

# The Beaumont CA Scandal: Can it Happen to You?

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## Key Take-Aways

- You won't have Beaumont's level of problems but you may have one or some of them
- What happened and why—lessons learned
  - Ignore the basics at your peril!
- Textbook example on crisis management
  - How does a new Council member help fix things?
  - How does the new City Manager help fix things?
- The rewards of taking on challenges & not turning your back to them

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## Beaumont's Crisis

- High growth city—needed ways to handle growth impacts
- Got too creative—massive CFD & improperly managed
- Insolvent for at least 7 years—nobody knew it!
- Court judgment of \$67 million—entire General Fund budget was \$29 M!
- Developer claims of \$20 million plus
- State wants \$4 million back (former RDA)
- Books were bad
- Reform Council comes in—we're off to the races!

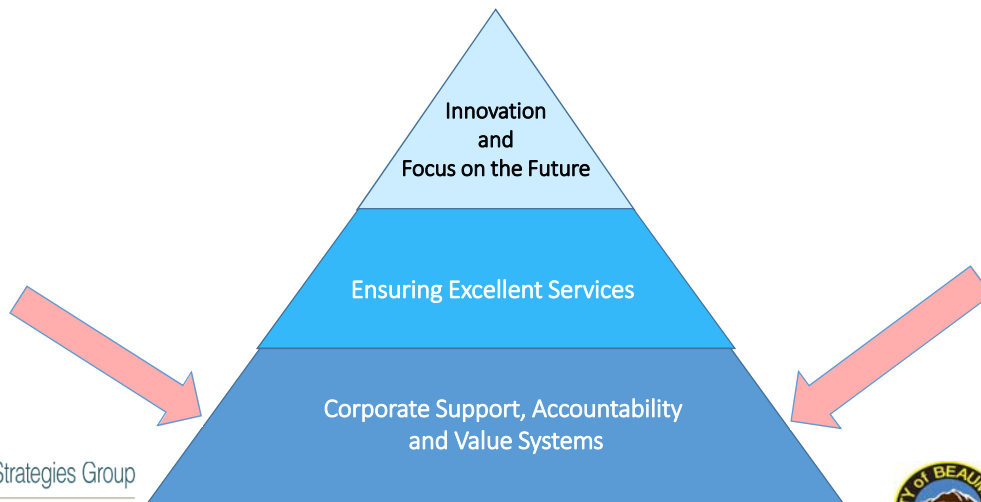
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## Three Critical Building Blocks of Good Government



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## What Happened?

- Played games with fund balance for general fund
  - Resources available to spend in your budget is: 1) fund balance plus 2) new revenues, right?
  - Do you know what spendable vs. total fund balance means?
  - Do you read your CAFR (financial statements)?
- Fund Balance (from City financial statements 6/30/13)
  - Non-spendable
    - Notes/Loans Receivable \$289,442
    - Advances to RDA \$21,500,000
  - Restricted \$0
  - Unassigned (\$6,866,481)
  - Total Fund Balance \$14,922,961

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## What Happened (cont.)?

- Budgets ignored--when can staff exceed or change your budget?
- Books were bad--who knows your books? Reliant on one person?
- CFD's—management, legal and accountability standards violated. Do you have these and how are they managed?
- DIF's—management, legal and accountability standards violated. How are these managed in your city?
- Violated SEC laws resulting in investigation—you don't want to experience this!

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## What Happened (cont.)?

- Have you talked to your Auditor's? Know what is a Management Letter or Review of Internal Controls?
- Do you know what you pay your employees vs. labor market? Beaumont was way over market
- After issuing bonds, do you know the disclosure requirements? This is what the SEC watches. You have insider information!
- COG lawsuit/judgment \$67 M and developer claims \$20M+
- Contracting is fine but don't include management & implementation with same firm!

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## What Models To Follow?

How Do You Eat an 800 Lb. Gorilla?

Don't Panic . . .

Not All At Once . . .

