

Trade Group Seeks Audits Of City Hall Tidelands Fund Moves

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A leading trade group is alleging that Long Beach City Hall violated its responsibilities as a state trustee over the city's port and tidelands by conducting back-room maneuvering in recent efforts to increase the amount of tidelands and Port of Long Beach-generated funds City Hall controls.

In the January 25 filing, the Pacific Merchant Shipping Association (PMSA) asked the California State Lands Commission (SLC) to use the agency's oversight powers to "police the actions" of City Hall in regards to the city's state-granted role as trustee of the port and the city tidelands.

"The Port of Long Beach is a public trust that by California law has to be managed for the benefit of all Californians," PMSA President John McLaurin said.

"We want to make sure that the activities undertaken in regards to public trust tidelands by city officials are taken with appropriate deference to the city's public trust obligations."

The trade group – which represents about 90 percent of the shipping lines and terminal operators serving West Coast ports – requested that the SLC investigate and perform audits of: a recent tidelands oil deal between the city and Occidental Petroleum (Oxy); the way City Hall officials placed Measure D on the November 2010 ballot; and, all the activities of the Long Beach Gas and Oil Department (LBGO) related to the tidelands.

The PMSA alleges that City Hall, in taking these actions, engaged in "a pattern and practice of behind-the-scenes activities" and breached its "fiduciary duty owed the people of the State of California and in violation of the Public Trust Doctrine."

"The concern is that the Port of Long Beach is simply being treated as an ATM machine by the city for purposes totally unrelated to the Tidelands Trust and the responsibilities of the city to the trust," McLaurin said.

In the 142-page filing, which includes 131 pages of City Hall e-mails obtained under the California Public Records Act, the PMSA also called on the SLC to investigate and perform an audit of the city's Tidelands Operating Fund.

McLaurin said that an audit of the Tidelands Fund is the only way to "ensure that the expenditures from that account are being used for state trust purposes."

The PMSA also believes that at the heart of the case is an issue of transparency on the part of Long Beach.

"I think everybody in the State of California needs to know what tideland funds are being spent on," McLaurin said.

The Long Beach Business Journal has also verified that despite a more than 50-year-old California statute requiring the state auditor to conduct an annual audit of the Long Beach Tidelands Operating Fund, no state audit has been conducted of the fund in at least 17 years.

The Oxy Deal

One of the City Hall actions that the PMSA is asking the SLC to investigate is an oil deal between the city and Oxy that was signed in November 2009.

"We have significant questions about the Oxy deal and Measure D and how these things were undertaken without any detailed analysis of the financial, economic or public trust impacts," McLaurin said.

The deal originated in a 2006 proposal from Oxy to the city that would see the oil firm invest in new oil production in the harbor tidelands area in exchange for a share in the profits of any new oil production generated. Oxy argued that the incentive for additional profit would justify additional investment above what Oxy was spending under its existing contract with the city. This would in turn increase oil production and also the city's cut of the oil profits.

"Without ongoing capital infusion, the oil production will decline and [the city] may not be able to withstand the next downturn in oil prices," LBGO Manager of Oil Operations Curtis Henderson told port officials in an April 2009 e-mail.

Under the previous city contract with Oxy, the port received about 95 percent of the profits from the roughly 450 existing oil wells tapping city-owned reserves while the city received about 5 percent.

The new contract, which took effect January 1, 2010, split profits from any new production between City Hall and Oxy, with no money going to the port. The city receives 51 percent of these new profits while Oxy receives 49 percent. The lions share of these new profits for the city will go to the City Hall-managed Tidelands Operating Fund, with a nominal amount going to the General Fund.

Because the new contract hinged on the difference between existing and future oil production, a critical step in formulating the new contract was to determine exactly what the existing wells would produce in the future. Oxy proposed using an estimate of what is called the base production amount.

In 2007, the SLC, LBGO, and Oxy formed a team to work on developing a base production estimate for the existing wells.

During the eight-month course of the team's work, the SLC participants grew dissatisfied. In an October 2009 letter to LBGO's

Henderson, a senior SLC official explained, “The SLC did not fully agree with the methodology used by the [team] to forecast future production from the [existing wells].” After the team released its findings, the SLC decided to develop a separate estimate in partnership with the port, which had already been looking to develop its own base estimate.

An April 2009 e-mail from port Chief Financial Officer Sam Joublat to LBGO’s Henderson explained the port’s reason for seeking a second base production estimate.

