

**INFORMATIONAL  
CALENDAR ITEM**

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**STAFF REPORT ON THE CITY OF LONG BEACH PUBLIC TRUST REVENUES,  
INCLUDING PROPOSITION D – A CITY OF LONG BEACH CHARTER AMENDMENT  
RELATING TO THE ALLOCATION OF PUBLIC TRUST REVENUES DERIVED FROM  
THE PORT OF LONG BEACH OPERATIONS, CITY OF LONG BEACH, LOS  
ANGELES COUNTY**

**INTRODUCTION**

The State Lands Commission (CSLC or Commission) has the statutory responsibility to oversee the management of sovereign public trust lands and assets by legislative grantees who manage these lands, in trust, on behalf of the State. (Public Resources Code section 6301, *et. seq.*; *State of California ex rel. State Lands Commission v. County of Orange* (1982) 134 Cal App. 3d 20, 23). The Commission and its staff exercise this responsibility and authority through various mechanisms, including informational staff reports discussing the status of a particular trust grant.

**BACKGROUND**

The State's sovereign tide and submerged lands within the City of Long Beach (City) were legislatively granted, in trust, to the City pursuant to Chapter 676, Statutes of 1911, and are held subject to the trust as subsequently amended by the Legislature. Through the City's Charter, portions of these public trust lands are within the Port of Long Beach (Port) and are managed by the Long Beach Board of Harbor Commissioners. The Harbor Commissioners are appointed by the Mayor and confirmed by the City Council. Port trust funds are held in the Harbor Revenue Fund. The City's remaining public trust lands and assets are managed by various other City departments, including the Gas and Oil Department, which oversees oil operations within the City. City trust funds are held in the Tidelands Operating Fund.

The Legislature has been significantly involved in the Long Beach trust grant since 1911. There are approximately twenty-three legislative acts which govern the use of the State's tide and submerged lands granted, in trust, to the City. All these statutes remain in effect and cumulatively provide the authority and parameters for use and management by the City of these public trust lands and assets. While the Legislature has provided no specific provision for Commission review of the City's management of its public trust lands, other than for oil operations plans and budgets and for projects involving the expenditure of oil revenues (Chapter 138, Statutes of 1964, First Extraordinary Session, as amended by Chapter 941, Statutes of 1991), the Commission

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has the general authority under Public Resources Code Section 6301, *et. seq.* to review the City's management of its trust grant..

The City and its trust grant have also been at the forefront of many of the California courts' analyses of public trust land and asset management and operations. For example, the seminal case guiding what constitutes a proper use of public trust revenues is *Mallon v. City of Long Beach*, (1955) 44 Cal. 2d 199. In 1951 the California Legislature passed a statute (Chapter 915) freeing tens of millions of dollars of tidelands revenue from the statutory and public trust restrictions. In 1953 the Legislature by concurrent resolution approved a city charter amendment authorizing the City of Long Beach to spend certain past and future tideland revenues for municipal purposes. The California Supreme Court had earlier ruled in *City of Long Beach v. Morse* (1947) 31 Cal 2d 254 that a city charter amendment approved by the Legislature authorizing the use of tidelands trust revenues for municipal purposes was a violation of the trust. The California Supreme Court in the *Mallon* decision not only affirmed this decision that use of trust funds for municipal purposes unconnected with the purposes and uses of the trust was a violation of the trust, but also violated California Constitution Article IV, §Section 31 (now Article XVI, § 6).

Specifically the Court determined that expenditures of tideland trust revenues outside trust lands by the City of Long Beach for uses such as a fire alarm system, a public library, public hospitals, public parks, off-street parking facilities, city streets and highways, storm drains and a city incinerator were not expenditures of state-wide interest for which state funds could properly be appropriated. The Supreme Court, in holding that "there being no benefit to all people of the state... it would be a gift of public monies and thus prohibited by the Constitution," rejected the argument that expenditures of trust revenues for municipal purposes should be permitted since they would be for "public" purposes. As a result of the *Mallon* decision, funds that were intended for the local government were returned to the State General Fund. As with any grant throughout the State, if the Legislature or courts determine that the City or Port used its trust revenues for non-authorized purposes the Legislature or courts could decide to revert the revenues to the State for uses that have a greater statewide benefit.

