CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE

[PROPOSED] NOTICE OF DECISION ON PETITION FOR ADOPTION OF REGULATION

Petitioner:

John R. Valencia, on behalf of an unnamed California-headquartered life sciences corporation.

Proposal affecting:

California Code of Regulations, Title 17.

Authority to adopt regulation:

Health & Safety Code section 125290.40, subdivision (j).

Agency contact:

Tamar Pachter, General Counsel.

Availability of petition:

The petition is available on the CIRM website at www.cirm.ca.gov, as a link to the Agenda for the March 12, 2008 meeting of the Independent Citizens' Oversight Committee, item number 13, and on request to the agency's contact person at tpachter@cirm.ca.gov or at 210 King Street, San Francisco, CA 94107.

Statement of reasons supporting determination:

INTRODUCTION AND SUMMARY OF DETERMINATION

The petitioner urges the adoption of a regulation that would define "California supplier" under Health & Safety Code section 125290.30, subdivision (i). That subsection provides:

> The ICOC shall establish standards to ensure that grantees purchase goods and services from California suppliers to the extent reasonably possible, in a good faith effort to achieve a goal of more than 50 percent of such purchases from California suppliers.

Staff recommends that the Independent Citizen's Oversight Committee (ICOC), CIRM's governing board, deny the petition. Existing regulation in the CIRM Grants Administration Policy is adequate to carry out the lawful purposes of section 125290.30,[1]

[1] All further statutory references are to the Health & Safety Code, unless otherwise noted.

subdivision (i). The proposed regulation is not likely to further the economic expansion goals of Proposition 71, and could violate the Commerce Clause of the United States Constitution. An appropriate definition for California supplier, if one is necessary, can and should be determined as part of a larger reconsideration of the GAP, which is ongoing by CIRM staff.

DISCUSSION

Petitioner's Proposal and Arguments

Petitioner urges the ICOC to adopt a highly restrictive definition of "California supplier," specifically:

> [W]henever referenced, "California Suppliers" means (a) a sole proprietorship, partnership, joint venture, corporation, or other business entity the owner(s) or policymaking officer(s) of which are domiciled in California and (b) whose permanent, principal office or place of business is located in California and (c) from which the supplier's trade or business is directed or managed.

Petitioner makes several arguments in support of the proposal:

- there is a statutory obligation for the ICOC to adopt a definition of the term "California supplier";
- the preference for California suppliers is a mandate that is necessary to achieve the stated goals of the initiative and the will of the voters who approved it;
- the specific definition proposed is consistent with the goal of advancing California's economic interests; with the statutory definition of "life science commercial entity" in section 125292.10, subdivision (o); with the Legislative Analyst's analysis of the fiscal impact of Proposition 71, as presented to the voters; and with the ballot arguments in favor of the initiative (and conversely, failure to adopt the specific definition proposed would result in failing to meet these goals and expectations); and
- California companies can provide the goods and services needed to conduct CIRM-funded research.[2]

CIRM has carefully considered these arguments and rejected them as a basis for adopting the proposed regulation, as follows.

[2] Petitioner also argues about the inadequacy of the statutory standard requiring purchases from California suppliers "to the extent reasonably possible, in a good faith effort" to achieve the goal. The regulation proposed, however, does not address these concerns.

CIRM's Analysis and Response

1. The ICOC Has Adopted a Regulation Establishing a Preference for California Suppliers

The ICOC has carried out its statutory obligation under section 125290.30, subdivision (i), to establish a standard for a preference for California suppliers. The CIRM Grants Administration Policy for Academic and Non-profit Institutions (GAP) is codified at Title 17 California Code of Regulations section 100500. The Grants Administration Policy for For-profit Organizations has just begun the rulemaking process, but incorporates by reference the relevant provisions of the GAP. Specifically, section III(C)(10) of the GAP provides in relevant part:

> It is a goal of Proposition 71 that more than 50 percent of the goods and services used in CIRM-supported research is purchased from California suppliers (Health & Safety Code section 125290.30, subpart (i)). To achieve this goal, CIRM expects the grantee to purchase from California suppliers, to the extent reasonably possible, the goods and services it uses in its CIRM-supported research. The grantee must provide a clear and compelling explanation in its annual programmatic report for not purchasing more than 50 percent of its goods and services from California suppliers. . . . .

There is no statutory obligation to further define California supplier.