One Bite At a Time



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## How To Repair Beaumont Without Resorting to a Bankruptcy Filing

- Create Your Team & Don't Skimp!
  - New City Attorney, City Council, 1 Interim City Manager, new consultants and specialized attorneys worked well together (but how?)
    - Trust, two-way communication, Council & staff/consultants listened
  - Created Emergency Operations Center (via phone)
    - Same as Stockton, San Bernardino, Oxnard
    - Treat the crisis like a flood or earthquake emergency
  - Stop the bleeding (cut \$4 million)
  - Start fixing the books (CFD's, DIF's and General Fund rev's/exp's)
    - The bad books probably got us to cut too much

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## How To Repair Beaumont Without Resorting to a Bankruptcy Filing (cont.)

- Negotiated new labor agreements (huge concessions)
- Changed mindset (what is it that we have of value?)
  - \$3 million infusion from renewed developer agreement
  - Started negotiating settlement of developer claims considering what they needed from us for their business plans
- Can't be afraid to spend money to save a lot more!
  - Reviewed past transactions and all bond covenants, etc. (found \$5 million)
  - Engaged COG in complex negotiations to settle \$67 million judgment
    - Sometimes a weakness is a strength

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## The Mayor and City Council Perspective

- Why I ran for City Council
  - I'm a Business Analyst
    - Independent fiscal audits taking longer each year
    - City Council not asking tough questions
    - Not one council member demanded accountability from City Manager
- Now that I'm elected, what are my initial thoughts and actions?
  - I needed the truth and couldn't trust staff or City Council
  - Reached outside
    - Approached COG leadership to address (eventual \$67 million) judgment
    - Met with DA's task force on government corruption
    - Requested the State Controller audit our internal controls



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## Build a Consensus on Council—Change Needed!

- Fellow council members must admit there's a problem
  - County Supervisor encouraged colleagues to reconsider their management leadership
- Start asking the tough questions in open council session
  - Other council members will follow once they see there is something wrong
  - Question every contract and every relationship in open session
  - Find the weak link
- Avoid City Manager's divide and conquer strategy (this is the CM that was indicted & pled guilty)
  - Refuse invitation to discuss agenda items face to face
  - Know what the City Manager and City Attorney are telling your colleagues (this is the CA that was indicted)
- Make sure law enforcement agencies keep watching the videos
- April 2015—FBI and DA raided City Hall, homes/offices of City Manager & long time City staff (consultants)

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**AGENTS OF  
CHANGE**



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## Persistence Pays Off

- 7 Arrested and \$12 Million in Restitution (and Counting.....)
  - Former City Manager & CFO arrested by DA
    - Since pled guilty to felonies, are under house arrest and paid \$1.1 million
  - Former Police Chief arrested due to illegal loans
    - Pled guilty and paid restitution
  - Former Planning Director arrested
    - Pled guilty and paid \$3 million in restitution
  - Former Public Works Director arrested
    - Pled guilty and paid \$3 million in restitution
  - Former Economic Development Director arrested
    - Pled guilty and paid \$4 million in restitution
  - Former City Attorney arrested – awaiting trial
    - E&O Insurance policy limit payment of \$900,000



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## Now What? Start Repairing & "Digging Out"

- Council to begin asking the tough questions of staff
  - Build community confidence behind a transparent internal investigation
- Council needs to be rowing in the same direction
  - Remind them how how each decision fits into the big game plan
- Need new City Manager and New City Attorney
  - Council needs their own people they can trust
- Long closed sessions
  - Political agendas take a back seat to the crisis at hand
- Keep the community informed



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## Council Member Perspective Changing Management



- A crisis of trust weighs heavily when picking the next City Manager, City Attorney and consultants
- Find a City Attorney whose focus will be your city
  - Tough to be THE priority in an established CA firm with many clients
- Take your time finding the right City Manager
  - Don't be afraid to go through more than one Interim CM
- Don't be afraid to negotiate

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## Organizing The Dream Team

- Don't Skimp on the solution
  - A major crisis demands a serious response
  - We spent more than any of us were comfortable
- Brought in Bob Deis to quarterback
  - Weekly team huddle—discussed strategy, objectives, responsibilities & deadlines
- Brought in Mike Busch, Urban Futures as Financial Advisor to City
- Hired Orrick, Stockton's BK attorney—very expensive but the eventual costs avoided were many times that
  - Helped with debt restructuring, helped find \$5 million and (with Bob) provided that BK perspective at COG \$67 million negotiations



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## COG Negotiations—A \$67,000,000 Nut to Crack!



