturing sector is still struggling and California’s unemployment rate is currently ranked 49 of the 50 states.⁴

In addition, The Project received a score of 5,768 points, which is exceptionally high for any type of project that is reviewed by the Authority. Typically projects approved by the Authority

⁴ Bureau of Labor and Statistics, December 2014.

Agenda Item – 4.A.1
Resolution No. 14-SM024
Application No. 14-SM024

score in the 1,000 to 2,000 point range.⁵ Relative to the amount of Qualified Property requested, the Applicant will be generating significant annual revenues, which in turn flows down to state and local governments in the form of additional taxes and downstream economic activity. The Applicant also anticipates employing 1,235 FTEs for the duration of the Project, which will last for approximately 20 years according to the Application (expected useful life of the equipment). At a time when manufacturing jobs are in decline within the state, these types of jobs can be very valuable by providing high wages. Moreover, according to Haas, it is the largest U.S. based manufacturer of machine tools, and retaining such companies can be a boon to the state's economy and long-term manufacturing sector viability. These factors align with the purposes of the Program as outlined in the statute, which is to: (1) increase quality employment opportunities, (2) encourage economic growth, (3) promote energy and resource efficiency, and (4) encourage advanced manufacturing and the development of emerging technologies in California.

As discussed in the Legal Questionnaire section above, Mr. Haas pled guilty to conspiracy to defraud the government based on actions that occurred almost fourteen years ago, in 2000 and 2001. Since that time, Mr. Haas served his prison sentence and repaid the required taxes and penalties. Company representatives have stated that it has subsequently made substantive modifications to the business structure and controls to avoid future fraud and abuse; it's a major employer in Ventura County,⁶ and local media reports reflect that the Haas Foundation has been active in giving back to the community.

However, one of the purposes of the Legal Status Questionnaire (LSQ) is to assist the State in determining the corporate or business character of the entities it will choose to provide public assistance. The nature of the legal disclosure is directly related to the type of financial assistance that the Program provides; this is exacerbated by the fact that, by design, the Program relies heavily on self-certification to ensure the exclusion is being used in accordance with statute and regulations.⁷ While the Applicant has stated that additional controls have been put in place and there is no reason to believe that Haas Automation, Inc. is not currently in compliance with all tax laws, potential abuse of the award would negate the net benefits test analysis and damage the integrity and efficacy of the Program.

Furthermore, when Staff requested further information and documentation on the issues disclosed in the LSQ, the Applicant rejected the request to provide further information beyond what is quoted in the above Legal Questionnaire section.

⁵ A score of 1,000 points means that the net benefits are just greater than the amount of the sales and use tax exclusion; therefore a score of in the 5,000 point range indicates that the benefits of the Project are approximately five times greater than the cost of the sales and use tax exclusion.

⁶ CA Employment Development Department,
<http://www.labormarketinfo.edd.ca.gov/majorer/countymajorer.asp?CountyCode=000111>

⁷ The application; reported Qualified Property purchase amounts; and the annual job, sales, and project information used to report to and inform the Legislature on the efficacy of the Program are all self-certified by applicants. An approved applicant could purchase equipment using the exclusion and fail to either report the purchase or provide an inaccurate purchase amount, potentially increasing the amount of sales and use tax avoided beyond what CAEATFA approved. Abuse of the award could negate the net benefits test analysis and damage the integrity and efficacy of the Program.

In evaluating the various policy goals and circumstances of this Application, Staff has grappled with finding a balanced approach. On one hand, the Applicant, which is one of the leaders in its industry, proposes to make significant capital investments for its Project that is anticipated to last approximately twenty years and create a significant number of jobs, consistent with the purposes of the Program. On the other hand, Mr. Haas' past legal violations represent the type of actions that the LSQ seeks to disclose and are directly related to the type of financial assistance the Program provides. The Executive Director, in consultation with legal counsel, has determined that to address the various policy goals, it is reasonable to approve the Application with additional conditions to appropriately safeguard and protect taxpayer dollars to reflect the unique circumstances of this application.