### PROPOSITION D

Proposition D is a City of Long Beach charter amendment that proposes two changes to the existing City Charter. First, Proposition D proposes to allow a transfer of up to 5% of the Port's **gross revenue** to the City's Tidelands Operating Fund. Currently, the City Charter allows for the Port to transfer up to 10% of its **net revenue** to the City's tidelands operating fund. The Board of Harbor Commissioners has the discretion to refuse a transfer request by the City Council, however since the City Council began requesting such a transfer in 1995, the Board has never refused such a request. This discretionary authority remains unchanged under Proposition D. As stated previously, the Harbor Commission is appointed to six-year terms by the Mayor and confirmed by

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the City Council. Further, the Mayor may remove any member of the Harbor Commission at any time with concurrence of two-thirds of the City Council.

While news sources estimate that the change in the transfer formula will increase the amount the Port transfers to the City's Tideland Operating Fund by approximately \$1 million to \$3 million a year, the Port has recently released an analysis<sup>1</sup> which shows that the change in the transfer formula will increase Port transfers by approximately \$6.6 million per year (see Scenario #1 vs. Scenario #3, slide #3, Exhibit C). This increase amounts to between 4% and 6% of the Port's net income. Unlike the section of Proposition D dealing with oil operations (discussed in more detail below) which allows the City Council to direct where the revenues will be deposited, the Port retains the discretion to refuse a transfer request by the City Council if the money is needed for Port operations. However, this portion of Proposition D is indicative of the City's ongoing endeavor to supplement the Tidelands Operating Fund with Port revenues without any fiscal analysis and consideration of the potential impacts to future port operations.

Second, Proposition D proposes to transfer the control, operation and management of oil extraction operations in the Harbor District out of the Port's jurisdiction and under the City's Gas and Oil Department jurisdiction. According to the City Attorney's Office, the City Charter already gives the City's Gas and Oil Department sole control over all the City's oil operations, even in the Harbor District. The City Attorney maintains that this part of Proposition D is solely intended to clarify the City's Gas and Oil Department authority over oil production within the City.

The oil production operations within the Port at issue involve wells located at the former Union Pacific site (within the West Wilmington Oil Field). In the early 1990's the Port purchased the 725-acre Union Pacific Railroad site for \$405 million, a price which reflected the value of the land, including mineral rights. Since that time, the Port has been operating and managing oil production from that site and has received the associated income generated from such oil production.

On August 3, 2010, the City Council considered whether to place Proposition D on the November ballot. During this meeting two harbor commissioners and maritime industry representatives requested that action be delayed until there was time to discuss the ramifications of the proposal on Port operations. Despite the request, the City Council voted to place Proposition D on the November ballot. As stated above, revenues from oil operations within the Union Pacific site are being deposited by the Port into the Harbor Revenue Fund. If Proposition D passes, the City Council, not the Port, will direct

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<sup>1</sup> Port staff presented a Power Point presentation to the Board of Harbor Commissioners at its October 18, 2010 meeting titled "Cash Flow and Net Income Forecast and Impact of Bond Rating Downgrade." This presentation is attached as Exhibit C. While the presentation does not identify Proposition D directly, the scenarios outlined in the presentation are identical to the potential impacts of Proposition D if passed.

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whether the revenues derived from oil operations at the Union Pacific site will be deposited into the Harbor Revenue Fund or the Tidelands Operating Fund. Although the City Attorney was reported as saying that, "in all likelihood, for the foreseeable future, oil money will in fact go into the Tidelands Fund." To the knowledge of Commission staff, neither the City nor the Port analyzed the potential financial impacts of the measure and the consequences Proposition D may have on the Port's operations, including its various security and environmental programs and capital improvement projects, prior to the Council placing Proposition D on the November ballot. Most of the information received by Commission staff as it relates to Proposition D has been from various news sources (See Exhibit A, Exhibit B and Exhibit D).

