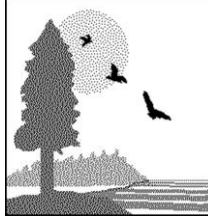


CALIFORNIA STATE LANDS COMMISSION

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July 3, 2012

File Ref: G05-03

Honorable Mayor Bob Foster
City of Long Beach
333 West Ocean Boulevard
Long Beach, CA 90802

City Council
City of Long Beach
333 West Ocean Boulevard
Long Beach, CA 90802

RE: Agenda Item NB-33: Public Safety and Infrastructure Oil Production Fee

Dear Mayor and Members of the City Council:

The California State Lands Commission staff understands that the city of Long Beach City Council has scheduled an agenda item, Agenda Item NB-33, for the July 3, 2012 council meeting that seeks to have the City Attorney draft a local ballot measure for the November ballot that would significantly increase the City's tax on oil production within the city limits. While Commission staff has had only limited time to review the item, it appears that the Council is considering combining and significantly increasing two flat taxes into a single tax on each barrel of oil produced that is tied to posted oil prices. Commission staff would like to take this opportunity to express our concern about how this tax on oil production could affect the City's fiduciary responsibilities as a trustee for the state and contractual obligations as the unit operator for both the Long Beach Unit and West Wilmington oil and gas operations. Commission staff also wants to offer our availability and assistance should the Council want additional information. Commission staff urges the Council to either not approve Item NB-33 or to reschedule a vote until such time after the staff of the City and Commission have had a chance to discuss this matter further.

The state's sovereign tide and submerged lands within the City were legislatively granted, in trust, to the City pursuant to Chapter 676, Statutes of 1911, as amended. As a result of these legislative grants, the City holds these sovereign tide and submerged lands, in trust, pursuant to both the common law Public Trust Doctrine and the

statutorily created trust grants, for the benefit of all the citizens of California. *Mallon v. City of Long Beach* (1955) 44 Cal. 2d 199, 209. This also includes those assets held by the Port of Long Beach. As with a private trust, the City, as trustee, must manage and utilize the state and Port's lands and their revenues solely for trust purposes and needs. The City is a trustee, both as to the lands themselves and as to the proceeds derived therefrom. *City of Long Beach v. Morse* (1947) 31 Cal. 2d 254, 257.

In addition to the City's role as a trustee over sovereign assets, including those that are held by the Port, the City is also the unit operator for both the Long Beach Unit and West Wilmington oil operations. As a result of being the unit operator, the City has legal obligations to the units that is separate from, and in addition to, its obligations as a trustee. Increasing the tax on the magnitude of what is proposed might very well conflict with the City's contractual legal obligations to both units as an operator if such an increase in the costs associated with development of the units distorts the economics of the development for the two units such that the unit contractor no longer finds it economical to develop. The state and the Port are the two primary participants of the operations, which mean that the direct and indirect effects of the tax will primarily affect state and Port revenues.

With this background, Commission staff offers the following comments for the Council's consideration.

First, from Commission staff's initial research, at least 60% of the oil that will be subject to this tax is produced from lands managed by the City as trustee either for the state or the Port. Commission staff is concerned that this appears to be an attempt by the City, in conflict with the City's duties as a trustee, to tax the state's tidelands trust revenues and to divert those revenues that are otherwise trust-restricted to the City's general fund. The net profits generated from the Port's portions of the units are required to go into the tidelands trust fund, whereas those generated from the state's portions are required to go to the state's General Fund. At today's prices, the proposed oil production tax is an approximate 400% increase over the existing production tax, which will have a deleterious effect on the net profits received by the state and the Port.

Second, the scenario mentioned in the City's staff report discusses the possibility of oil prices dropping significantly which would result in a tax of \$1.00 per barrel. It seems highly unlikely that the tax assessed would ever be the \$1.00 per barrel, as adjusted, as that would require oil prices dropping to \$50 per barrel. If oil prices drop that low (or lower), it is unlikely that oil, at least at the two units where the City is the unit operator, will continue to be economical to produce. The enactment of the \$1.00 per barrel tax will only serve to tilt the economics in favor of terminating production and thus terminating whatever revenue that the City is intending to capture with this tax. The cessation of production will not only remove the City's proposed production tax revenue, it will also terminate the many other sources of revenue that the two units produce for the tidelands trust, the City, and the state.

Third, it is not clear what the production fee, particularly when applied to the oil produced from the units, is intended to "appropriately compensate the City" for as stated at Agenda Item NB-33, page 3. The City is already well compensated. Just from the state's share of the West Wilmington operations alone, over the next ten years at \$100

per barrel oil, the City will receive approximately \$85 million for its general fund through current assessed taxes, management fees and cost overrides paid to the City. This is separate from and in addition to what the City receives from the Port's share of the West Wilmington operation and the Long Beach Unit operation.

Commission staff is appreciative of its relationship with the City's staff and the work that the City does in managing the public trust lands, trust assets and both oil operation units. 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. Thank you for the opportunity to comment on Agenda Item NB-33.

Sincerely,



JESSICA RADER
Staff Counsel

cc: Christopher Garner
J. Charles Parkin