

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

*Consideration of E&J Gallo Winery's Request to Approve a Time Extension for the Three
Year Initial Term of the Title Conveyance Agreement¹*

**E&J Gallo Winery
Application No. 14-SM007**

May 16, 2017

Prepared By: *Ellen Hildebrand, Analyst*

SUMMARY

Applicant – E&J Gallo Winery

Location – Livingston, Merced County

Industry – Biogas Capture and Production

Project – New Biogas Capture and Production Facility (Alternative Source)

Value of Qualified Property – \$17,592,381

Estimated Sales and Use Tax Exclusion Amount² – \$1,481,278

Amount of Time Requested:

- One year, until May 20, 2018, for the Term of the Master Regulatory Agreement (four years from the date of initial CAEATFA Board approval)

SUMMARY

In May 2014, the CAEATFA Board approved a sales and use tax exclusion (“STE”) for E&J Gallo Winery (“E&J Gallo” or the “Applicant”) for the purchase of \$17,592,381 of Qualified Property for the construction of an anaerobic digestion facility (the “Project”). The Master Regulatory Agreement (“Agreement”) initial term provided the Applicant with three years from the date of Board Approval to utilize its STE award. The initial term of the Agreement can be extended by the Board upon a finding that an extension is in the public interest and advances the purposes of the program.³

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%.

³ The provision of the regulations allowing CAEATFA to waive the requirement that all purchases of Qualified Property be made within three years of Application approval is in Regulation Section 10035(b)(1)(A).

As of January 30, 2017, E&J Gallo has used the STE to purchase \$13,170,732 of Qualified Property (75% of the total Qualified Property approved). E&J Gallo requested an extension of the Agreement initial term by one year to accommodate technical delays. The Applicant states that they have encountered several technical delays related to their High Rate Anaerobic Digester and Low Rate Anaerobic Digester. Neither digester performed as anticipated during initial start-up and testing, and some equipment needed to be redesigned. E&J Gallo has since begun to operate the facility and is continuing to install equipment to improve its performance. This equipment has been ordered and delivery and commissioning is scheduled for Q2 and Q3 of 2017. E&J Gallo anticipates that the equipment will be fully operational by Q1 2018.

About the Applicant

E&J Gallo Winery was founded in 1933 in Modesto, California, and is the world's largest, family-owned winery and the largest exporter of California wines.

Project Description

E&J Gallo is in the process of designing and building the Livingston Water Innovation and Energy (LWINE) Facility that will be comprised of an anaerobic digester system and two 1 MW engines that will send power to the LWINE facility and adjacent E&J Gallo facilities. The Project will convert 158 million gallons per year of waste water and 47,250 tons of grape pomace into biogas that will be used to generate electricity and heat. The Applicant represents that the engines will provide enough energy to cover 50 percent of the E&J Gallo Winery's annual electrical load. There will also be substantial byproducts from the process, including the treatment of 158 million gallons of winery waste water effluent for use in vineyard irrigation and compostable material and organic fertilizer.

Consistent with CAEATFA policy, the Qualified Property in this Application will be used to manufacture biogas and it also includes a portion of the 2 MW power generation equipment used to power the facility. The Project's equipment will consume 45 percent of the total amount of energy generated, therefore 45 percent of the power generation equipment is eligible for an STE under the Program. However, the remaining 55 percent of the power generation equipment was not included in the Application as this represents the proportion of electricity that will be sold to the grid.

Agreement Term Extension Request

E&J Gallo has requested that the initial term of the Agreement be extended from May 20, 2017 to May 20, 2018 to accommodate technical development delays in the Project timeline.

Staff Evaluation

E&J Gallo has indicated that though their Project experienced technical delays, they expect to install the remaining equipment in 2017 and become fully operational in Q1 2018. Because many STE Projects involve cutting edge technology, it is not uncommon for Projects to

experience technical delays. Because E&J Gallo has ordered the remaining equipment and anticipates that the facility will be fully operational in Q1 2018, staff believes that extending the term of the Agreement will allow for the Project to be completed, and is therefore in the public interest and advances the purpose of the program.