If the transfer of the oil operations to the City's Gas and Oil Department occurs and the City Council directs these oil revenues be deposited into the Tidelands Operating Fund, the Port estimates it would lose approximately \$100 million in net cash flow over Fiscal Years 2011-2015 cumulatively (See Exhibit C, slide #2). Over the five years, this accounts for approximately 15% of the Port's annual net income. When combined with the increase in transfer formula, the impact of Proposition D could account for approximately 20% of the Port's annual net income. Further, according to the Port, oil revenue is counter cyclical to the revenue from imports. For example, in FY 2008 revenue from oil operations made up for the drop in imports. Oil production from the oil properties within the Harbor District is predicted to continue until 2030. It is unknown which City entity, the Port or the Gas and Oil Department, would be responsible for any required remediation and the abandonment of the oil wells.

The loss of 20% of net income due to the loss of oil revenues and a change in the transfer formula would likely have a significant effect on Port operations. The impacts to Port operations may include a reduction in the Port's credit rating due to anticipated reductions in its annual cash flow. Currently, the Port has a "AA" credit rating (as rated by Standard & Poor's). Even if Proposition D does not pass, the Port anticipates that its cash reserves will be significantly reduced by 2011 as a result of reduced revenues and substantial investment in environmental programs and infrastructure projects. In the event Proposition D passes and the City Council directs oil revenues be deposited in the Tidelands Operating Fund, there will be a significant decrease in cash flow and with existing debt obligations it is likely the Port will either have to borrow more for or spend less on its \$3.1 billion five-year capital plan. These expenditures include security measures, environmental programs and capital improvement projects, such as the replacement of the Gerald Desmond Bridge (a \$1 billion replacement project), the Middle Harbor Project, maintenance dredging projects, the Port's Clean Truck Program and the Clean Air Action Plan. Additionally, if the Port's credit rating is downgraded, the Port will pay more in interest (see Exhibit C, slide #4).

### Trustee Responsibilities

The City holds these sovereign tide and submerged lands, in trust, for the benefit of all the citizens of California. As with a private trust, the City, as trustee, must manage and

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utilize the State's lands and their revenues solely for trust purposes and needs, pursuant to both the common law Public Trust Doctrine and the statutorily created trust grants. As such, any funds diverted from the Harbor Revenue Fund are still required to be used for public trust purposes benefitting public trust lands within the City.

As the Legislature's delegated trustee of these public trust lands and trust assets, the City has the primary responsibility and authority to administer the trust on a day-to-day basis and to manage its granted public trust lands and assets for the benefit of all the people of California, including the duty to prudently balance competing public trust uses of trust assets to accommodate public trust needs.

On September 22, 2009, Commission staff sent a letter to the City Council reminding them of their duties and responsibilities as a trustee for the State. In the letter, Commission staff stated:

*"The Port is a significant public trust asset and vital component of the national, state and local economies. Pursuant to its fiduciary duty as the State's trustee, the City should carefully consider the potential impact to Port operations that any change to the current formula allowing transferring funds between the two public trust funds may have; including balancing the potential adverse impact to the Port's environmental, transportation and security programs from the additional loss of funds against the benefits to the City's other public trust lands."*

Commission staff is unaware of any evidence that the City Council analyzed and considered any potential impacts to Port operations when it voted to place Proposition D on the November ballot. Over the past couple of months, Commission staff has requested information from the Port or City documenting potential impacts on Port operations, but received none, until the week of October 18<sup>th</sup>.

At its October 18, 2010 meeting, the Board of Harbor Commissioners heard an informational presentation by Port staff giving a preliminary analysis of the Port's five-year cash flow and net income forecast given four scenarios, including a scenario that mirrors what Proposition D is seeking to accomplish (see Exhibit C). Cumulatively, for Fiscal Year 2011-2015, under Scenario #4, which includes a 5% transfer of gross operating revenue and a transfer of oil revenues from the Harbor Revenue Fund to the Tidelands Operating Fund, the Port's contribution to the Tidelands Operating Fund would more than triple, the Port would need to borrow an additional \$151 million to fund its current five-year capital plan and its net income would decrease by \$148 million, as compared to Scenario #1, which equates to the status quo (i.e. if Proposition D does not pass). The presentation did not include a staff report or any additional details beyond what is shown in Exhibit C. During the discussion following the presentation, many of the Harbor Commissioners requested additional details and analysis to supplement the presentation.

