

COMMENTS

THE NEW YORK STATE COMPTROLLER AS SOLE TRUSTEE OF THE COMMON RETIREMENT FUND: A CONSTITUTIONAL GUARANTEE?

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I. INTRODUCTION

In New York State, members of state and municipal pension funds enjoy a constitutionally protected right to their pensions.¹ As a result, if the pension fund were to see a devastating diminution of any kind, taxes statewide could skyrocket to meet this constitutional guarantee, since an ailing fund would need to seek assistance from the state legislature to meet its constitutional obligations. Many of the pension benefits guaranteed by this clause are drawn from the state's Common Retirement Fund (CRF)—a \$156 billion fund² managed by the state comptroller as sole trustee.³ This structure is unusual; most comparable public pension funds are managed by boards of trustees.⁴

For decades, critics and reformers have expressed concerns that a statewide elected official acting as sole trustee of such an enormous

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¹ N.Y. CONST. art. V, § 7. The New York State Constitution grants beneficiaries a vested right to their pension benefits and prohibits any action by the state that could impair these benefits; article V, § 7 provides that "membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired." *Id.*

² OFFICE OF THE N.Y. STATE COMPTROLLER, NEW YORK STATE AND LOCAL RETIREMENT SYSTEM COMPREHENSIVE ANNUAL FINANCIAL REPORT 31 (2008), available at http://www.osc.state.ny.us/retire/word_and_pdf_documents/publications/cafr/cafr_08.pdf.

³ N.Y. RETIRE. & SOC. SEC. LAW § 13 (McKinney 1999); § 422(1) (McKinney 2005).

⁴ David Hess, *Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development*, 2 VA. L. & BUS. REV. 221, 239 (2007).

fund used to pay constitutionally guaranteed benefits is a recipe for abuse.⁵ In fact, in many instances in New York State and elsewhere, pension fund fiduciaries have abused their authority and used pension fund business for personal and financial gain.⁶

The performance of public pension funds is also a recurring topic of scrutiny in the legal and financial academic disciplines.⁷ There is evidence that public funds do not perform as well as their private counterparts, and although this can be explained in part by lower tolerance for risk, many commentators also suggest that poor performance is caused or exacerbated by inappropriate political influences.⁸ For decades commentators have discussed problems involved with management of public funds by elected officials, concerned that “[t]he most obvious conflict of interest is that of the government official” who “would have compelling personal, political, and governmental reasons for favoring an investment of pension funds.”⁹ The status of the comptroller as an elected official, his or her role as sole trustee of the fund, the size of the Common Retirement Fund, and the fact that it exists to fund a constitutionally protected benefit all work together to emphasize the importance of an earnest and ongoing conversation in state government about CRF governance, including the comptroller’s role as sole trustee of the fund.

The respective roles of the legislature and the comptroller must be addressed as part of any movement toward retirement fund reform. The comptroller’s role as sole trustee is clearly laid out in statutory language, but there is some controversy as to whether the sole trustee model is itself guaranteed by the state constitution, which also grants the legislature the power to “define the powers and duties” of the state comptroller.¹⁰ In light of recent scandals, some critics have raised the prospect of reorganizing the fund to include a board of trustees; as a result many news reports have asserted, without analysis, that a constitutional amendment would be required in order to alter the sole trustee model of the Common

⁵ See discussion *infra* Part IV.

⁶ See discussion *infra* Part IV A–D.

⁷ See, e.g., Julia L. Coronado et al., *Public Funds and Private Capital Markets: The Investment Practices and Performance of State and Local Pension Funds*, 56 NAT’L TAX J. 579 (2003); David Hess, *Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices*, 39 U.C. DAVIS L. REV. 187 (2005); Hess, *supra* note 4; Note, *Public Employee Pensions in Times of Fiscal Distress*, 90 HARV. L. REV. 992 (1977) [hereinafter *Fiscal Distress*].

⁸ See, e.g., Coronado, *supra* note 7, at 579–81.

⁹ *Fiscal Distress*, *supra* note 7, at 1013–14.

¹⁰ N.Y. CONST. art. V, § 1.

Retirement Fund.¹¹ Some of these reports bemoan the difficult process of amending the constitution and discount the prospect of creating a board, referring to the harsh “[p]olitical realities” of the “lengthy and politically daunting” constitutional amendment process.¹² Others call for the change even if it requires a constitutional amendment because they see the problem as so pressing.¹³ It is certainly not so clear, however, that a constitutional amendment would be required; indeed it appears that legislation could be enacted to make the change without running afoul of the constitution.

The purpose of this Comment is to discuss the history and function of the New York State Constitution’s nonimpairment clause and address whether it dictates the State Comptroller’s role as sole trustee of the Common Retirement Fund. The Comment will discuss some of the events that have caused the decades-old call for reform of the Office of the State Comptroller, and will also briefly survey some of the arguments in favor of alternative approaches to investing the CRF.

¹¹ Elizabeth Benjamin, *Probe Eyes Hevesi & Deputy*, N.Y. DAILY NEWS, July 9, 2007, at 8 (“Making such a change would require approval by the Legislature and perhaps even an amendment to the state Constitution, which must be passed by two separately elected Legislatures and then go to a public referendum.”); Editorial, *A Pension System Ready for Change*, ALB. TIMES UNION, Mar. 24, 2009, at A8 (“New York’s Constitution gives the comptroller the sole responsibility for, and power over, the pension fund. . . . [and] New York’s leaders and lawmakers should debate, with ample public input, whether the state should preserve the comptroller’s sole trusteeship, or change the state Constitution to create a bipartisan board to oversee the pension system.”); Editorial, *Keep Those Pension Checks Coming*, NEWSDAY, Dec. 23, 2007, at A50 (“DiNapoli is skeptical about the merits of that change—it has problems of its own and it might well need a state constitutional amendment.”); Editorial, *Other People’s \$150 Billion*, N.Y. TIMES, July 22, 2007, at 11 (“Among other things, [revising the sole trusteeship] would mean revising the state constitution.”); Editorial, *Tall Order for Tom*, N.Y. DAILY NEWS, Sept. 17, 2007, at 24 (“Much is riding on DiNapoli because the state constitution designates the controller as the sole trustee of the fund.”); Danny Hakim, *Inquiries Raise Questions About State Fund*, N.Y. TIMES, July 10, 2007, at B2 (“Changing the sole trusteeship would require amending the state constitution, a lengthy and politically daunting process.”); James T. Madore, *Pension’s Biggest Backer: In Role as NY Comptroller Overseeing Retirement Accounts, LI’s Thomas DiNapoli Says Office’s Troubles are Firmly in the Past*, NEWSDAY, Dec. 3, 2007, at A8 (“There now appears to be little support for reducing DiNapoli’s hold over the pension fund, which would require a constitutional amendment.”); James M. Odatto, *State Pension Reform Ramps Up Oversight*, ALB. TIMES UNION, Dec. 13, 2007, at A1 (“Both Spitzer and DiNapoli showed little support for the notion of moving control of the pension fund to a board instead of the comptroller, who is the sole trustee under the state constitution.”); Mary Williams Walsh & Danny Hakim, *Where Investing \$154 Billion Is One Man’s Job*, N.Y. TIMES, Aug. 22, 2007, at B1 (“Political realities make it unlikely that New York State’s sole trusteeship will be abolished any time soon. Doing so would take an amendment to the state constitution, an arduous process that requires two subsequent legislatures to enact a bill to that effect.”).

¹² Hakim, *supra* note 11, at B2; Walsh & Hakim, *supra* note 11, at B1.

¹³ *A Pension System Ready for Change*, *supra* note 11, at A8.

Although the Court of Appeals has held that the Comptroller's independent discretion is an aspect of the constitutional protection of the retirement fund, these holdings have come down in fact-specific contexts dealing with encroachments by the state legislature, or so-called "pension raid" scenarios, where the primary purpose of the legislative mandate interfered with the Comptroller's discretion, for a legislative purpose other than improving the fund.¹⁴ These cases do not foreclose, on constitutional grounds, the creation of a board of trustees to replace the Comptroller as sole trustee. This paper is not intended to advocate for a board of trustees, but rather to clarify the realistic options that should be discussed in the ongoing debate about pension fund reform, defuse the currently popular belief that the creation of a board is politically unrealistic, and emphasize the possibility that a board of trustees could be created to govern the Common Retirement Fund without amending the state constitution.

