The Public Piggy Bank Goes to Market: Public Pension Fund Investment in Common Stock and Fund Trustees' Social Agenda

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Although public pension funds are to be held in trust for the exclusive benefit of pensioners and beneficiaries, some trustees are using the funds' tremendous financial clout to effect social change. The use of public pension funds for this purpose violates numerous state and federal statutes as well as the United States Constitution.

I. INTRODUCTION

Public pension funds across the United States have amassed half-a-trillion dollars in retirement funds. Pursuant to state and federal law, these funds must be invested and reinvested in a diverse portfolio of holdings to obtain the best possible return. Because of the ever-increasing size of the portfolios, fund trustees have expanded the types of investments into areas previously unheard of for "safe" pension investments.

Public pension funds have increased their holdings in private corporations from one percent in 1950 to thirty-nine percent in 1989.¹

This ever-expanding involvement raises several questions. The pension system administrators owe a fiduciary duty to the beneficiaries of the funds to maximize the return on the investment. Fund investment must be based on sound economic principles. However, some public pension funds have begun basing investments on factors such as a corporation’s stand on environmental issues, corporate governance issues (the balance of power between stockholders and management), affirmative action, and other types of “social investing.” Federal statutory provisions in the Internal Revenue Code, the Securities and Exchange Act of 1934, the Clayton Antitrust Act, and the Employee Retirement Income Security Act (ERISA) also play a role in determining the legality of certain investments. Each of these statutes requires that the investment of pension funds be made for the exclusive benefit of the beneficiary. The 1934 Act and the Clayton Act also have reporting requirements from which institutional investors are exempt only if they do not seek to influence the management of the corporation.

In California, the state constitution clearly prescribes a duty by which the trustee of the pension funds must act for the sole and exclusive benefit of the pensioners. The standard of care is that of a prudent investor. When California public pension fund systems invest in particular companies to further a social agenda, a clear conflict exists between those actions and the duty mandated by the state constitution.

Social investment also raises issues under the United States Constitution First Amendment Freedom of Speech and Association Clauses. Because public employee contributions to the pension funds are compulsory, the funds’ administrators should not use those monies to make political or ideological statements. This paper argues that pensioners have the constitutional right not to fund political activities with which they disagree. Another concern is the extent to which public entities should be able to control private corporations.

Until 1967, California public entities could not invest in private corporations at all. This rule is still used in one state, and other

1. at 10 (1990) [hereinafter PUBLIC PENSION PLANS] (citing EMPLOYEE BENEFIT RESEARCH INSTITUTE, QUARTERLY PENSION INVESTMENT REPORT, 4TH QUARTER 1989 (Mar. 1990)).


states strictly control the type and amount of investments. On the federal level, the Social Security system is prohibited from investing in the private sector because of the perceived danger of the federal government coming to own significant parts of major corporations.

The amount of money held by public pension funds concentrates substantial power in "one" shareholder, especially when the public investor chooses to become active in pursuing its own social agenda. When the state, as a large shareholder, plays a role in corporate governance, the line between private enterprise and government-run programs begins to blur.

Pension fund investment has gone beyond simple investment in "blue chip" common stock. Although a large percentage of the

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4. For example, South Carolina restricts investments to government bonds and corporate bonds rated AA, and West Virginia permits investment in fixed income domestic investments only. Id.


6. Corporate governance is the term used to describe the internal organization of a corporation, specifically the balance of power between stockholders and management. This encompasses such issues as "independent" directors (directors who do not have a financial or familial interest in the corporation or its other directors or management), confidential voting, and proxy contests.

7. Public pension funds themselves acknowledge that simply their being a governmental agency means that special interest groups will attempt to curry favor and influence investment and proxy decisions:

As special interest groups seek 'pressure points' in the public sector through which to exert their influence, the pension funds provide an inviting target. Groups looking to influence corporations in dealing with the environment, animal rights, certain consumer products, foreign competition, and yet-to-be-defined moral issues of all sorts, will lead a parade of well-intentioned followers to the doorsteps of the pension funds. Such actions are more likely in the future than they were in the past for several reasons:

1. Pension funds keep getting larger.

2. Pension fund activities in the corporate arena have proven that funds do have influence and can effect change as active shareholders.

3. The Federal Government's focus on large pension funds also tends to draw more attention to the potential influences impacting these funds.

CAlIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM INVESTMENT OFFICE, FIVE-YEAR OUTLOOK 7, 8 (1990).