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### Consistency with the Public Trust Doctrine

As a general precept, the effect of a legislative grant is to create a trust in which the local government is trustee, and the State is the trustor, and the people of the State are the beneficiaries of the trust. The legal consequence of this relationship is that the proper use of public trust lands and public trust revenues remains a statewide concern and the proper subject of Commission review. *Mallon v. City of Long Beach*, supra at 209. Public trust revenues are subject to the same trusts as the trust lands themselves. And, the use of trust lands and revenues derived therefrom for non-trust purposes is a violation of the trustee's fiduciary duty to the trust and its beneficiaries.

Traditional public trust uses are considered to include water-related commerce, navigation, and fisheries. Harbor development is an example of a classic public trust use, potentially encompassing all three. And, although courts have recognized that the Public Trust Doctrine is flexible and that it includes water-related public serving and recreational uses, as well as environmental protection, open space, and preservation of scenic areas, the overarching principle of the Public Trust Doctrine is that trust lands and trust assets belong to the statewide public and are to be used to benefit the statewide public rather than for local community or municipal purposes.

Proposition D does not, on its face, raise a Public Trust Doctrine revenue or land use consistency issue because any transfer of revenues from the Port's Harbor Revenue Fund to the City's Tidelands Operating Fund would remain subject to the public trust and still be required to be expended for public trust purposes. However, the City has a fiduciary duty, as the State's trustee, to balance competing public trust needs and to carefully consider any potential impacts to Port operations that any change to the City Charter may have. The issue in diverting revenues from the Port is whether the City would be impairing Port operations of statewide and even national importance to fund less critical operations. In addition, should public trust funds be spent for non-trust purposes, the City would be in clear violation of the Public Trust Doctrine, its statutory trust grant, and the State Constitution.

In the past, the Port has gone to great lengths to assist the City, beyond the annual transfer authorized by the current City Charter. According to the Port, it has contributed over \$790 million to the City since 1990. This equates to approximately \$41.5 million per year on average. Commission staff has not initiated either an investigation or audit, but has recently become aware, through news sources, of some questionable expenditures and budgeted expenditures of public trust revenues both by the City and the Port. Commission staff has received an explanation of some of these expenditures sufficient to determine that such expenditures are not inconsistent with the common law Public Trust Doctrine and the City's trust grant. However, staff believes that further information is needed to determine trust consistency, given the Supreme Court decision in *Mallon*, for other questionable expenditures and budgeted expenditures such as: the Port providing over \$200,000 in scholarships since 2007; \$50,000 by the Port to fund the Long Beach Municipal Band and \$75,000 by the Port to fund the City's Fourth of

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July fireworks (Port FY 2011 Budget); and \$65,000 by the City's Tidelands Operating Fund to fund the Long Beach Municipal Band (City FY 2011 Budget).

Conclusion

The current economic crisis facing most cities and counties in our state, including the City of Long Beach, is significant, complex and severe. In fact, the City was forced to cut more than \$18.5 million to achieve a balanced city budget for fiscal year 2011. The current fiscal crisis also clearly has ramifications on the State's budget and General Fund operations. Based on staff's past experience with other trust grants in the state, it is precisely this kind of economic environment where the Commission and its staff must vigilantly conduct their oversight responsibilities on behalf of all citizens of the state. As stated above, Proposition D does not, on its face, violate the City's trust grant or the Common Law Public Trust Doctrine. However, staff is unaware of any detailed and comprehensive analysis conducted by the City, as trustee for the State, analyzing any potential fiscal implications and impacts to Port operations that may result from Proposition D. Further, staff is unaware of any analysis that provides a public trust rationale for authorizing significant diversions of public trust revenues from the Port or for the more minor expenditures listed above which raise public trust consistency concerns.