RECOMMENDATION

Staff conditionally recommends approval of Resolution No. 14-SM024 for Haas Automation, Inc.'s purchase of Qualified Property in an amount not to exceed \$81,426,200 anticipated to result in an approximate sales and use tax exclusion value of \$6,856,086, subject to the following conditions, which will be included in the Master Regulatory Agreement between the Authority and the Applicant:

1. The Applicant must select and pay for a third party auditor, subject to the approval of the Authority, to conduct an audit at least annually pursuant to an agreed-upon procedures engagement, also subject to the approval of the Authority, that will among other things verify that the Qualified Property purchases included in reports submitted to the Authority are located at the Project locations. The third party audit will last for the duration of the initial term of the award (three years), plus one additional year to cover all reports submitted to the Authority.
2. The Applicant must acquire and pay for a surety bond for the amount of the sales and use tax exclusion award plus 5% to reimburse the State of California if any of the conditions of the Master Regulatory Agreement are violated. The terms of the surety bond shall be subject to the approval of the Authority.

Alternatively, the Applicant may submit a more detailed explanation and representation of its internal controls and measures to prevent tax fraud, by providing documentation of the following:

- a. A description of the business structure;
- b. A description of internal controls put in place;
- c. A list of new staff positions and a description of each position's duties and responsibilities;
- d. Copies of audits; and
- e. Copies of internal policies and procedures regarding invoicing, purchasing, and accounting.

Agenda Item – 4.A.1
Resolution No. 14-SM024
Application No. 14-SM024

Any documentation submitted by the Applicant will be subject to the review of the Authority. Staff's findings may be presented to the Board for further consideration before a Master Regulatory Agreement may be finalized, and if not satisfied, the Authority may ultimately require the surety bond noted above.

3. The clawback provisions allowing the Authority to recover Financial Assistance used by the Applicant is expanded to include violation of the Master Regulatory Agreement and providing false or misleading information in the application or any report as grounds for recovery of Financial Assistance.
4. The Applicant must submit a quarterly report of the purchases made using the sales and use tax exclusion. This report will require the same information that is normally required in an Applicant's Semi-Annual report, with the only difference being the frequency of the reporting.
5. The Applicant must comply with all applicable local, state and federal laws and regulations during the term of the Master Regulatory Agreement.

**RESOLUTION APPROVING AND AUTHORIZING EXECUTION OF A MASTER
REGULATORY AGREEMENT WITH HAAS AUTOMATION, INC.**

March 17, 2015

WHEREAS, the California Alternative Energy and Advanced Transportation Financing Authority (the “Authority” or “CAEATFA”) has received the Application of **Haas Automation, Inc.** (the “Applicant”), for financial assistance in the form of a master regulatory agreement (the “Agreement”) regarding tangible personal property utilized in an Advanced Manufacturing process or for the design, manufacture, production or assembly of Advanced Transportation Technologies or Alternative Source products, components, or systems (“Qualified Property”) as more particularly described in the staff summary and in the Applicant’s Application to the Authority (collectively, the “Project”); and

WHEREAS, the Applicant has requested the Authority to enter into the Agreement to acquire Project equipment with an estimated cost not to exceed \$81,426,200 over a period of three years; and

WHEREAS, the Applicant believes that this form of financial assistance will enable it to avail itself of the benefits of an exclusion from sales and use taxes relative to the Qualified Property pursuant to California Revenue and Taxation Code Section 6010.8; and

WHEREAS, approval of the terms of the Agreement and authority for the Executive Director, Deputy Executive Director, or Chair of the Authority to execute the necessary documents to effectuate the Agreement is now sought;

NOW, THEREFORE, BE IT RESOLVED by the California Alternative Energy and Advanced Transportation Financing Authority, as follows:

Section 1. The Project constitutes a “project” within the meaning of Public Resources Code Section 26003(a)(8)(B).