- If this isn't addressed, a Chapter 9 filing is in our future
- This weakness was converted to a strength i.e. no general fund cash available and we'll dispose of this liability in BK court—it set the parameters--key team members were experts on BK
- It was difficult to get every City principal on the same page with this—one interim CM and one CC member didn't want to negotiate—can't look divided to opposing parties
- Attorneys/consultants recommended using a mediator (retired BK judge)—told other side what happens in BK
- Had elected officials at the table to assist in buy-in with their Board
- Then Todd, new CM came and negotiations picked up
- Deal was amazing and complex—Todd will explain later

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## Once the Dust Begins to Settle

- Time to rebuild the community's trust
  - Getting our message out
  - Monthly messages from Mayor
- State of the City speech—Tout your success
  - Balanced budgets—return to solvency
  - New outstanding leadership team
  - Lowered Mello-Roos (CFD) payments & more transparency
  - First ever Street Maintenance Dept.-aggressive 5-year road repair program
  - Attracting new business & local jobs



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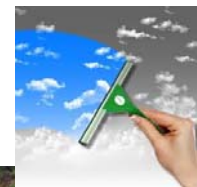
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## Road to Recovery—Gaining Trust thru Transparency

- All participants agreed to do “the right thing” even if it hurt and was more difficult
- Zero tolerance for improper activities—referred uncovered facts to the DA on a sitting Council member
  - Very painful to the sitting Council—potential setback
- Full cooperation with the DA
  - Lots more work but was mutually beneficial--\$12 million in restitution
- Overly transparent in all activities—it slows things but you pay for the sins of your predecessors!



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## Road to Recovery--Settling High-Stakes \$67,000,000 Court Judgment

Patience is  
bitter,  
but its fruit  
is sweet.

*Jean-Jacques Rousseau*

- **Beaumont had Already Lost!**

- Judgment Rendered
- Beyond the City's Financial Limits

- **Failure Was *NO* Option**

- Developed a Strategy Founded on Strengths and Weaknesses
- Ensured that the Negotiating Team was on the Same Page
- Team Was Coordinated BEFORE Sitting at the Table

- **Took Our Time**

- Negotiations Took a Year
- Started Small and then Went Big
- Cautious of Unintended Consequences

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## Road to Recovery--Settling High-Stakes \$67,000,000 Court Judgment (cont.)

- **Maintained Full Transparency in Negotiations**

- Hid Nothing and Provided Detail as Requested
- Insisted 2 Elected Representatives be at the Table

- **Demonstrated that Beaumont Citizens were Victims as Well**

- Established Trust
- Kept Discussions Focused

- **Kept an Open Mind and Got Creative**

- Demonstrated Beaumont's Value to the Region
- Shared New Revenues to Off-Set Claims on Cash
- Offered (DIF) Cash for Transportation Projects that Helped Neighbors

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## Road to Recovery (cont.)

### • **Would You Like to Know About the Other Challenges?**

- Concluded the SEC Investigation
  - Spent More than \$1 Million in Legal/Consulting Fees
  - No City Fines Levied (Former CM Fined and Barred from Securities Industry)
- Fully Satisfied Findings of the SCO Audit
- Completed BOE Audit
- Implemented Significant CFD Savings
- Expanded Core Services
  - Public Works
  - Public Safety (Police and Fire)
  - Finance and Accounting



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## New City Manager's Perspective: What did I know when I applied for the job?