“It is [the port’s] fiduciary responsibility to get an independent appraisal of our asset before we sell to Oxy,” Joublat wrote.

The SLC and the port eventually came up with their own estimate, while Oxy and LBGO remained supportive of the first estimate.

The problem was that the two estimates, each based on their own methodology, varied greatly. Port documents suggested that the Oxy-supported estimate was 62-percent lower than the SLC/port estimate.

“Since Oxy is proposing to split profits over the existing reserves, then the lower the existing reserve (the base amount), the higher the amount they will split,” wrote the port’s Joublat in a March 2009 e-mail to port senior executives.

Over the vehement objections of the port and the SLC, City Hall eventually accepted the much lower Oxy estimate. Nonetheless, the Long Beach City Council approved the deal supported by Oxy and LBGO.

Port officials at the time estimated the lower base amount would result in shifting as much as \$150 million in potential port profits over 10 years to the city. Based on the average annual port oil profits over the past 10 years – about \$13.1 million a year – the amount potentially going to the city under the lower base estimate over 10 years would likely be closer to \$81 million.

Measure D

On November 2, 2010, Long Beach voters approved Measure D, which made two changes to the City Charter regarding the Port of Long Beach.

One change stripped the Port of Long Beach Harbor Commissioners of any authority over oil properties in the port area and gave this authority to City Hall, including any revenue generated by said properties.

The second change was in the way of an annual transfer of port profits to City Hall is formulated. Previously, the transfer amount was based on 10 percent of the port’s audited annual net profits. Measure D changed this to 5 percent of the port’s gross revenue.

What Measure D was really about from an industry viewpoint, was quite simple: money and control. That is, greater sums of port money for City Hall officials to spend as they see fit and more control by City Hall over the harbor department.

Prior to the election, nearly all of the major stakeholders involved in port-related industries expressed opposition to Measure D, citing several major concerns. The PMSA raised these same concerns in their filing to the SLC.

First, City Hall rushed the measure onto the ballot with almost zero vetting and with no analysis of the long-term impacts on the port.

On August 3, the final day for considering ballot measures for the November ballot, the city council approved Measure D for the ballot. The only public discussion of the Measure D item was during the July 27 Charter Amendment Committee meeting and at the August 3 council meeting. From the charter committee discussions on July 27, it is clear that the language for Measure D had only just been drafted. In fact, at the August 3 council meeting, the city attorney was still tweaking the language, only moments before the vote to place it on the ballot.

Not presented at the August 3 city council meeting was a study, report or analysis of how Measure D would impact the port. It was later learned that one was never done.

A study of Measure D by the SLC released shortly before the election stated that state lands staff, despite numerous requests to City Hall for such a study, report or analysis, was “unaware of any evidence that the city council analyzed and considered any potential impacts to port operations when it voted to place [Measure D] on the November ballot.”

A second concern raised by the PMSA to the SLC was that Measure D is shifting significant portion of the port’s revenue to City Hall, threatening the financial security and competitiveness of the port.

Port financial staff at the time estimated that Measure D would shift more than \$130 million from the port to the Tidelands Fund over the next five years – \$100 million in oil revenues and \$33 million in added port-to-city annual transfers. This represents roughly 20 percent of the port’s net income per year.

A major question asked by the PMSA and many opponents of both the Oxy deal and Measure D is, what is the Tidelands Operating Fund actually funding?

By state law, the funds can only be spent in the tidelands and then only on very specific uses such as maritime, navigation, recreational, environmental, fisheries and the promotion of maritime commerce.

An audit, the PMSA argues, would offer a much needed degree of transparency into the day-to-day functioning of the Tidelands Operating Fund.

The State Auditor

A final issue that was not included in the PMSA filing is one involving a 1964 California statute mandating an annual audit of the Long Beach Tidelands Operating Fund.

The statute, known as section 138, was cited as recently as 2005 in a ruling on a suit pitting, ironically, the State Lands Commission against the City of Long Beach. In the ruling, the judge cited Section 138, reminding both parties that, “each year the Auditor General must ‘audit the Long Beach tideland revenues and expenditures and report thereon to the Legislature.’”

Under state government code, the auditor general’s main role is to examine and report annually upon the financial statements prepared by the executive branch of the state, to perform other related assignments, including performance audits, that are mandated by statute.

However, in November 1992, the nearly 100-member staff of the California Office of the Auditor General was shuttered due to state budget cuts. Roughly six months later on May 7, 1993, Gov. Pete Wilson signed into law new legislation that formed the Bureau of State Audits and renamed the head of this office as the state Auditor.