II. HISTORY OF THE NEW YORK STATE CONSTITUTION'S NONIMPAIRMENT CLAUSE

Historically, public pensions were characterized as a gift from the sovereign, but even before the constitutional amendment introducing the nonimpairment clause into the New York State Constitution, the treatment of pension funds by courts had been evolving. Prior to the enactment of the nonimpairment clause in 1938, courts regarded state and municipal pensions as legislative "gratuities" that did not vest any contractual right in the recipient, or alternatively, as a right that vested upon retirement. In the 1889 case *Pennie v. Reis*, for example, the United States Supreme Court denied a due process claim attempting to collect contributions to a public pension fund made from a deceased police officer's salary, where the police officer died before retirement.¹⁵ The Court held that the fund's character as a benefit for the police officer was "subject to change or revocation at any time, at the will of the legislature" and that "[t]here was no contract on the part of the State that its disposition should always continue as originally provided."¹⁶ The opinion concluded that there would be no vested right until payments to the police officer had commenced, and characterized the officer's pre-retirement interest in the pension

¹⁴ See *infra* Part V.A.

¹⁵ *Pennie v. Reis*, 132 U.S. 464, 471 (1889).

¹⁶ *Id.*

fund as “a mere expectancy created by the law, and liable to be revoked or destroyed by the same authority.”¹⁷

In the 1935 case of *Roddy v. Valentine*, the Court of Appeals indicated that a similar outcome was entirely possible in New York State.¹⁸ The court enforced the contractual pension right of a retired police officer who had taken up employment with another police department after his retirement, in spite of a law enacted after the date of his retirement barring pensioners from collecting their pensions in addition to other civil service compensation after retirement.¹⁹ The court also, however, discussed the nature of a participant’s interest in the pension fund more generally. Although the court conceded that pension benefits were no longer considered a mere “gratuity,” it also stated that this interest “can hardly be deemed contractual.”²⁰ The court suggested that it may be “quasi contractual” but concluded that, under any interpretation, “there seems to be no doubt that it is subject to change or even to revocation at the will of the Legislature.”²¹

Three years after the *Roddy* case, the New York State Constitution was amended to include the nonimpairment clause, guaranteeing that the dicta from *Roddy* would not come to fruition and deprive contributors to a pension fund of their accrued interest.²² The nonimpairment clause of the New York State Constitution, as well as similar provisions in other states’ constitutions, guarantees a vested contractual right to pension benefits upon commencement of membership in the state pension system.²³ In a 1958 case, the Court of Appeals indicated that the amendment was intended to guarantee pension rights to the public employee during his or her employment rather than vesting the interest at retirement since public employees forsake the higher wages that might be possible in the private sector in favor of state employment and they are induced to do so by other compensation,

¹⁷ *Id.*

¹⁸ *Roddy v. Valentine*, 197 N.E. 260, 262 (N.Y. 1935).

¹⁹ *Id.*

²⁰ *Id.* at 261–62.

²¹ *Id.* at 262.

²² 2 REVISED RECORD OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF NEW YORK 1405 (1938) (“[T]he Court of Appeals has held that on retirement the obligation partakes of a contractual relationship (*Roddy v. Valentine*). Previous to fulfilling all requirements for retirement, however, the pension and retirement systems are at the mercy of the legislatures . . . and the members have little, if any assured protection.” (quoting a memorandum supporting the amendment)).

²³ N.Y. CONST. art. V, § 7; Darryl B. Simko, *Of Public Pensions, State Constitutional Contract Protection, and Fiscal Constraint*, 69 TEMP. L. REV. 1059, 1060 (1996).

such as a guaranteed pension.²⁴ The record of the constitutional convention suggests a similar intention—to ensure that each state worker receives the “reward or benefit [that] is part of the compensation which he accepts in lieu of the greater rewards of private employment” and to protect public retirement systems from legislative interference.²⁵

Twenty years after the nonimpairment clause was added to the constitution, the New York State Special Legislative Committee on Revision and Simplification of the Constitution characterized the clause as a “Significant Problem Area” and complained that although there may be cause to retain such an amendment guaranteeing benefits, the clause as enacted was inadequate and exceedingly vague regarding what exactly constitutes “benefits” or exactly how such benefits would be impermissibly “impaired.”²⁶ This continuing ambiguity has arguably contributed to the current impression that an amendment to the constitution would be necessary in order to change the fund’s management structure.

III. THE ORGANIZATIONAL STRUCTURE OF THE NEW YORK STATE COMMON RETIREMENT FUND

The New York State Common Retirement Fund was created in 1967 to hold and distribute the assets of the Police and Fire Retirement System (PFRS) and the Employees’ Retirement System (ERS), with the State Comptroller acting as sole trustee.²⁷ For the 2006–07 fiscal year, the pension fund’s net assets were valued at \$156 billion.²⁸ Altogether, over one million members participate in the Common Retirement Fund, including employees, retirees, and other beneficiaries.²⁹ State law directs how the CRF may be invested.³⁰ Employers contribute to the system, and some employees make contributions as well, depending on which system they participate in and other variables such as tier of employment.³¹

²⁴ *Birnbaum v. N.Y. State Teachers Ret. Sys.*, 152 N.E.2d 241, 245 (N.Y. 1958).

²⁵ 2 REVISED RECORD OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF NEW YORK 1405 (1938).

²⁶ NEW YORK STATE SPECIAL LEGISLATIVE COMMITTEE ON REVISION AND SIMPLIFICATION OF THE CONSTITUTION, STAFF REPORT NO. 21 ON RETIREMENT 25, 29–30 (1958).

²⁷ N.Y. RETIRE. & SOC. SEC. LAW § 422(1) (McKinney 2005).

²⁸ OFFICE OF THE N.Y. STATE COMPTROLLER, *supra* note 2, at 21.

²⁹ *Id.* at 12.

³⁰ *See, e.g.*, N.Y. RETIRE. & SOC. SEC. LAW § 13 (McKinney 1999).

³¹ New York State Office of the State Comptroller, Snap Shot of New York State Common Retirement Fund, <http://www.osc.state.ny.us/pension/snapshot.htm> (last visited May 22, 2009).

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The Office of the State Comptroller carries out the Comptroller's fiduciary duty through several departments attending to different aspects of CRF investment, with assistance from internal and external advisors. Internal investment staff and external advisors are all part of the organizational chart leading to the Comptroller, who makes a final review of investment decisions. The Comptroller, as sole trustee, is the sole fiduciary accountable for pension fund investments and management, and its performance and oversight.³² A First Deputy Comptroller reports directly to the State Comptroller, and oversees Deputy Comptrollers who lead the Departments of Pension Investment and Cash Management (PICM) and Retirement Services. Assistant Deputy Comptrollers report to the Deputies. The Deputy Comptroller for PICM is directly accountable for the areas of corporate governance, equity and fixed income, alternative investments, and real estate, while the Deputy Comptroller for Retirement Services is responsible for accounting, actuarial, administrative services/quality performance, Advisory Council affairs, benefit calculations and disbursement, and a number of other services.³³ The Division of Investments and Cash Management invests the fund, which is divided into different asset classes (domestic equities, international equities, fixed income, real estate, short term, and alternative investments).³⁴

The Office of the State Comptroller has a wide variety of other responsibilities in addition to managing the Common Retirement Fund. The Comptroller is also responsible for overseeing the finances and procurement practices of state agencies, public authorities, and municipalities; managing the state payroll; conducting audits and investigations; analyzing legal issues related to state finances; releasing opinions; and reviewing the budgets of New York State and New York City.³⁵

IV. SCANDALS INVOLVING PENSION FUND INVESTMENT AND THE ONGOING CALL FOR REFORM

Due to the fund's status as one of the largest institutional investors in the nation, the Comptroller, as sole trustee, wields a

³² New York State Office of the State Comptroller, Fiduciary Responsibilities of Comptroller, <http://www.osc.state.ny.us/pension/fiduciary.htm> (last visited May 22, 2009).