Fees

In accordance with CAEATFA Regulations,⁴ the Applicant will pay an Additional Administrative Fee of \$500 because extending the initial term requires a modification to the Applicant's Master Regulatory Agreement.

Staff Recommendation

Staff recommends that the Board approve E&J Gallo Winery's request to extend the initial term of the Agreement by one year to May 20, 2018 as it is in the public interest and advances the purpose of the program.

Attachments

Attachment A: E&J Gallo Winery's Letter Requesting Waiver (April 24, 2017)

Attachment B: E&J Gallo Winery's Staff Summary at Time of Approval.

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

**A RESOLUTION OF THE
CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION
FINANCING AUTHORITY APPROVING A TIME EXTENSION FOR
E&J GALLO WINERY'S INITIAL TERM FOR THE MASTER REGULATORY
AGREEMENT**

May 16, 2017

WHEREAS, on May 20, 2014 the California Alternative Energy and Advanced Transportation Financing Authority (the "Authority"), a public instrumentality of the State of California, approved a Sales Tax Exclusion ("STE") in the amount of \$17,592,381 of Qualified Property for **E&J Gallo Winery** (the "Applicant"); and

WHEREAS, within three years of the approval by the Authority, the Applicant must make all purchases of the total amount of Qualified Property listed in the approval resolution (Regulations Section 10035(b)(1));

WHEREAS, upon a finding that it is in the public interest and advances the purposes of the Program, the Authority may waive the requirement that all purchases of Qualified Property be made within three years of Application approval (Regulations Section 10035(b)(1)(A));

WHEREAS, the Applicant has requested a waiver of the requirement to purchase all of the Qualified Property within three years, due to unexpected delays in the Project timeline, extending the term by one year to May 20, 2018;

WHEREAS, granting the waiver will allow the Project to proceed and the state to receive the anticipated environmental and economic benefits that justified the initial approval of the Project in accordance with the law, thereby advancing both the public interest and the purposes of the Program.

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

Section 1. The Authority finds that it is in the public interest and advances the purposes of the Authority to extend the initial term of the Agreement to May 20, 2018.

Section 2. This resolution shall take effect immediately upon its passage.

Attachment A: E&J Gallo Winery's Letter Requesting Waiver (April 24, 2017)



E. & J. GALLO WINERY

April 24, 2017

Deana J. Carrillo
Executive Director, CAEATFA
915 Capitol Mall Room 457
Sacramento, CA 95814
caeatfa@sto.ca.gov

RE: SB71 Alternative Source and Advanced Transportation Manufacturing Sales and Use Tax Exclusion Program – Three –Year Purchase Requirement Compliance for E&J Gallo Winery

Dear Ms. Carrillo,

E&J Gallo Winery (the "Company") would like to formally request a one-year extension of time to complete purchasing Qualified Property per our Master Regulatory Agreement under the SB 71 Sales and Use Tax Exclusion Program.

The Company has begun operating the facility and is continuing to install equipment to improve the performance for energy production. The Company is currently installing two equipment centers (Dissolved Air Flootation (DAF) and a Decanter) for solids removal.

- We have issued Purchase Orders to acquire and install these units.
- Delivery and commissioning of this equipment is scheduled for the 2nd and 3rd quarter of 2017.
- We anticipate the equipment to be fully operational by 1st quarter 2018.

Unfortunately we have encountered several delays during our construction, start-up and testing process which have extended our project completion timeline:

- **High Rate Anaerobic Digester (HRAD)**
 - Initial design of HRAD had an average design TSS (Total Suspended Solids) of 1200
 - Original testing showed TSS in ranges of 600 to 1300
 - During start up found TSS in range of 200 to 20,000+
 - Installed step screen, rotary screen, settling tank on infeed
 - Identified that TSS needs to be less than 800 in order to keep the Anaerobic system functioning (not lose the anaerobic bacteria out of top of the system)
 - Now including Dissolved Air Flootation (DAF) in order to reduce TSS on infeed and be able to feed system at rate
- **Low Rate Anaerobic Digester (LRAD) had issues with the feed system**
 - Identified during initial start-up: unable to feed the system at the design rate (% solids) because the Vendor did not properly test the system
 - Original grinding and feeding equipment did not work properly

- Vendor proposed changes to the system
- Vendor went Bankrupt (Out of Germany) before implementing changes
- Gallo redesigned feed and grinding system
- Gallo testing new systems and will continue to evaluate the modifications
- Feed to solids management system did not reduce the solids adequately
- Installing equipment to reduce these solids to a level that allows for proper solids removal.