Politicians may also look to pension funds for self-serving purposes. New York Governor Mario Cuomo, referring to IRA M. MILLSTEIN & LEE SMITH, OUR MONEY'S WORTH: THE REPORT OF THE GOVERNOR'S TASK FORCE ON PENSION FUND INVESTMENT (1989) [hereinafter OUR MONEY'S WORTH], a project of the New York State Industrial Cooperation Council, stated: "We have hundreds of billions of dollars and can't find money to build jails . . . . We have hundreds of billions of dollars and we can't find money to build roads and bridges." Id. at 11. Pension funds become a very attractive target for spending because politicians can correctly assume, at the fund's expense, that this spending of pension fund dollars will not be missed until after they have left office. Id. at 11-12.
money is invested in companies listed in the Standard & Poor's 500, pension fund trustees have expanded their portfolio to include "alternative investments," which include leveraged buyouts, venture capital, "special situations," and real estate. These high-risk investments are often inappropriate for public pension funds and jeopardize the sole purpose of the pension fund — to provide benefits to pensioners and beneficiaries upon retirement.

This article relates the various investment strategies of the California Public Employee Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), and the Council of Institutional Investors (CII), and identifies federal and state laws that are implicated by the pension funds' actions. When certain recently-implemented investment practices are laid side-by-side with the statutes and constitutional provisions enacted to guide those practices, the trustees' investment of pension funds appears to skirt the very edge of the law and, in some cases, is plainly illegal.

II. PLANS FOR INVESTING IN CORPORATIONS

The following sections demonstrate just a sampling of the various agenda that certain public pension funds are pursuing.

A. California Public Employees' Retirement System's Plan

CalPERS, established in the 1930s, is a pension fund system that invests retirement funds for more than 870,000 state workers and retirees. Its fifty-eight-billion dollar portfolio makes it the largest pension fund in the United States and the fourth largest retirement system of any kind in the world.9 CalPERS' Board consists of thirteen members, six elected by various employee constituencies and

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8. Special situations is a catch-all category for non-traditional investments or undervalued securities which are not otherwise categorized under either venture capital or corporate restructuring including, but not limited to, the following types of situations: Turnarounds — investments in companies which are insolvent. . . White Knight — a friendly acquiror welcomed by the management of a company which is the target of an unfriendly or hostile takeover attempt. . . Active Minority Positions — investments in the stock of public companies where investors encourage management to pursue strategies that will maximize shareholders' value. . . Equity or Debt Infusions (including subordinated debt) — investments in ventures or entities that are not otherwise classified as venture capital investments. . . Oil and Gas and other Energy Related Investments — investments made in the exploration, accumulation, movement, or sale of oil or gas or other energy sources.


9. Letter from Dale M. Hanson, Chief Executive Officer of CalPERS (Oct. 4, 1990) (on file with author).

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seven appointed by political officials and the state legislature.\textsuperscript{10} The CalPERS Corporate Governance Plan for the 1991 Proxy Season recommended sponsoring thirteen shareholder proposals ranging from confidential voting and management compensation committees comprised entirely of independent directors, to opting out of Delaware's anti-takeover statute and reincorporating Pennsylvania corporations in Delaware.\textsuperscript{11} The plan also recommended working informally with specific companies regarding their "problem" areas such as management compensation,\textsuperscript{12} corporate crime, and shareholder votes publicizing unpopular positions. Finally, the plan sought to "[p]romote the dissemination of corporate governance ideals through publication and speeches."\textsuperscript{13}

The CalPERS Board, concentrating its efforts on poor economic performers and corporations with a high percentage of institutional investors, focused its activities on three broad types of issues:

1. Issues that impair or restrict the ability of shareholders to select the "best" directors. Specifically, CalPERS promoted the creation of

\begin{itemize}
  \item The CalPERS Board consists of:
    \begin{itemize}
    \item (a) One member of the State Personnel Board, selected by and serving at the pleasure of the State Personnel Board.
    \item (b) The Director of the Department of Personnel Administration.
    \item (c) The State Controller.
    \item (d) The State Treasurer.
    \item (e) An official of a life insurer and an elected official of a contracting agency, appointed by the Governor.
    \item (f) One person representing the public, appointed jointly by the Speaker of the Assembly and Senate Rules Committee.
    \item (g) Six members elected under the supervision of the board as follows: (1) Two elected by members of the system.
        \item (2) [One] elected by the active state members of the system.
        \item (3) [One] elected by and from the active local members of the system who are employees of a school district or a county superintendent of schools.
        \item (4) [One] elected by and from the active local members of the system other than those who are employees of a school district or a county superintendent of schools.
        \item (5) [One] elected by and from the retired members of the system.
    \end{itemize}
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11. Memorandum from CalPERS to Members of the CalPERS Investment Committee 18.0-18.1, Regarding Corporate Governance Plan for 1991 Proxy Season (on file with author) [hereinafter CalPERS Corporate Governance Plan].