³³ OFFICE OF THE N.Y. STATE COMPTROLLER, *supra* note 2, at 16.

³⁴ N.Y. STATE OFFICE OF THE STATE COMPTROLLER, 200TH ANNIVERSARY COMMEMORATIVE HISTORY 1797–1997, at 24 (1997).

³⁵ New York State Office of the State Comptroller, What are the Comptroller's Responsibilities?, <http://www.osc.state.ny.us/about/response.htm> (last visited May 22, 2009).

great deal of influence in securities litigation and the financial markets. The convergence of this influence with the Comptroller's status as an elected official has occasionally created an appearance of impropriety and allegations of corruption and abuse of discretion in New York and elsewhere.

A. The Most Recent Comptroller Controversies: Former Comptroller Alan Hevesi

The most recent controversy involving the State Comptroller and pension fund investment is the one involving former Comptroller Alan Hevesi, who resigned after pleading guilty to felony charges unrelated to CRF management.³⁶ After his resignation, however, reports surfaced that Hevesi and one of his top aides may have used pension fund business in order to secure loans and favors for family and friends.³⁷ Like other comptrollers, Hevesi has also faced pay-to-play allegations. In one instance, a large campaign contributor secured an investment of almost half a billion dollars from the pension fund³⁸ and there are allegations that one of Hevesi's top advisors and an aide working inside of the Comptroller's Office received millions of dollars in placement fees for directing business to the fund.³⁹ These controversies have prompted investigations by the Albany County District Attorney and New York State Comptroller and Attorney General, as well as a preliminary investigation by the Securities and Exchange Commission.⁴⁰

B. Allegations of Pay-to-Play in Former Comptroller McCall's Office

New York State Comptroller Alan Hevesi is not the first Comptroller to face criticism, and New York is not the only state whose comptroller or trustee has found himself or herself embroiled in scandal. Previous New York State comptrollers have faced

³⁶ Hakim, *supra* note 11, at B2 ("It was an initial investigation by Mr. Soares that led Mr. Hevesi to plead guilty to a felony, defrauding the government, and resign in December after revelations that he had used state workers to chauffeur his ailing wife.")

³⁷ Danny Hakim, *U.S. Examines Pension Fund of New York*, N.Y. TIMES, Oct. 12, 2007, at A1.

³⁸ Danny Hakim, *Cuomo Pension Fund Inquiry Reaches Bank of Ireland Unit*, N.Y. TIMES, Oct. 14, 2007, at A37.

³⁹ Mike McIntire, *Pension Inquiry Reveals a Power Broker's Web*, N.Y. TIMES, May 14, 2009, at A1; Ed Robinson, *Tougher Rules on Pension-Fund Fees*, N.Y. POST, Sept. 13, 2007, at 2.

⁴⁰ Nicholas Confessore, *Cuomo Announces Inquiry Into Conflicts Under Hevesi*, N.Y. TIMES, May 8, 2007, at B3; Michael Gormley, *SEC Probes Hevesi on Pension*, ALB. TIMES UNION, Oct. 13, 2007, at A3; Hakim, *supra* note 37, at A1.

allegations of conflicts of interest in the manner in which pension money managers are chosen and how investments are made.⁴¹ Comptroller H. Carl McCall was criticized for repeatedly doing business with campaign donors, and he acknowledged and responded to some of this criticism with a call for public financing of campaigns in order to eliminate the appearance of conflicts of interest.⁴²

Additional criticism arose regarding pay-to-play in class action litigation. Because public pension funds are such large institutional investors, the comptrollers and boards that control them are often involved in class action litigation on behalf of beneficiaries.⁴³ The litigant with the largest stake in a case typically chooses lead counsel, and enormous pension funds such as the New York State Common Retirement Fund are often in this position. In one case, Comptroller H. Carl McCall advocated for the selection of two of three law firms that had made about \$100,000 in contributions to McCall's campaign around the time when the firms were selected and retained.⁴⁴ The third firm received other business from the Comptroller's Office, unrelated to this particular case.⁴⁵

Other plaintiffs in the class action contested the appointment and accused the New York State Retirement Fund (and the other lead plaintiffs) of choosing the firm to reward it for campaign contributions.⁴⁶ The Third Circuit upheld the District Court's finding that there was inadequate proof of pay-to-play, but emphasized that the appointment of counsel based on considerations of campaign contributions rather than the interests of all of the plaintiffs would be highly inappropriate: "A movant that was willing to base its choice of class counsel on political contributions instead of professional considerations would . . . have quite clearly demonstrated that it would 'not fairly and adequately protect the interests of the class.'"⁴⁷ The Court explained that if the other plaintiffs had been able to "back[] up their claims" there

⁴¹ Lynn Hume, *Pay-to-Play: Draft Rule Due on Investment Adviser Giving*, BOND BUYER, Mar. 31, 1999, at 4.

⁴² H. Carl McCall, Letter to the Editor, *Good Timing at Times Square*, CRAIN'S N.Y. BUS., Sept. 23, 1996, available at WL 4723689.

⁴³ See Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1503 (2006).

⁴⁴ James D. Cox et. al., *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1611 (2006).

⁴⁵ Shaila K. Dewan, *Donors to McCall Profit in Cases State Pursues Against Corporate Wrongdoers*, N.Y. TIMES, Aug. 14, 2002, at B4.

⁴⁶ *In re Cendant Corp. Litig.*, 264 F.3d 201, 269 (3d Cir. 2001).

⁴⁷ *Id.*

would have been grounds to disqualify the group including the CRF from serving as lead plaintiff.⁴⁸

The Court also stated that in similar cases it would be appropriate for a district court to require public institutional investors to disclose campaign contributions that may be related to the selection of counsel, and “submit a sworn declaration describing the process by which it selected counsel and attesting to the degree to which the selection process was or was not influenced by any elected officials.”⁴⁹ The firms involved eventually received \$55 million for their work on the settlement, and in the year after the case the firms, their partners, and families contributed almost \$200,000 to McCall’s campaign.⁵⁰ Commentators argue that these practices may not only “invite[] corruption,” but may also inflate securities litigation rates.⁵¹

C. *The Investigation of Comptroller Edward V. Regan*

The conflict of interest between the fundraising concerns of an elected official and the investment and business decisions that must be made by a trustee to such a large fund is exemplified by the scandal involving Comptroller Edward V. Regan in the late 1980s. In 1989, the State’s Commission on Government Integrity investigated contributions made to Regan’s campaign by investment bankers and finance attorneys and found that those who made contributions to the Comptroller’s campaign or otherwise helped with fundraising were apparently rewarded with business from the Comptroller’s office.⁵² That same year, New York Governor Cuomo appointed a Task Force on Pension Fund Investment calling for, among other reforms, the creation of a seven-member board of trustees to administer the CRF.⁵³ The Commission’s report

⁴⁸ *Id.*

⁴⁹ *Id.* at 270 n.49.

⁵⁰ Cox et al., *supra* note 44, at 1611–12; Dewan, *supra* note 45, at B4.

⁵¹ John C. Coffee, Jr., *Corporate Securities: Nobody Asked Me, But...*, N.Y. L.J., Jan. 18, 2007, at 5.

⁵² STATE OF N.Y. COMM’N ON GOV’T INTEGRITY, *THE MIDAS TOUCH: CAMPAIGN FINANCE PRACTICES OF STATEWIDE OFFICEHOLDERS* 67–68 (1989) (“The fund-raising statistics show that the overwhelming majority of contributions to the Comptroller’s campaign committee come from the financial, legal, and real estate communities that do extensive business with his office, that contributions rose dramatically in the period following Palumbo’s ‘give-to-get’ memorandum, that particular firms who gave money to the Committee did, in fact, receive substantial business from the Comptroller’s Office, and that those involved in the fund-raising effort also received substantial business from the Comptroller.”); Gary Spencer, *State Bar Balks at Restrictions on Municipal Bond Lawyers*, N.Y. L.J., Apr. 7, 1998, at 1.