SLC Chief Counsel Jennifer Luchessi said that the responsibility to perform an audit called for in the 1964 statute would likely transfer from the auditor general’s office to the new state auditor’s office.

“I believe the intent of the Legislature was to have these audits done – by whatever audit agency exists in the state government,” Luchessi said.

In fact, there are examples of the reconstituted state auditor’s office conducting audits required of the former auditor general by state law.

However, a search of all publicly accessible audits performed by the state auditor since the reformation of the state office in 1993 reveals that no audit or investigative report has been performed on the city Tidelands Operating Fund in the past 17 years. In addition,

officials at the state lands commission and the city auditor's office could find no one who remembers such an audit being done by the auditor general or the state auditor.

SLC Executive Officer Curtis Fossum said he was not sure if the agency had ever investigated the Long Beach Tidelands Fund as a whole, but pointed out that the SLC has been close to litigating the city on several tidelands projects such as the Long Beach Convention Center. Fossum also pointed to numerous lawsuits since the 1950s that have involved the expenditures of tidelands funds.

The same statute also requires Long Beach to annually provide the Legislature with "a detailed statement of all expenditures of oil revenue . . ."

According to the Long Beach City Auditor's office, the city addresses this requirement by submitting a comprehensive annual financial report (CAFR) to the state. The SLC confirms that the city has been submitting an annual CAFR.

The CAFR details the various city funds' revenues and expenses for a given year, including both the Tidelands Operating Fund and the Tidelands Oil Revenue Fund. However, the CAFR is not a line-by-line reporting of what tidelands funds are spent on. The CAFR aggregates these revenues and expenses into broad financial categories.

It appears to come down to how the phrase "detailed statement" is interpreted.

For example, the 2009 CAFR – the latest issued by the city – details that the Tidelands Operating Fund had operating expenses in 2009 of \$82.3 million. These expenses are broken out under four categories: Personal Services (\$25.9 million); Maintenance and Other Operations (\$46.3 million); Amortization (\$714,000); and, Depreciation (\$9.5 million).

However, there is no further break down of each of these categories. There is no way to tell, for example, what specific projects the \$46.3 million from the Maintenance and Other Operations category is being spent on.

Remedies Without A Timeframe

For its part, the state lands commission said it is taking the PMSA filing very seriously and analyzing it closely.

"Each of the commissioners and I received a copy of the filing, as well as the attorney's general's office," the SLC's Fossum said. "We are looking at it now and discussing it with the attorney general's office."

Asked if city and port officials had been notified about the PMSA filing, Fossum responded, "I am not aware if they have received a copy yet."

Fossum admits that the SLC doesn't have staff looking at the specific issues raised in the PMSA filing and due to staffing cuts likely doesn't have the staff to conduct the investigations and audits requested. However, Fossum said that the SLC is working with the state attorney general to determine if the work could be performed from the AG's office.

While SLC officials would not speculate on the outcome of the PMSA filing, they did offer several possible remedies.

If nothing amiss is found in the audits, the status quo would reign.

"It may simply be a question of what kind of stewardship and fiduciary responsibility the city is bringing between its port operations and its other operations," Fossum said. "And if there is nothing illegal, then what we would likely do is simply report back to the commission and the Legislature on whatever those conclusions might be."

Fossum points out that the Legislature is the ultimate arbiter on trust issues.

"We can make recommendations on the trust, but only the Legislature can make changes to the trust," Fossum said.

If problems were found, several additional scenarios open up. The first would be referring the case to the attorney general's office (the SLC does not have prosecutorial powers). A second scenario would be that the city may have to pay back money already taken from the port.

Fossum pointed to the Nexus lawsuit in the late 1990s, where the City of Los Angeles was found to have improperly used port tidelands funds for non-tidelands uses.

"The end result was that the City of Los Angeles had to give back some \$60 million to the port over a number of years to pay back those tidelands funds that were inappropriately removed," Fossum said.

"Ultimately, the city is the responsible trustee and it is their obligations to manage those lands and those funds as a trustee of the state," Fossum said.

The results of any investigations or audits may not be soon in coming, though. Given the staffing and budget problems being felt throughout Sacramento, it is no surprise that SLC officials declined to give a time frame for any action.

"We are still reviewing the letter and trying to organize ourselves and think about what the PMSA is really alleging. With that said, we don't have any kind of real time line on how we are going to respond," Luchessi said. ■