- **Other Equipment Integration and Commissioning Challenges**

- Biogas treatment: Biogas Dewatering, Biosulferix tank level control, Carbon filter
- Flare operation: Meeting specifications for local air district
- Generator start up: Syncing to the grid, air emission issues due to NoX control items (ammonia feed system),
- Aerobic system start up (losing the integrity of the Anoxic tank),

If additional information or clarification is required, please contact Business Manager Edward Jackson at (209) 341-5593 or edward.jackson@ejgallo.com or Engineering Project Manager Tom O'Donnell at (209) 613-1905 or tom.odonnell@ejgallo.com.

Respectfully,



Michael Roland
Vice President, Engineering

Cc: Edward Jackson @ edward.jackson@ejgallo.com
Tom O'Donnell @ tom.odonnell@ejgallo.com
Ellen Hildebrand @ ehildebrand@sto.ca.gov

Attachment B: E&J Gallo Winery’s Staff Summary at Time of Approval

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

Request to Approve Project for Sales and Use Tax Exclusion (STE)⁵

**E&J Gallo Winery
Application No. 14-SM007**

Tuesday, May 20, 2014

Prepared By: *Alejandro Ruiz*

SUMMARY

Applicant – E&J Gallo Winery

Location – Livingston, Merced County

Industry – Biogas Capture and Production

Project – New Biogas Capture and Production Facility

Value of Qualified Property – \$17,592,381

Estimated Sales and Use Tax Exclusion Amount⁶ – \$1,481,278

Estimated Net Benefits – \$24,432

Application Score⁷ –

Fiscal Benefits Points:	771
<u>Environmental Benefits Points:</u>	<u>246</u>
Net Benefits Score:	1,016
<u>Additional Benefits Points:</u>	<u>110</u>
Total Score:	1,126

Staff Recommendation – Approval

⁵ All capitalized terms not defined in this document are defined in the Program’s statute and regulations.

⁶ This amount is calculated based on the average statewide sales tax rate of 8.42%.

⁷ Point values in the staff summary may not add up correctly due to rounding in the Application worksheet.

THE APPLICANT

E&J Gallo Winery (“E&J Gallo” or the “Applicant”) was founded in 1933 in Modesto, California. E&J Gallo is the world’s largest, family-owned winery and the largest exporter of California wines.

The major shareholders (10.0% or greater) of E&J Gallo Winery are:

Dry Creek Corporation

The corporate officers of E&J Gallo Winery are:

Joseph Gallo – CEO & President
Robert Gallo – Co-Chairman of the Board
James Coleman – Co-Chairman of the Board

THE PROJECT

E&J Gallo is designing and building the Livingston Water Innovation and Energy (LWINE) Facility that will be comprised of an anaerobic digester system and two 1 MW engines that will send power to the LWINE facility and adjacent E&J Gallo facilities (the “Project”). The Project will convert 158 million gallons per year of waste water and 47,250 tons of grape pomace into biogas that will be used to generate electricity and heat. The Applicant represents that the engines will provide enough energy to cover 50 percent of the E&J Gallo Winery’s annual electrical load. There will also be substantial byproducts from the process, including the treatment of 158 million gallons of winery waste water effluent for use in vineyard irrigation and compostable material and organic fertilizer.

Consistent with CAEATFA policy, the Qualified Property in this Application will be used to manufacture biogas and it also includes a portion of the 2 MW power generation equipment used to power the facility. The Project’s equipment will consume 45 percent of the total amount of energy generated, therefore 45 percent of the power generation equipment is eligible for an STE under the Program. However, the remaining 55 percent of the power generation equipment is not included in this Application as this represents the proportion of electricity that will be sold to the grid.