⁵³ GOVERNOR’S TASK FORCE ON PENSION FUND INVESTMENT, *OUR MONEY’S WORTH* 52

emphasized “the scope of the Comptroller’s discretionary decision-making, especially as it affects those groups,” individuals and businesses in the financial and real estate communities, and pointed out that “[t]his discretion is at its greatest over investment decisions for assets of the Common Retirement Fund.”⁵⁴ The Commission discussed the “enormous fees” generated by CRF transactions for “brokers, fund managers, and banks who manage the investments” and “legal fees for attorneys who represent [those involved]” and voiced concerns that “[t]his exclusive (and obscure) discretion to award enormous benefits, unique among statewide officeholders, has provided . . . the ingredients for potential abuse of many kinds, but particularly in the area of campaign finance.”⁵⁵

The Commission found that a high-level advisor on the state payroll at the Comptroller’s office acted as a liaison to Regan’s campaign committee, and that this liaison “wrote a series of memoranda to the Comptroller on Comptroller’s Office letterhead, setting forth in detail a campaign fundraising agenda that appear[ed] to link campaign contributions with the award of lucrative investment management contracts and other business by the Comptroller’s Office.”⁵⁶

In meetings leading up to the Regan scandal, campaign fundraisers (some of who were also state employees) observed that by virtue of his office and role as sole trustee of the CRF, the Comptroller has “more leverage than most elected officials since he provide[s] firms with actual dollars” and suggested a campaign strategy that would “make it clear that those who give will get.”⁵⁷ Fundraisers discussed a plan in which the Comptroller’s office and campaign committee would set up advisory boards “for each segment of the Common Fund’s asset base In order to get on these boards, members would be invited to pay \$20,000 a year, and of course, Ned [Regan] would end up doing most of the investment business with these people.”⁵⁸

(1989); Philip S. Gutis, *Task Force Challenges Regan As Single Trustee of Pension*, N.Y. TIMES, June 22, 1989, at B2.

⁵⁴ STATE OF N.Y. COMM’N ON GOV’T INTEGRITY, *supra* note 52, at 56–57.

⁵⁵ *Id.* at 57–58.

⁵⁶ *Id.* at 54.

⁵⁷ *Id.* at app. 3, exhibit 12 (Aug. 23, 1985 memorandum by Joe Palumbo entitled “Meeting with Rod Smith [from the National Republican Senatorial Committee]”).

⁵⁸ *Id.*

D. Notable Scandals Outside of New York

Similar scandals have occurred in other states. Perhaps the most notorious is the situation in Connecticut, where former state treasurer Paul Silvester and others were indicted and convicted for corruption-related charges including bribery; in one instance a lawyer gave an outright bribe in the amount of \$2 million to Silvester in exchange for a contract to manage the state's pension fund.⁵⁹ Although other controversies have not reached the extent of those in Connecticut, North Carolina's treasurer has also been accused of giving legal and investment business to large campaign donors.⁶⁰ This has led to calls from union officials to change the system of pension investment from a sole trustee organization to one with a board of directors; in an opinion piece for the *News & Observer* in North Carolina, the executive director of the state employees association there wrote: "Forty-six states have recognized a need to remove the opportunity to choose money managers for personal or political gain."⁶¹ Connecticut also has a sole trustee in charge of its state pension fund.⁶²

Of course pension fund scandals and mismanagement concerns are not limited to funds run by sole trustees. One example is San Diego's municipal retirement system, which is run by a board; six former members of that board are being prosecuted for alleged conflicts of interest that may have contributed to the system's one billion dollar deficit.⁶³ Other pension controversies have recently unfolded in Ohio and Illinois.⁶⁴

V. THE SOURCE OF THE COMPTROLLER'S ROLE AS SOLE TRUSTEE
AND THE LEGISLATURE'S ROLE IN ADMINISTERING THE CRF

The Comptroller's role as sole trustee is not found in the plain language of the Constitution;⁶⁵ instead, that authority was granted

⁵⁹ Stacey Stowe, *Lawyer Convicted in Corruption Scandal in Connecticut Seeks a New Trial*, N.Y. TIMES, Apr. 13, 2004, at B5.

⁶⁰ Neil Weinberg, *Pensions, Pals, Payola*, FORBES, Mar. 12, 2007, at 42.

⁶¹ Dana Cope, Editorial, *Beneath the Pension Praise*, NEWS & OBSERVER (Raleigh, N.C.), Apr. 24, 2007, at A11.

⁶² DENISE L. NAPIER, INVESTMENT POLICY STATEMENT FOR THE STATE OF CONNECTICUT RETIREMENT PLANS & TRUST FUNDS 4 (2007), available at <http://www.state.ct.us/ott/pensiondocs/IPSoct2007.pdf>.

⁶³ Greg Moran, *Court Lets Pension Case Go Forward: 6 Ex-Board Members Are Facing Charges*, SAN DIEGO UNION-TRIB., Sept. 8, 2007, at B1.

⁶⁴ Mary Williams Walsh, *Ex-Chief of S.E.C. Says Pension Funds in Danger*, N.Y. TIMES, Oct. 31, 2007, at C3.

⁶⁵ N.Y. CONST. art. V, §§ 1, 7. Illinois offers a comparative illustration; Illinois's

by the legislature in statute.⁶⁶ The nonimpairment clause creates in pension fund members a vested contractual right to their benefits, and “benefits” has been read by the Court of Appeals to include the discretion of the state comptroller.⁶⁷ This appears to have brought about an understanding by some, particularly in the news media, that “discretion” is meant to require sole discretion as sole trustee. These cases, however, addressed the Comptroller’s discretion in light of specific attempts by the legislature to alter the pension fund; the courts often refer to the reserved power of the legislature, and do not foreclose the possibility of an alteration of the manner in which the pension fund is invested, perhaps removing the comptroller as sole trustee.

A. Cases Involving the Comptroller and the Nonimpairment Clause

In determining whether a legislative action is an unconstitutional impairment of pension benefits, there is a distinction to be made between legislative meddling in fund investment and the legitimate exercise of legislative discretion over fund management. After all, the Comptroller’s present role as trustee was a statutory creation, and is not itself a constitutional mandate. This distinction is supported by case law; even where the Court of Appeals has invalidated statutes as violating the nonimpairment clause, it appears to have done so because the legislature’s actions were preoccupied with political concerns such as boosting the state economy or bailing out struggling municipalities. The court has pointed out that the state, in addition to the Comptroller, has a fiduciary duty to pension fund members. Where the legislature has exercised its prerogative to reform the fund’s management, in accord with its duty to members and with the fund’s performance clearly in mind, rather than exploiting it for an unrelated end, statutes have been upheld. The crux of a nonimpairment clause claim is necessarily *impairment* of pensioner’s benefits, and it is not a settled question whether the change to a board of trustees would

constitution has a provision similar to New York’s, but uses a board to manage its retirement fund. ILL. CONST. art. XIII, § 5; 40 ILL. COMP. STAT. 5/22A-101 (2007).

⁶⁶ N.Y. RETIRE. & SOC. SEC. LAW § 13 (McKinney 1999); §422(1) (McKinney 2005).

⁶⁷ See, e.g., *Sgaglione v. Levitt*, 337 N.E.2d 592 (N.Y. 1975) (holding that a statute mandating CRF investment in Municipal Assistance Corporation bonds is unconstitutional because it impairs pensioners’ right to the comptroller’s sole discretion); *McDermott v. Regan*, 624 N.E.2d 985 (N.Y. 1993) (holding that a statute altering funding methods of the CRF, diminishing employer contributions, is unconstitutional, discussing *Sgaglione’s* decision upholding the Comptroller’s role as trustee “as authorized by statute”).

constitute such an impairment.

1. *Brown v. N.Y. State Teachers Ret. Sys.*, 269 N.Y.S.2d 649 (N.Y. App. Div. 1966), *aff'd*, 226 N.E.2d 319 (N.Y. 1967).