12. CalPERS suggested to the management of two corporations in which it owns stock that executive compensation be monitored because the compensation was "out of line" with the companies' financial performance. The two corporations targeted by CalPERS were ITT and W.R. Grace & Co. Joyce Terhaar, \textit{PERS Zeros in on Exorbitant Pay for CEOs}, SACRAMENTO BEE, Dec. 11, 1990, at C1. Both companies agreed to adopt the CalPERS-sponsored proposals and CalPERS subsequently said it would withdraw its resolutions. Marcia Parker, \textit{California System Drops Three Proposals}, PENSIONS & INVESTMENTS, Jan. 21, 1991, at 4.

13. CalPERS Corporate Governance Plan, \textit{supra} note 11, at 18.1. The plan does not indicate the resources for these projects, such as who will give the speeches, to whom, and at what cost.
Shareholder Advisory Committees (SACs)\textsuperscript{14} by sponsoring shareholder proposals and publicizing the advantages of SACs.\textsuperscript{16} CalPERS sought to improve director quality by implementing written nomination criteria, compensating the directors with company stock, voting "no" on the election or nomination of certain or all directors more frequently, and increasing shareholder participation in the nomination process. CalPERS also promoted confidential voting by sponsoring proposals to implement confidential voting in three different corporations, informally encouraging such voting, and continuing to ask the Securities and Exchange Commission to study the subject.\textsuperscript{18} Additionally, CalPERS sought to discourage the use of abstentions to defeat shareholder proposals.\textsuperscript{17}

2. Issues which impair or restrict the ability of directors to supervise a company's managers. Specifically, CalPERS wanted to encourage director independence, encourage effective oversight of management compensation, and reduce corporate crime.\textsuperscript{18}

3. Issues in which the interests of the shareholders and the companies' managers or directors may not harmonize. CalPERS decided to discourage "poison pills" to avoid corporate takeovers,\textsuperscript{19} encourage companies to opt out of state anti-takeover laws, and encourage reincorporation out of states whose laws CalPERS believes are particularly inimical to shareholders' interests.\textsuperscript{20}

14. A Shareholder Advisory Committee is a committee composed of a corporation's shareholders who want input into management decisions. It is a means to include shareholders in the decision-making process of the board of directors.

15. SACs by definition would impose costs on corporations, thus depleting assets otherwise available for reinvestment or dividends. SACs may also be unnecessary and duplicative at a time when directors themselves, who are compensated with stock ownership rather than cash, are aligning their interests more closely with those of their constituents. As those interests converge, directors may well embrace a progressive corporate governance approach. Jayne W. Barnard, 


16. \textit{See supra} note 11 and accompanying text.

17. CalPERS Corporate Governance Plan, \textit{supra} note 11, at 18.3-18.10.

18. CalPERS Corporate Governance Plan, \textit{supra} note 11, at 18.10-18.13. CalPERS did not define the type of crime addressed here, but could refer to fraud, polluting, price fixing, collusion, or none of the above.

19. A "poison pill" is a device used to thwart a takeover attempt. "The most common pill, the 'flip-in', enables stockholders of a target company to purchase additional shares in the firm at half price if a hostile bidder purchases more than, say, 20 percent of the company's stock. Once triggered, the pill dilutes the target's stock and makes it prohibitively expensive for a raider to seize control. William Myers, \textit{Showdown in Delaware: The Battle to Shape Takeover Law}, 23 Institutional Investor 64, 69 (Feb. 1989).

Consistent with the plan, Dale Hanson, Executive Officer of CalPERS, wrote to the Securities and Exchange Commission asking them to alter the proxy rules under Section 14(a) of the Securities and Exchange Act of 1934. CalPERS proposed forty-eight changes, divided into 4 categories: (i) structure and procedures, (ii) shareholder communications, (iii) enhancement of disclosure, and (iv) Securities and Exchange Commission filing and review of proxy materials. CalPERS’ stated goal was to “join in the dialogue of corporate governance and reduce volatility and increase long-term share values.”