- **Seven Senior Staff Members Arrested**
- **Nearing Bankruptcy**
  - WRCOG Judgement
  - Developer Claims
  - Other Claims
- **No Idea of the City's Cash Position**
  - No Dependable Audits
  - No Solid Annual Budgets
  - Cash Balances? – Ummmmmm.....
- **Active Investigations**
  - Riverside County DA
  - SEC
- **Lack of Credibility**
  - Beaumont Citizens
  - Neighboring Communities
  - Area Agencies



- **Has to be A LOT More that I Don't Know**

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## City Manager's Perspective: Here We Go!

- **Who doesn't like a challenge?**
- **There were are so many assets!**
  - Solid City Council
  - Strong Consulting Team
  - Committed Staff Team
  - Sustained Development Activity
- **"You really can't make things any worse"**

*John Pinkney, City Attorney, SBEMP*



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## What Had To Be Done?

- **The World Doesn't Wait!**
  - Major Negotiations
  - Major Capital Projects
  - No Audits
  - Annual Budget
  - People Need You Now!
- **Prioritize and be Realistic**
  - What stops?
  - What slows down?
- **Be Ready to Move!!!!**
  - No Paralysis by Analysis
  - Take Risks
  - Take Charge
  - Be Accountable
- **Build Relationships**
  - Citizens
  - City Council
  - City Staff
  - Others
- **Establish a Baseline**
  - Specific Strategies for Each Major Issue
  - Walking Away Points for Each Negotiation
  - Coordinate w/City Council

**Keep  
Calm  
and  
Eat the  
Gorilla**

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## The World Doesn't Stop in a Crisis!

- **Citizens Need Attention**
  - Account for All Public Funds
    - *Past and Present*
    - *Mello-Roos*
  - Concerns About Lack of Services
  - Expectations for Improved Quality of Life/Economic Development
  - Concerns Over Fiscal Sustainability
- **Growth Continues**
  - Accelerating Activity of Existing Developments
  - Integrate New Policies/Approaches
  - Prepare for New Development
- **Governmental Mandates**
  - Financial Reporting
  - Wastewater System  
(Including Prop. 218 Rate Process)



## What Made Stability Possible?

- **City Council Courage**
  - Assembled World-Class Consulting Team
  - Heeded Advice of Consulting Team
  - Provided Clear Direction
  - Negativity Did Not Slow Them Down
  - **DID NOT SHY AWAY FROM THE TRUTH**
- **Took Advantage of Unique Opportunities**
- **Conservative Fiscal Planning**
- **City Staff Assistance – New MOUs and Concessions**

**PHEW!**



## Valuable Lessons!



- **Citizens Really Appreciate the Effort**

- There Will be Anger and Frustration
- You Will be Expected to Forgo Your Private Life
- Faith in Your Staff is Imperative
- Good People will be There
- Failure IS NOT an Option

- **Watch out for the Indirect Damage**

- Negativity Will Creep into the Community's Psyche
- Recruiting Top Talent is a Challenge
- Keep that Sense of Humor Handy!



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## Finance is INVALUABLE!

- You are **THE** Link to Transparency and Public Confidence
- Develop Sound Fiscal Models to Ensure Fiscal Sustainability
- Develop/Implement Appropriate Financial Policies
- **Tell Your Community How it Really Is!**



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## Review of Key Take-Aways

- Ignoring the basics can get you in trouble!
  - Like, ignoring budgets and retrospective review with auditors
  - Keep an eye on CFD's and DIF's
  - If you contract for services, separate management from service delivery
  - Relying on few people for information, can be a sign of vulnerability (common in other agencies)
  - Read your budget and CAFR (financial statements)—review with auditors
  - If another agency is suing you, there may be something wrong
  - Change your auditors every 3-5 years
- Crisis Management
  - Treat it like a flood or earthquake and create an EOC
  - Create your team and don't skip (staff, consultants and fellow council members)
  - Make the time to understand and get everyone on the same page
  - Communicate with the community—the good, bad and ugly!
  - Make the tough decisions quickly—it makes the later ones easier
  - Develop a plan and stick with it
  - Don't be afraid, you are not alone
- It will be difficult, but the rewards of making a difference will stay with you

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## The Beaumont CA Scandal: Can it Happen to You?

QUESTIONS ?



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