*Brown v. New York State Teachers Retirement System*⁶⁸ offers some insight into whether a change in fund management is, in fact, an impairment. In a decision briefly affirmed by the Court of Appeals “upon the opinion at the Appellate Division,”⁶⁹ the Third Department held that it is within the legislature’s discretion to change a public retirement fund’s management structure in spite of the constitutional vesting of rights and prohibition of impairing benefits.⁷⁰

In *Brown*, a group of teachers sued when a change to the state’s education law increased the number of members on the New York State Teachers’ Retirement System’s board.⁷¹ Under the previous statute dictating the board’s composition, three of seven posts were to be filled by teachers; the new statute maintained three teacher-representatives while increasing the overall size of the board to nine members.⁷² The teachers argued that their diminished proportional representation and diluted power on the board was an unconstitutional impairment of pension benefits.⁷³ The court held for the Retirement System, finding that proportionate representation on the board was not a benefit guaranteed by the state constitution’s nonimpairment clause.⁷⁴

2. *Sgaglione v. Levitt*, 337 N.E.2d 592 (N.Y. 1975).

In *Sgaglione v. Levitt*, the Court of Appeals held that the legislature unconstitutionally impaired pension benefits by forcing the state comptroller to purchase Municipal Assistance Corporation (MAC) bonds as a bailout strategy during a New York City financial crisis.⁷⁵ The court in *Sgaglione* held that the deprivation of the Comptroller’s “independent judgment” in making investments constituted an impairment of the pension benefits guaranteed by

⁶⁸ *Brown v. N.Y. State Teachers Ret. Sys.*, 269 N.Y.S.2d 649 (N.Y. App. Div. 1966), *aff'd*, 226 N.E.2d 319 (N.Y. 1967).

⁶⁹ *Brown*, 226 N.E.2d at 320.

⁷⁰ *Brown*, 269 N.Y.S.2d at 650.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.* at 650–51.

⁷⁵ *Sgaglione v. Levitt*, 337 N.E.2d 592, 594 (N.Y. 1975).

the Constitution.⁷⁶

The court also pointed out, however, that while the constitution only literally protects “benefits” there is necessarily an implication that the underlying “contract” is protected as well.⁷⁷ Citing *Brown* and other cases, the court referred to the “flexibility” reserved to the legislature to change the “management of the funds” and “the manner of paying contributions” and “to fund deficiencies in actuarial reserve, and to authorize the investment of the funds.”⁷⁸ The opinion mentioned that the Comptroller’s role as sole trustee was in fact a statutory grant of authority from the legislature, and that the difference between an appropriate exercise of legislative power and an unconstitutional one is the difference between “authority to invest and a mandatory direction to invest in certain securities, and in certain minimum amounts, whether or not the State Comptroller deems it advisable.”⁷⁹ The court characterized the statute as one requiring the comptroller to “mindlessly invest in whatever securities [the legislature] direct[s],” therefore violating the nonimpairment clause.⁸⁰

In a later case, a plaintiff cited *Sgaglione* for its contention that the deferral of payments from schools to the New York State Teachers’ Retirement Fund similarly impaired pensioners’ benefits.⁸¹ In effect, the deferral of payments served as a loan to the schools.⁸² The state legislation enacting this loan, however, reserved to the fund’s Board of Trustees the right to approve or reject the deferral.⁸³ The Third Department rejected the plaintiffs’ claim and distinguished *Sgaglione* because the legislation in the case at hand, as opposed to the legislation in *Sgaglione*, “preserved the Board’s freedom to exercise its independent judgment whether to make the loan to the school districts.”⁸⁴

The background and subsequent interpretation of *Sgaglione* suggest that protection of the Comptroller’s “independent discretion” referred to his or her independence vis-à-vis the

⁷⁶ *Id.* at 596.

⁷⁷ *Id.* at 594.

⁷⁸ *Id.* at 595 (citing *Brown v. N.Y. State Teachers Ret. Sys.*, 226 N.E.2d 319 (N.Y. 1967)).

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Bd. of Educ. of W. Islip Union Free Sch. Dist. v. N.Y. State Teachers Ret. Sys.*, 605 N.Y.S.2d 432, 433 (N.Y. App. Div. 1993). As a public retirement system, the New York State Teachers’ Retirement Fund is covered by the state constitution’s nonimpairment clause. N.Y. CONST. art. V, § 7.

⁸² *Bd. of Educ. of W. Islip Union Free Sch. Dist.*, 605 N.Y.S.2d at 433.

⁸³ *Id.*

⁸⁴ *Id.*

legislature, as opposed to “independence” as a “sole” trustee. In *Sgaglione* the state legislature attempted to force the state comptroller to invest in securities regardless of whether he thought the investments were sound. This type of direction would clearly infringe upon the comptroller’s—or any other fiduciary’s—powers and responsibilities to the fund. The facts of *Sgaglione* leave open the question whether a statutory change from a sole trustee to a board would effect such an infringement, or if it would fall within the purview of the legislature as part of its authority to change the “management of the fund.”

3. *McDermott v. Regan*, 624 N.E.2d 985 (N.Y. 1993).

In *McDermott*, public employees and their representatives challenged state legislation changing the funding method of the Common Retirement Fund.⁸⁵ The proposed change was from an aggregated cost method, which requires funding some benefits before they accrue, to a projected unit credit method, which would have allowed the state to find a “surplus” in the pension fund and dramatically reduce the amount that employers would have been required to pay into the system.⁸⁶ The law was in response to a statewide economic crisis, and was intended to alleviate the burden of this crisis upon state and municipal employers⁸⁷ by lowering the short-term obligations of state and local governments to the fund.⁸⁸

Citing *Sgaglione*, the Court of Appeals held that the funding change violated the nonimpairment clause by impairing the Comptroller’s ability to “exercise his independent judgment” as trustee of the fund.⁸⁹ The Court did not mention the management structure of the fund, or the status of Comptroller as “sole” trustee; it discussed the Comptroller’s discretion in relation to that of the legislature, which, in this case, was held to have unconstitutionally encroached upon his autonomy.⁹⁰ The court cited the *Sgaglione*

⁸⁵ *McDermott v. Regan*, 624 N.E.2d 985, 987 (N.Y. 1993).

⁸⁶ *Id.*

⁸⁷ *Id.* at 989.

⁸⁸ Gerard E. Harper, *Discipline is Imposed on Fiscal Legislation*, N.Y. L.J., Oct. 3, 1994, at S8.

⁸⁹ *McDermott*, 624 N.E.2d at 988 (“[T]he critical inquiry involved whether the [fund would] be impaired by depriving the State Comptroller of freedom to exercise his independent judgment whether to invest in [the] bonds.’ This Court answered that inquiry in the affirmative.” (citation omitted) (quoting *Sgaglione v. Levitt*, 337 N.E.2d 592, 596 (N.Y. 1975))).

⁹⁰ *Id.* at 988 (“Similarly [to *Sgaglione*], where the State Comptroller here has been divested of his autonomous judgment as to whether the PUC method is preferable to the AC method, we hold that section 210 violates the Nonimpairment Clause.”).

opinion's disinterest with "whether the scheme was 'good, indifferent, or bad,'" indicating that the impairment does not lie in the depletion of the fund, but rather in the inappropriate (and unconstitutional) encroachment upon the discretion and autonomy of the Comptroller's statutory authority as trustee of the fund.⁹¹

The Court also discussed the legislature's "limited" role in overseeing the Common Retirement Fund, and the state's fiduciary responsibility to fund participants "to act in their best interests":⁹²

[T]he New York State Constitution authorizes the State to circumscribe the Comptroller's powers and duties. . . . Where the State maintains such authority in regard to the actual trustee of the funds . . . concomitant with that authority is the State's duty to act in a manner consistent with the goal of the 'protection' of these funds The State must show, like any other trustee or fiduciary, that it has not breached that duty.⁹³

Commentators do not universally agree that the statute in *McDermott* actually impaired pension benefits. The Court of Appeals characterized Chapter 210 as a "radical change" which "deplete[d] several years of accrued retirement benefits involving millions of dollars and arguably destabilize[d] the fund."⁹⁴ Some commentators, however, have suggested that Chapter 210 merely deprived the fund of payments that it was not yet entitled to receive, and the court's decision in *McDermott* "relied on the broadest possible interpretation of the Constitution" by finding impairment in the deprivation of the Comptroller's discretion to decide what funding method is best for the fund.⁹⁵

4. *McCall v. State*, 640 N.Y.S.2d 347 (N.Y. App. Div. 1996)

McCall v. State, a Third Department case, dealt with legislation passed in the aftermath of the *McDermott* decision. After Chapter 210 was held unconstitutional in *McDermott*, Comptroller McCall enacted a plan to restore the contributions that were lost while the overturned funding method was still in place.⁹⁶ Rather than appropriate the contributions according to the Comptroller's plan,

⁹¹ *Id.* (quoting *Sgaglione*, 337 N.E.2d at 595 (N.Y. 1975)).