In addition to its corporate governance stance, in 1989 CalPERS expressed a social responsibility policy: “To the extent companies violate laws or basic human rights, CalPERS will exercise its powers as a shareholder to seek to eliminate such abuses.” This statement

Knoll, treasurer of Pennsylvania, wrote to Bill D. Ellis, president of CalPERS, asking him not to pursue policies to thwart Pennsylvania’s legislation.


22. Letter from Dale M. Hanson, Chief Executive, CalPERS, to Linda Quinn, Director, Division of Corporate Finance, Securities & Exchange Commission (Nov. 3, 1989), reprinted in Institutional Investors: Passive Fiduciaries to Activist Owners, 1990 INST. ON PRACTICING LAW 454. In response to this proposal, one critic noted:

The inclination of corporate executives to make wealth-maximizing but risky decisions might not be improved much by the introduction of a class of professional kibitzers who answer to financial intermediaries . . . . [R]isk taking lies at the heart of the social contribution of publicly traded corporations. Risk is an inevitable element of research and development, technological change, and the creation of wealth. Publicly traded corporations are ideally suited for risk taking precisely because their stock is publicly traded. The risk can thus be born efficiently by individuals holding diversified portfolios. By revising the proxy voting rules to favor institutional investors, we may well end up with corporate executives who act like custodians of existing wealth, playing not to lose rather than to win.


23. CALIFORNIA PUBLIC EMPLOYEES’ RETIREMENT SYSTEM, WHY CORPORATE GOVERNANCE?, at 10 (Nov. 7, 1989). Many states, California included, prohibit the public pension funds from investing in South Africa. This prohibition has been litigated only to a very small extent. A recent Maryland case upheld Baltimore’s ordinance prohibiting such investment by the Employees’ Retirement System of Baltimore. Board of Trustees v. Mayor of Baltimore, 317 Md. 72, 562 A.2d 720 (1989), cert. denied, 493 U.S. 1093 (1990). In that case, the court held that the city had not violated the Contracts Clause because divestment did not impermissibly alter the pension fund trustees’ fiduciary duties to their beneficiaries. Id. at 101-07, 526 A.2d at 734-36. The court also held that the trustees were only required to obtain a “‘just’ or ‘reasonable’ return while avoiding undue risk,” not to maximize the return. Id. at 107, 562 A.2d at 737. This holding represents a dangerous step in social investment jurisprudence because it leads the courts away from concern for the pension fund beneficiaries, for whose exclusive benefit the funds are to be maintained. Instead, the courts are now concerned with other social matters better left to government agencies and officials accountable to the people.
gives no explanation as to what social injustices will be attacked or if the beneficiaries have any input into which inequities CalPERS should choose to fight. If CalPERS achieves its goals in reforming shareholder participation, institutional investors such as itself will have greatly increased power.

The focus of CalPERS shareholder proposals has already shifted to the social agenda that the Board’s Social Responsibility Criteria state:

The Board’s stated fiduciary duty is to obtain the highest return for the Fund commensurate with acceptable levels of risk. This implies that non-financial considerations cannot take precedence to pure risk/return considerations in the evaluation of investment decisions. However, action taken by the Fund as a share-owner can be instrumental in encouraging action as a responsible corporate citizen by the companies in which the Fund has invested.

The Board expects the managements of the companies whose equity securities are held . . . to conduct themselves with . . . a view toward social considerations . . .

If a company operates in a country or environment where serious human rights violations occur, the Board expects to see maximum progressive practices toward elimination of these violations. For employees who are disadvantaged because of such violations, the Board expects the companies to persist in availing themselves of every reasonable and legally permissible means to ensure that all of their employees and families have what they need to pursue a life of dignity and personal well-being. Operating in such an environment shall carry with it special reporting burdens necessary to keep shareholders informed. If there is apparent lack of progress, the matter shall be viewed carefully to determine if a company is implicitly acquiescing in other parties’ repressive practices.

Should satisfaction of the Board’s criteria by any company not be adequate, the Board will consider what action to take . . . [including] correspondence with the company, meetings with company officials, sponsoring of shareholder resolutions or, as a last resort, liquidation of System holdings in the company, if the sale is consistent with sound investment policy.  