Section 2. The requested master regulatory agreement constitutes “financial assistance” within the meaning of Public Resources Code Section 26003(a)(6).

Section 3. The Applicant is a “participating party” within the meaning of Public Resources Code Section 26003(a)(7).

Section 4. The Executive Director, Deputy Executive Director, or Chair of the Authority (the “Authorized Signatories”) are hereby authorized for and on behalf of the Authority to approve any changes to the Project as the Executive Director shall deem appropriate, provided that the amount of the Qualified Property to be purchased may not be increased above the amount approved by the Authority.

Agenda Item – 4.A.1
Resolution No. 14-SM024
Application No. 14-SM024

Section 5. The standard form of the Agreement between the Applicant and the Authority typically utilized by the Authority is hereby approved with the recommended changes set forth as conditions one through five in the staff recommendation on this matter. The Authorized Signatories are hereby authorized and directed, for and on behalf and in the name of the Authority, to execute, acknowledge and deliver to the Applicant the Agreement in substantially the form filed with or approved by the Authority including the recommended changes set forth as conditions one through five in the staff recommendation on this matter, The Authority understands and agrees that pursuant to the terms of the Agreement, the obligations of the Applicant may, under some circumstances, be carried out or assumed by a successor or assignee entity, or by an affiliate of the Applicant.

Section 6. Each of the Authorized Signatories, acting alone, is hereby authorized and directed to do any and all ministerial acts, including (without limitation) the execution and delivery of any and all documents and certificates they may deem necessary or advisable in order to consummate the Agreement and otherwise effectuate the purposes of this Resolution.

Section 7. The Applicant shall assure CAEATFA that all Qualified Property listed in the quarterly reports pursuant to the Agreement shall be installed, maintained and operated in compliance with all applicable local, state and federal laws.

Section 8. The Agreement shall only apply to Qualified Property that the Applicant certifies will be installed, maintained and operated at facilities within the State of California.

Section 9. The adoption by the Authority of this Resolution for the Applicant shall not be referred to in any application before any governmental agency as evidence of the feasibility, practicality or suitability of the Project or in any application for any required permission or authority to acquire, construct or operate the Project.

Section 10. This Resolution is effective immediately and will remain in full force and effect unless the Regulatory Agreement, as defined in CAEATFA Regulations Section 10035(a), is not executed within thirty (30) days of the date of this Resolution. The Executive Director may extend the thirty days if necessary.

Section 11. The Applicant shall select and pay for a third party auditor, subject to the approval of the Authority, to conduct an audit at least annually pursuant to an agreed-upon procedures engagement, also subject to the approval of the Authority, that will among other things verify that the Qualified Property purchases included in reports submitted to the Authority are located at the Project locations. The third party audit will last for the duration of the initial term of the award, plus one additional year to cover all reports submitted to the Authority.

Section 12. The Applicant shall either: (1) acquire a surety bond, the terms of which shall be subject to the approval of the Authority, for the amount of the sales and use tax exclusion award plus 5% to reimburse the State of California if any of the conditions of the Master Regulatory Agreement are violated, or (2) submit a more detailed explanation and representation

Agenda Item – 4.A.1
Resolution No. 14-SM024
Application No. 14-SM024

of its internal controls and measures to prevent tax fraud, by providing documentation the following: (a) a description of the business structure; (b) a description of internal controls put in place; (c) a list of new staff positions and a description of each position's duties and responsibilities; (d) copies of audits; and (e) copies of internal policies and procedures regarding invoicing, purchasing, and accounting. Documentation submitted by the Applicant, pursuant to subsection (2) of this section, shall be reviewed by the Authority, and the findings of the Authority's review may be presented to the Authority Board for consideration at a future meeting date before entering into a Regulatory Agreement with the Applicant.

Section 13. The Applicant shall submit a quarterly report of the purchases made using the sales and use tax exclusion. This report will require the same information that is normally required in an Applicant's Semi-Annual Report.