⁹² *Id.* at 988–89.

⁹³ *Id.* at 989.

⁹⁴ *Id.* at 988.

⁹⁵ Harper, *supra* note 88, at S8.

⁹⁶ *McCall v. State*, 640 N.Y.S.2d 347, 349 (N.Y. App. Div. 1996); *see also* discussion of *McDermott*, text accompanying *supra* notes 85–86.

however, the legislature passed a law granting a credit to state and municipal employers, assessing the amount they would otherwise have had to pay against the supplemental reserve fund (SRF).⁹⁷ The Comptroller and members of the retirement fund challenged the legislation as an unconstitutional impairment of benefits.⁹⁸

The Third Department invalidated the portion of the law granting a credit to employers as unconstitutional.⁹⁹ The court held that the SRF is a part of the retirement system, and as such falls under the authority of the state comptroller as trustee; in large part, the court's reasoning relied on the comptroller's fiduciary role, and the fact that members of the retirement system are constitutionally entitled to his independent judgment regarding the most fiscally appropriate method of management and investment of the fund.¹⁰⁰ The court pointed out that the law infringed on the constitutionally protected contractual right to the Comptroller's independent judgment in investing the fund for the benefit of both members and taxpayers.¹⁰¹

5. *Guzdek v. McCall*, 749 N.Y.S.2d 827 (N.Y. Sup. Ct. 2002).

Guzdek v. McCall held that a legislative action did not unconstitutionally impair pension benefits. The statute that prompted this case ("Chapter 411") provided for the payment of administrative costs directly from the pension fund as long as current and future obligations would not be affected by the payment.¹⁰² The Comptroller previously collected these costs from employers.¹⁰³ The legislation was in response to successful management of the pension fund, which allowed investment earnings to offset employer contributions completely.¹⁰⁴ In years when employer contributions are zero, the law would allow the Comptroller to pay administrative costs from the fund itself, rather than seek reimbursements from employers.¹⁰⁵ The law was challenged by a group of retirement system members who claimed that it unconstitutionally impaired their pension benefits by, among

⁹⁷ *McCall*, 640 N.Y.S.2d at 349.

⁹⁸ *Id.*

⁹⁹ *Id.* at 350–51.

¹⁰⁰ *Id.* at 350.

¹⁰¹ *Id.*

¹⁰² *Guzdek v. McCall*, 749 N.Y.S.2d 827, 829 (N.Y. Sup. Ct. 2002).

¹⁰³ *Id.* at 832.

¹⁰⁴ *Id.* at 830.

¹⁰⁵ *Id.*

other impairments, denying them of their right to the Comptroller's independent discretion in managing the fund for the benefit of members.¹⁰⁶

The Albany County Supreme Court upheld Chapter 411, and distinguished *Guzdek* from prior cases where the challenged legislative enactments were primarily and obviously concerned only with solving the state's financial problems (and not the soundness of the state retirement fund).¹⁰⁷ In this case, Chapter 411 was clearly enacted with the welfare of the pension fund as a primary concern, with its "safety trigger" and "circuit breaker" provisions limiting its applicability to years when current and future pension benefits were absolutely insulated from impairment by administrative payments.¹⁰⁸ The court held that Chapter 411's scope, dealing with "a change in the manner of how administration contributions are paid," qualifies as within the legislature's reserved authority (alluded to in earlier cases), and does not constitute a "radical change" because it did not destabilize the fund or "strip" the Comptroller of his independent judgment, "personal responsibility, [or] commitment to his oath of office."¹⁰⁹ This holding, while emphasizing the importance of the Comptroller's independence from the legislature, also highlights the distinction between impermissible "pension raid" statutes that use the fund for completely unrelated, often political purposes, and permissible statutes enacted in accordance with the state's fiduciary duty to investors and with the fund's continued strength clearly in mind.

B. Conclusions Regarding Case Law

Members of the retirement system are guaranteed a contractual right to their pension benefits by the New York State Constitution. Since the Comptroller is sole trustee under the current statutory scheme, the constitutional guarantee translates to a protection of the Comptroller's independent judgment. It appears, however, that a statutory change from a sole trustee to a board would merely vest in the board the authority and discretion currently exercised by the Comptroller. In other words, the Comptroller's role as sole trustee is not inherent in the nonimpairment clause—the management structure of the fund was determined by the legislature in statute.

¹⁰⁶ *Id.* at 831–32.

¹⁰⁷ *Id.* at 836.

¹⁰⁸ *Id.* at 833.

¹⁰⁹ *Id.* at 834–35.

“The Constitution does not, in terms or otherwise, preserve naked pension rights *qua* rights but, rather, the benefits of the contractual relationship.”¹¹⁰ The question is whether the sole trustee structure of the Common Retirement Fund is a benefit included in that contractual relationship at all.

On one hand, the courts that have dealt with nonimpairment clause cases, including New York’s highest court, have rested a great deal of their reasoning on the State Comptroller’s “independent judgment” and “autonomy” in striking down legislative infringements. On the other hand, the cases where these laws have been held unconstitutional have often involved so-called “pension raid” statutes where the legislature has viewed the pension fund as a resource in tackling state and municipal economic crises.

Pension raids are exactly the type of problem the nonimpairment clause was enacted to address,¹¹¹ and are distinct from a statute changing the fund’s management structure. “Independent” and “autonomous” in the pension raid context can be interpreted in relation to encroachment by the legislature on the Comptroller’s fiscal decisions, and not necessarily requiring the Comptroller’s “sole” judgment as one single trustee or divesting the legislature of its prerogative regarding broader issues of fund management. In fact, during debate over the amendment at the 1938 Constitutional Convention, one supporter specifically discussed the supposed problem of “freezing’ unsound systems” around the state that were in need of substantial reforms.¹¹² He allayed these concerns by stating that “[s]o long as the benefits are not diminished or impaired there is no barrier to improvement in the systems,”¹¹³ suggesting that the nonimpairment clause was never intended to obstruct management reforms to retirement funds such as the CRF.

This interpretation of independence and autonomy in relation to attempts by the legislature to raid pension funds is supported by the Supreme Court’s interpretation of the case law in *Guzdek*.¹¹⁴ In a case where the Comptroller was indeed supportive of the legislature’s action, the law was upheld in part because it was enacted with the interests of pension fund members as an utmost

¹¹⁰ *Mutterperl v. Levitt*, 393 N.Y.S.2d 837, 839 (N.Y. Sup. Ct. 1975), *aff’d*, 363 N.E.2d 587 (N.Y. 1977).

¹¹¹ See discussion *supra* notes 15–21 and accompanying text.

¹¹² 2 REVISED RECORD OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF NEW YORK 1405–06 (1938).

¹¹³ *Id.*

¹¹⁴ See discussion of *Guzdek*, *supra* notes 107–09 and accompanying text.

concern. In contrast, the Comptroller's independence has been cited as inviolable in cases where the legislature attempted to force the purchase of specific bonds as a bailout for New York City's financial crisis, or where the state attempted to solve a budget deficit by manipulating the method of funding the CRF in order to immediately create a surplus and release employers from years of contributions.