In California, the holding of this case is easily distinguishable from general social investment of public pension funds. As opposed to the the court’s holding in Board of Trustees, California pension trustees are required to maximize the return of their investments. Furthermore, the Baltimore case was decided partially on the basis that any harm to the fund would be de minimus. Id. at 107, 562 A.2d at 737. This argument is weak even in Baltimore, where the court did note that “in absolute terms, the costs of the divestiture may be large.” Id. at 107 n.36, 562 A.2d at 737 n.36. In California, the subject is not even debatable. Even if social investment resulted in a decrease in return of only one-half of one percent, that is equivalent to $290 million for CalPERS alone! By no standards could this be labeled “de minimus.”

The South African divestiture legislation has prompted more law review articles than litigation. See, e.g., Ann Catherine Blank, The South African Divestment Debate: Factoring “Political Risk” into the Prudent Investor Rule, 55 U. Cin. L. Rev. 201 (1986); Joel C. Dobris, Arguments in Favor of Fiduciary Divestment of “South African” Securities, 65 Neb. L. Rev. 209 (1986); Patricia McCarroll, Socially Responsible Investment of Public Pension Funds: The South Africa Issue and State Law, 10 Rev. L. & Soc. Change 407 (1980-1981). Although this is a topic closely related to public pension funds’ social investment in other areas and corporate governance activist policies, further discussion is beyond the scope of this article.

24. CalPERS, Board’s Social Responsibility Criteria (June 20, 1989) addendum to
During 1990, the CalPERS Board established policies in support of the following environmental proposals: Valdez Principles Report, establishment of an environmental board committee, elimination or reduction of fluorocarbon production, and elimination of styrofoam use.

Although CalPERS has softened its approach to the 1992 proxy season, the Wall Street Journal quotes Dale Hanson as saying that the change did not herald "any change in philosophy, other than the fact that we are going to be doing it on a lower profile." This low key approach, which involves writing private letters to companies and quiet negotiations, may be seen by some as a retreat from the policies so blatantly advanced the year before. It is perhaps more likely that the response to the flurry of publicity surrounding its previous actions dampened CalPERS' success. At any rate, CalPERS has not indicated any willingness to desist in its attempts to remold corporations in an image it feels more appropriate, nor has the fund made any efforts to limit the extent of its noneconomic activity.


25. The Valdez Principles (set out in S. Con. Res. 84, 101st Cong., 2nd Sess. (1990) (enacted)) are a ten-point guideline which creates a voluntary system of corporate self-governance. The first eight principles request that companies reduce waste, use resources wisely, market safe products, and accept responsibility for past harm to the environment. Points nine and ten call on companies to have at least one member on their corporate board familiar with environmental issues and to allow annual public audits of their environmental progress. CalPERS agreed to adhere to the Principles in their proxy voting policy, and Cal-STRS agreed to follow points one through eight. Tracy Fine & A.G. Block, The Valdez Principles: Is It Time to Put Bambi in the Boardroom?, CAL. J., Nov. 1990, at 541.

Thomas Hayes, California Governor Pete Wilson's Director of the Department of Finance, responded as follows to the passage of the resolution:

Government has no business in a corporate board room. Our relationship with business should focus on assuring ourselves that businesses are run in a manner that protects our investments. Those in private industry are experts in that arena. We should do our job — there are plenty of environmental laws for us to enforce — and allow business to do its job, recognizing the long-term benefits of environmental awareness.

Id. at 545 (Hayes' statement was made when he held the position of California State Treasurer).


28. Id.
B. California State Teachers’ Retirement System’s Plan

CalSTRS, established in the early 1900s, is California’s second largest retirement fund with a twenty-five-billion dollar portfolio.\(^29\) CalSTRS, like CalPERS, is under the authority of the Secretary of State and Consumer Services, who reports directly to the Governor.\(^30\) CalSTRS is funded in large part by contributions from public employer agencies and the State’s general fund. To the extent these funds are negatively affected by noneconomic investing, general taxpayers foot the bill.\(^31\)

The CalSTRS Statement of Investment Responsibility states CalSTRS’ philosophy that public retirement systems should operate

\(^{29}\) The Teachers’ Retirement Board administers the CalSTRS fund. The Board is composed of the Superintendent of Public Instruction, the Controller, the Treasurer, the Director of Finance, a member of the governing board of a school district or community college district, two classroom teachers (K-12), one community college teacher of business or economics, one retirant of the system, one officer of a life insurance company, one officer of a bank, and one member of the public. CAL. EDUC. CODE § 22200 (Deering 1989 & Supp. 1992).