ANTICIPATED COSTS OF QUALIFIED PROPERTY

The anticipated Qualified Property purchases are listed below:

Influent Pump Station (2 Pumps)	\$ 182,145
Pretreatment and High Rate Anaerobic Digester System	3,296,806
Low Rate Anaerobic Digester System	4,017,550
Digestate Solids Handling	2,238,496
Biogas Handling	1,560,757
Generators (45% of total cost)	1,260,775
Switchgear (45% of total cost)	253,241
Aerobic Treatment System	2,989,692
Pond & Pump Station	1,161,680
Equipment structure and enclosure	631,239
Total	<u>\$17,592,381</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 the Project conceptualization, design and planning began in 2012. The site preparation and construction, including laying concrete foundations and building physical infrastructure, began in 2013. In 2014, the anaerobic digestion system components will be built, with the entire facility completed by the end of 2014.

PROJECT EVALUATION

NET BENEFITS

The total cost of the Qualified Property purchases is anticipated to be \$17,592,381 and the total net benefits are valued at \$24,432 for the Project. The Project received a Total Score of 1,126 points, which exceeds the required 1,000 point threshold and a total Environmental Benefits Score of 246 points, which exceeds the 100 point threshold.

- A. **Fiscal Benefits (771 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 \$1,142,019 resulting in a Fiscal Benefits score of 771 points for the Project.

- B. Environmental Benefits (246 points).** The Project will result in \$363,691 of total pollution benefits over the life of the Facility resulting in an Environmental Benefits Score of 246 points for the Project. These benefits derive from displacing the use of fossil fuel through the production of biogas and the avoidance of emissions that would otherwise be produced if the grape pomace was sent to a landfill to decompose.
- C. Additional Benefits (110 points).** Applicants may earn additional points for their Total Score. The applicant submitted information and received 110 additional points.
- 1. Permanent Jobs (20 of 75 points).** The Applicant's Project will support a total of seven permanent jobs at its Facility. CAEATFA estimates that approximately one 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 20 points for the Project.
 - 2. Construction Jobs (40 of 75 points).** The Applicant's Project will support a total of 38 construction jobs at its Facility. CAEATFA estimates that approximately six of these jobs will be attributable to a marginal increase in jobs created due to the approved STE resulting in a Construction Jobs Score of 40 points for the Project.
 - 3. Unemployment (50 of 50 points).** The Applicant's Project is located in Merced County which has an average annual unemployment rate of 15%. This is above 110% of the average annual statewide unemployment rate which is currently 8.8% resulting in an Unemployment Score of 50 points for this Project.

STATUS OF PERMITS/OTHER REQUIRED APPROVALS

All necessary permits for construction and operation are now in place.

LEGAL QUESTIONNAIRE

Staff reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. The responses did not disclose any information that raises questions concerning the financial viability or legal integrity of this Applicant.

CAEATFA FEES

In accordance with CAEATFA Regulations,⁸ the Applicant has paid CAEATFA an Application Fee of \$10,000 and will pay CAEATFA an Administrative Fee of up to \$70,369.

RECOMMENDATION

Staff recommends approval of Resolution No. 14-SM007 for E&J Gallo Winery's purchase of Qualified Property in an amount not to exceed \$17,592,381 anticipated to result in an approximate sales and use tax exclusion value of \$1,481,278.

⁸ California Code of Regulations Title 4, Division 13, Section 10036

RESOLUTION APPROVING AND AUTHORIZING EXECUTION OF A MASTER REGULATORY AGREEMENT WITH E&J GALLO WINERY

May 20, 2014

WHEREAS, the California Alternative Energy and Advanced Transportation Financing Authority (the “Authority” or “CAEATFA”) has received the Application of **E&J Gallo Winery** (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 \$17,592,381 over a period of 3 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.

Section 5. The proposed form of the Agreement between the Applicant and the Authority, as filed with the Authority prior to this meeting, is hereby approved. The Authorized Signatories

Agenda Item 4.B.2

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, with such insertions, deletions or changes therein as the Authorized Signatory executing the same may require or approve, and with particular information inserted therein in substantial conformance with the staff summary and in the Applicant's Application to the Authority, such approval to be conclusively evidenced by the execution and delivery thereof. 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 semi-annual 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.