The Third Department's interpretation in distinguishing *Board of Education of West Islip* is also telling. In that case, the source of pension benefits was essentially used to give a loan to schools. Such a use would appear to deplete or impair the fund, but because the trustees of the fund retained their autonomous judgment in deciding to use the fund in such a way, the loan was not an unconstitutional impairment.¹¹⁵ In addition, the Court of Appeals indicated in *McDermott* that at least part of the problem with the legislature's encroachment is the inescapable conclusion that the legislation was intended to resolve a state financial crisis and was not in keeping with the legislature's fiduciary responsibility to make changes to the CRF in order to benefit pensioners, and that it may have constituted a breach of the state's duty to retirement system participants.¹¹⁶

The creation of a board of trustees to invest the CRF would be a change in management structure, but it would not dilute any particular constituency's influence on fund management. The statutory amendment in *Brown* did more than just change the fund's management structure—it diluted teachers' influence over their retirement fund. Even in the face of this arguably tangible dilution of the teachers' authority on the board, the court rejected their reasoning and held in favor of the fund.¹¹⁷

Read in context, the case law regarding the independent discretion of the Comptroller as sole trustee of the CRF does not foreclose reforming the fund to move fiduciary authority to a board of trustees, as long as that board of trustees maintains the same level of independence from legislative encroachment. Advocates of such a change have suggested this interpretation of the case law in

¹¹⁵ See discussion of *Bd. of Educ. of W. Islip*, *supra* notes 81–84 and accompanying text.

¹¹⁶ *McDermott v. Regan*, 624 N.E.2d 985, 989 (N.Y. 1993) (“Thus, in those areas where the Legislature has some flexibility with respect to the administration of the fund, it yet remains bound by the same fiduciary duties required of any other acting in a fiduciary capacity, those of protecting the interests of the beneficiary. Here, it is uncontroverted that the only factor the Legislature considered when it chose to alter the funding method was that of the fiscal crisis facing the State.” (citation omitted)).

¹¹⁷ *Brown v. N.Y. State Teachers Ret. Sys.*, 269 N.Y.S.2d 649, 651 (N.Y. App. Div. 1966).

the past.

In its report almost twenty years ago, the Governor's Task Force on Pension Fund Investment called for a board of trustees to replace the comptroller as sole trustee, and clearly stated that "the proposed changes in the trusteeship can be achieved by amending state law. No constitutional amendment is required."¹¹⁸ The report briefly cited to *Sgaglione's* mention of legislative flexibility and *Brown's* affirmance of a new and less proportionate board composition as evidence that contemporaneous claims that a constitutional amendment was needed were mistaken.¹¹⁹ Nearly two decades later, however, with many news reports premising the reform debate on the assumption that such an amendment would be necessary to institute a board of trustees, the question apparently has not been conclusively resolved.

VI. THE LATEST CALL FOR A BOARD

A number of reforms have been suggested by key players in Albany and beyond since Hevesi's departure from the Office of State Comptroller. His successor, Comptroller Thomas DiNapoli, has undertaken an impressive reform effort; he has instituted new internal controls in the Office, and is working with the Insurance Department to achieve further transparency and accountability.¹²⁰ In light of the most recent developments involving kickbacks to Hevesi's aides and advisors, DiNapoli has also banned so-called "placement agents" from being involved in pension fund investments, and he has begun strongly advocating for a public financing bill that would apply to comptroller candidates to help eliminate the connection between campaign contributions to state comptroller candidates and the investments that are eventually made.¹²¹ Comptroller DiNapoli has said himself, however, the integrity of the fund under any management structure will ultimately depend on the scruples of the person at its helm,¹²² and as illustrated by the actions of Comptroller Regan's campaign

¹¹⁸ GOVERNOR'S TASK FORCE, *supra* note 53, at 53.

¹¹⁹ *Id.*

¹²⁰ STATE OF N.Y. OFFICE OF THE STATE COMPTROLLER, NEW YORK STATE COMMON RETIREMENT FUND PENSION REFORM AGENDA OVERVIEW (2007), *available at* <http://www.osc.state.ny.us/pension/reform.pdf>.

¹²¹ Office of the New York State Comptroller, DiNapoli Bans Placement Agents: Renews Call for Public Campaign Financing; Review of Hevesi Investments Underway (April 29, 2009), <http://www.osc.state.ny.us/press/releases/apr09/042209.htm>.

¹²² *See infra* note 129 and accompanying text.

fundraising staff, the fund's integrity may depend not only on the trustee himself, but also upon many other advisors and staff members.¹²³

In the current climate, whenever the topic of changing the management of the fund to a board from the sole trustee structure is proposed, the proposal is often written off as a fool's errand, since such a change is said to require a constitutional amendment. While a detailed analysis of whether a board of trustees is preferable to a sole trustee falls beyond the scope of this paper, it is important during this time of sweeping reforms inside and outside of the Comptroller's office to consider all of the available options in order to reach an optimal result, even if that result does not ultimately require the creation of a board of trustees.

The recent discussion of changing the organization of the pension fund to place control in the hands of a board of trustees rather than a sole trustee is not novel. Interestingly, more than one state comptroller has suggested or advocated for the change to a board, only to come under fire for improper investment activities later in his tenure as sole trustee. Comptroller Edward V. Regan supported the sharing of responsibility with a board, while suggesting that the board should remain under his control.¹²⁴ As discussed previously, Comptroller Regan's office was later criticized when internal memoranda written by close advisors suggested that "[t]hose [w]ho [g]ive [w]ill [g]et," meaning the comptroller should reward top donors with business and favorable investments.¹²⁵ During their respective campaigns, Comptrollers H. Carl McCall and Alan Hevesi both supported the change to a board of trustees for the fund.¹²⁶ McCall was later accused of giving pension fund business to money management firms that made large campaign

¹²³ See *supra* notes 52–58 and accompanying text.

¹²⁴ Mary Judice, *Managers Told to Run Funds Only for Retirees*, NEW ORLEANS TIMES PICAYUNE, Apr. 24, 1992, at C1 ("Regan also said a sole trustee wields too much power and that he had urged legislation calling for a board of trustees instead."); Elizabeth Kolbert, *Regan, Under Fire, Comptroller Tends to Job, Not Image*, N.Y. TIMES, Mar. 9, 1989, at B1.

¹²⁵ Kolbert, *supra* note 124 at B1; See *supra* notes 52–58 and accompanying text.

¹²⁶ Chris Clair, *November Election: New York Could Change Way It Oversees Pension Assets*, PENSIONS & INVESTMENTS, Sept. 30, 2002, at 32 (quoting former Comptroller Alan Hevesi as saying "I have a bias toward boards of trustees The decision-making is collegial, it's subject to full disclosure and lots of independent people join in the decision-making. Having a board of trustees is preferable" and discussing McCall's support for a board of trustees to share oversight of the fund); Harold McNeil, *McCall, Faso Vow to Guard Pension Public Employees' Union Hears Candidates*, BUFFALO NEWS, Oct. 23, 1993, at B4 ("McCall told delegates that while it is a heady experience being sole trustee of the third-largest pension fund in the country, he would be willing to share the responsibility with a board of trustees.").

contributions,¹²⁷ and Hevesi's alleged misuse of the fund is currently under investigation.¹²⁸ Current Comptroller Thomas DiNapoli, who took the position in the wake of Hevesi's resignation, has supported the sole trustee structure. Even Mr. DiNapoli, however, qualifies his support somewhat: "I don't argue that, by definition, a sole trustee is better than a board. But any system that is dependent on human beings is open to compromise, and things that will go wrong."¹²⁹

In 1993, the State Assembly passed a bill that would have created a board of trustees to direct the Comptroller in investing the Common Retirement Fund as a custodian rather than trustee.¹³⁰ This legislation would have created a seventeen-member board, with the Comptroller acting as member and chairperson, and directed the composition of the board as well as the manner in which members would be chosen.¹³¹ The bill, passed by the Democratic Assembly, had its detractors in the Republican Senate; even the Senate Majority Leader, however, countered the proposal with his own version of a much smaller, four-member board of trustees rather than a defense of the sole trustee structure.¹³² The Majority Leader claimed that the Assembly's proposal "would simply carve in statute the comptroller's existing hand-picked advisory board, which could be used as convenient 'cover' for questionable investments that sacrifice pensioners' future financial security to reward political friends or bolster fas[h]ionable social causes."¹³³ His criticism was apparently devoid of potential constitutionality issues.