2. The Preference is a Goal, and Achievement of that Goal Does Not Require Adopting a Restrictive Definition of California Supplier

As petitioner notes, the purposes of Proposition 71 include generating new tax revenues, advancing the biotech industry in the state, and improving the state's health care system. The preference for California suppliers is not a "mandate" as petitioner suggests, but a goal. The achievement of all these goals is not dependent on adopting a particular definition of "California supplier." As stated therein, the intent of Proposition 71 was to accomplish these goals "through the development of therapies that treat diseases and injuries with the ultimate goal to cure them." It is the research itself that is the focus of the initiative and that is expected to be the engine in the achievement of these goals. There is no evidence that the will of the voters would be stymied if grantees are not restricted to the types of California suppliers petitioner proposes.

3. The Proposed Definition of California Supplier Is Not Analogous to Other Geographical Restrictions in Proposition 71

The specific definition proposed may be consistent with other geographical restrictions found in Proposition 71, but is not analogous to those provisions. The requirement that members of the Facilities Working Group be real estate specialists who are California residents is designed to insure that the working group has the necessary

expertise in the California real estate market; it is not designed to generate income for these specialists, who earn only a nominal per diem. Similarly, the definition of a "life science commercial entity" determines the qualifications of members appointed to serve on the ICOC, who also earn just a nominal per diem in exchange for service. The prevailing wage requirement for workers paid pursuant to a CIRM-funded facilities grant does not discriminate against out of state workers, it simply requires payment of a prevailing wage for all workers regardless of residence. Neither the Legislative Analyst's ballot analysis nor the ballot arguments in favor of the initiative depend on restricting the definition of California supplier as petitioner has suggested; these analyses rely on all kinds of "indirect" benefits to the economy from funding research within the state.

4. The Proposed Definition of California Supplier Is Not Necessary to Fulfill Either the General Economic Goals of Proposition 71 or the Specific Requirements of the Preference for California Suppliers.

Petitioner fails to consider that one of the purposes of Proposition 71 was to attract new researchers, new institutions and new businesses to the state to increase the ability of the state to generate new revenue. To create new tax revenue and new jobs it is not necessary to restrict the definition of California supplier to those companies that are headquartered in California, whose principals are residents of California, and whose operations are directed from within the state. These kinds of indirect benefits can also be achieved by including any supplier that makes sales taxable in California, that pays income tax in California, that employs California residents, or that has a brick and mortar presence in California. These kinds of California suppliers also contribute indirect economic benefits to the state. It is for this reason that the ICOC has awarded research grants to out of state institutions and investigators that are willing to perform CIRM-funded research in California. Restricting the definition of California supplier as petitioner suggests would not necessarily increase the new revenue available to the state. There is nothing peculiar to residency in California that predicts a supplier's economic contribution to the State of California.

5. The Proposed Definition of California Supplier May Not Survive a Facial Constitutional Challenge Under the "Dormant" Commerce Clause.

The definition of California supplier that petitioner proposes is not only unnecessary to achieve the goals of Proposition 71 and the preference for California suppliers, it may constitute a facial violation of the Commerce Clause of the United States Constitution. In *Granholm v. Heald*, 544 U.S. 460, 472 (2005), the Supreme Court explained:

> Time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." [Citations omitted.] This rule is essential to the foundations of the Union. The mere fact of nonresidence should not foreclose a producer in one State from access to markets in

> other States. [Citations Omitted.] States may not enact laws that burden out-of-state producers or shippers simply to give a competitive advantage to in-state businesses. This mandate "reflect[s] a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." [Citations omitted.]

The Ninth Circuit U.S. Court of Appeals similarly held in *Conservation Force, Inc. v. Manning*, 301 F.3d 985, 995 (9th Cir. 2002), that:

> A state discriminates against interstate commerce by treating differently in-state and out-of-state economic interests, including consumers of natural resources, such that the regulation benefits the former and burdens the latter. . . . Where discrimination exists, the regulation is subject to strict scrutiny under which it is the state's burden to show that the discrimination is narrowly tailored to further a legitimate interest. [Citations omitted.]

The regulation petitioner proposes would require CIRM grantees to discriminate against out of state residents in favor of in state residents. As earlier shown, this discrimination would not appear to serve any legitimate state interest, and may therefore violate the Commerce Clause. For this reason as well, CIRM declines to open a rule making proceeding to adopt the proposed regulation.

CONCLUSION AND [PROPOSED] DECISION

CIRM appreciates the interest and concern expressed in the petition and the motivation behind it to ensure the benefits of Proposition 71 to all Californians. CIRM agrees with petitioner that California suppliers will be able to provide a great majority of the goods and services needed by grantees, but disagrees about what the definition of those suppliers should be in order to carry out the intent of Proposition 71.