In 1989, the Governor's Task Force on Pension Fund Investment included a change from a sole trustee to a board of seven trustees in its recommended pension fund reforms, and dismissed arguments that such a change would require a constitutional amendment.¹³⁴ The Task Force cited several reasons for this recommendation, including: the "awesome [oversight and management] responsibility" for a sole trustee entailed by the fund's "expanding

¹²⁷ Clair, *supra* note 126, at 32.

¹²⁸ Isabelle Clary, *Real Estate Helping N.Y. Common Fund Through Subprime Blast*, PENSIONS & INVESTMENTS, Oct. 1, 2007, available at <http://www.pionline.com/apps/pbcs.dll/article?AID=/20071001/REG/70928042/1030/TOC>.

¹²⁹ *Id.*

¹³⁰ Assem. 2454, 1993 Leg., 216th Reg. Sess. § 2(b) (N.Y. 1993).

¹³¹ Assem. 2454, 1993 Leg., 216th Reg. Sess. § 421-a (N.Y. 1993).

¹³² Ralph J. Marino, Letter to the Editor, *Viewpoints: Protecting Retirement Funds*, NEWSDAY, June 15, 1993, at 85.

¹³³ *Id.*

¹³⁴ GOVERNOR'S TASK FORCE, *supra* note 53, at 52–54, 60–61.

economic power, the increasing complexity of the financial markets[,] . . . the growing number of proxy votes, tender offers and similar issues” as well as the preference for a “more representative form of governance” and the improvement a board offers to “the quality of decision-making by bringing into the process a broader array of viewpoints and diversity of sources of information.”¹³⁵ The report also argued that “a board would increase the capacity of the System to address the new and expanding range of issues arising from [the] System’s ownership and corporate governance responsibilities”¹³⁶—responsibilities which have surely increased over the past two decades—and that a board would be better able to devote an appropriate amount of time and attention to the fund’s management.¹³⁷

In 2007, the Stanford Law School’s Institutional Investor’s Forum Committee on Fund Governance released a report on Best Practice Principles (“the Clapman Report,” referring to Peter Clapman, who chaired the committee). Although the Clapman Report does not condemn the sole trustee structure, in a footnote the structure is characterized as “rare,” requiring the development of an advisory committee incorporating experienced members with varied and balanced skill sets.¹³⁸ At the same time, the report emphasizes the need for a qualified, experienced board that, “[v]iewed as a group . . . should be composed of individuals with a portfolio of skills that allows it to make responsible, informed investment and legal decisions.”¹³⁹ The report also calls for ongoing evaluation and education to improve trustee competencies.¹⁴⁰ In addition to a diverse range of financial and legal competencies, the ideal board would include members able to devote the requisite amount of time and attention to upholding fiduciary duties.¹⁴¹ The report emphasizes the need to strike a “delicate balance of authority and responsibility between the board and staff” and preserving this balance by publishing “a charter that articulates the role and responsibility of trustees and staff [which] should also describe the process that determines the hiring and dismissal of key staff and

¹³⁵ *Id.* at 52–53.

¹³⁶ *Id.* at 53.

¹³⁷ *Id.*

¹³⁸ STANFORD INSTITUTIONAL INVESTORS’ FORUM, COMMITTEE ON FUND GOVERNANCE, BEST PRACTICE PRINCIPLES 8 n.9 (2007), available at <http://www.law.stanford.edu/ClapmanReport>.

¹³⁹ *Id.* at 7.

¹⁴⁰ *Id.* at 10.

¹⁴¹ *Id.*

provide for a regular scheme to assess staff performance.”¹⁴²

While Comptroller DiNapoli’s ongoing reform efforts will undoubtedly address many of these important principles of fund governance, it is important to consider the move from a sole trustee to a board as a tenable option in the ongoing reform debate. Although statutory, regulatory, and internal improvements can help to achieve many of these best practices, a board structure may be more conducive to achieving certain reforms. For instance, it stands to reason that the duties and responsibilities of staff are more likely to blur when staff and advisory committees must shoulder a great deal of responsibility, working below a comptroller who is a sole trustee with inherently limited competency and a vast array of other official duties unrelated to the fund.

Current state comptroller Thomas DiNapoli has suggested that it is preferable to have one individual who is completely accountable for the pension fund, and that citizens can express their concerns at the ballot box.¹⁴³ Critics may fear the potential damage that could be done in between elections, however, and sole accountability is necessarily coupled with a degree of self-regulation that critics of the current system find disquieting. Although supporters of the current system argue that a sole trustee is more accountable than a board of trustees, there are currently many individuals and organizations involved in pension fund investments, with a variety of occasionally conflicting interests. The Comptroller, of course, has an extensive staff, and is required by state law to consult with an advisory board incorporating input from investment advisors from the private sector.¹⁴⁴

The diversity of a board of trustees also offers the benefit of additional expertise and experience. The State Comptroller is a popularly elected politician with many different responsibilities unrelated to managing the pension fund, including oversight of state finances, conducting audits, managing the state payroll, etc. Even the most competent and qualified comptroller is unlikely to rival the diversity of experience and expertise of a board of several fiduciaries. Although the Comptroller has an arsenal of employees and consultants with impressive qualifications and varied backgrounds, their efficacy is limited compared to that of a board of trustees, and their interests may not always coincide with those of beneficiaries. Arguably, as pointed out in the 1989 Task Force

¹⁴² *Id.* at 8.

¹⁴³ Walsh & Hakim, *supra* note 11, at B1.

¹⁴⁴ N.Y. RETIRE. & SOC. SEC. LAW § 11 (McKinney 1999); § 423(b) (McKinney 2005).

report, a board of trustees would also increase the amount of direct attention paid by fiduciaries to the management of the fund.¹⁴⁵

Certainly, boards of trustees are not immune to corruption, and the concentration of authority and accountability in a sole trustee has arguable advantages. Indeed, a board with too many members appointed by the legislature could legitimize “pension raid” statutes; such a statute could set forth the proposal and defer to the board the power to approve or deny it, thereby maintaining the appearance of fiduciary independence—and the constitutionality of the statute—while actually assuring the exploitation of the fund for inappropriate purposes. That result is precisely what the nonimpairment clause was meant to prevent, and a board structure should not circumvent it through a technical subversion of its intent.

It is important, however, that the state legislature, the governor, and reform experts tapped by Mr. Dinapoli earnestly explore all of the options and engage in a sincere debate about pension fund reform, rather than limiting their proposed reforms to those fit for the continuation of a sole trustee structure. In order to achieve this level of candid, open, and inclusive discussion, it is important to point out that the change from a sole trustee to a board is in fact a politically realistic option, and would not require a state constitutional amendment.

VII. CONCLUSION

During this latest cycle of pension fund reform debates, even advocates for a board of trustees seem resigned to the “political reality” that such a change would require a constitutional amendment. The discourse is therefore constrained to the topic of improving of the sole trustee structure, rather than exploring a broad spectrum of reforms. A review of nonimpairment clause case law, however, suggests that the change could be achieved in statute, without amending the state constitution. The comptroller’s role as sole trustee is not inherent in the New York State Constitution’s Nonimpairment Clause, and the case law does not necessarily suggest that the sole trustee structure is a “benefit” that would be included in contractual relationship between retirement system members and the state. If this is indeed the case, a statutory scheme immediately moving the management of the fund from the

¹⁴⁵ GOVERNOR’S TASK FORCE, *supra* note 53, at 52–53.

State Comptroller to a board of trustees would not run afoul of the state constitution's nonimpairment clause.

It is not necessarily clear that such a move would be desirable, or likely to improve the performance or integrity of the Common Retirement Fund—that determination is best left to the financial and policy experts currently reassessing the Office's investment practices. It is crucial, however, that the determination is in fact made, and that legislative leaders earnestly study and discuss the ramifications of the sole trustee versus a board, rather than summarily dismissing this important and very realistic option as too remote a possibility to warrant serious consideration.