\(^{30}\) Some CalSTRS members are appointed by the Governor, and some are elected officials in their own right. Id. To the extent that the Governor is an elected official accountable to the people as are the directly elected officers sitting on the Board, the Board as a whole is (at least theoretically) accountable to the people of California.

The CalSTRS Board must annually file with the Governor and with the Senate and Assembly a report on all phases of its work which could affect the need for public contributions for the costs of administration of the system, including the subjects of benefits, programs, practices, procedures, and any comments on trends and developments in the field of retirement. CAL. EDUC. CODE § 22218. The precise contents of the report are set out in great detail in CAL. EDUC. CODE §§ 22218.5-22218.7 (Deering 1989).

State statutes also provide that an independent public accountant will audit the financial statements of CalSTRS and will file a copy of the audit report with the Governor, the Secretary of the Senate, and the Chief Clerk of the Assembly. CAL. EDUC. CODE § 22220 (Deering 1989).

\(^{31}\) A state statute provides that in addition to contributions from the employee and the employing agency (taxpayer dollars), “the state shall contribute a sum certain for a given number of years for the purpose of payment of benefits.” CAL. EDUC. CODE § 22002. More specifically, § 23400 requires employing agencies to contribute monthly eight percent of the total of all salaries upon which members salaries are based. CAL. EDUC. CODE § 23400 (Deering Supp. 1992). Furthermore:

[T]he General Fund . . . [w]ill transfer to the Teachers’ Retirement Fund an amount equal to 1.075 percent of the total of the salaries of the immediately preceding calendar year upon which members’ contributions are based. The percentage shall be adjusted to reflect the contribution required to fund the normal cost deficit when the unfunded obligation has been deemed to be eliminated by the board based upon a recommendation from its actuary. If a rate increase or decrease is required, the adjustment may be for no more than 0.25 percent per year and in no case may the transfer exceed 4.3 percent of the total of the salaries of the immediately preceding calendar year upon which members’ contributions are based. CAL. EDUC. CODE § 23402(a) (West Supp. 1992).
at a higher level than the private sector in social responsibility activities, and that, as a large investor, it "is in a position to exert influence on the corporations in which it has invested." CalSTRS established four main principles for its investments:

1. "The preservation of principal and maximization of income will clearly be the primary and underlying criteria for the selection and retention of securities."\(^{32}\)

2. "Noneconomic factors will supplement profit factors in making investment decisions. . . . The consideration of non-economic factors is for the purpose of ensuring that the Retirement System . . . does not promote, condone, or facilitate social injury."\(^{33}\)

3. "Social injury" exists when basic human rights or dignities are undermined. Specifically, this refers to equal employment opportunities, right to join a union, and equal access to housing, medical care, transportation, recreation, and education. Social injury also occurs if "it is the prevailing belief of the members of the Retirement System that the practices of a corporation result in undesirable side effects for others, and that the side effects are grave in nature." These include, among others, "[p]ractices which are known to endanger the environment," the sale of weapons and technology to governments which systematically suppress human rights, the sale and distribution of therapeutically ineffective or dangerous drugs, and the purchase of goods from or sale of goods to companies known to disregard worker safety.\(^{34}\)

4. The extent of CalSTRS' responsibility in this regard is determined by the number of shares held and the gravity of the social injury.\(^{35}\)

Examples of CalSTRS policy include voting proxies in favor of Echlin, Inc. withdrawing its operators from South Africa and opposing a proxy urging Proctor and Gamble to require that Integrated Pest Management\(^{37}\) be used on all agricultural products that it sells.\(^{38}\)

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33. Id. This language written by CalSTRS is directly contradicted by the next three principles which CalSTRS espouses. The use of non-economic measures to gauge success is antithetical to the preservation of principal and the maximization of income.
34. Id. at 2.
35. Id. at 2-3.
36. Id. at 4.
37. Integrated Pest Management is the combination of farming techniques to reduce the amount of pesticides used during food production.
38. Minutes, Teachers' Retirement Board Investment Committee, Jan. 5, 1990,
C. Council of Institutional Investors' Plan

The Council of Institutional Investors (CII) is a Washington, D.C.-based group co-founded in 1985 by former California State Treasurer Jesse Unruh. CII encompasses sixty-five mostly public pension funds with assets exceeding three-hundred-billion dollars. Its mission is to expand the domain of "shareholder rights" and use the coalition of institutional investors to exert influence on the corporations in which they hold stock. The Council was organized in response to corporate raider T. Boone Pickens' bid for Phillips Petroleum, in which many CII members held stock. The CII members believe that flexing the collective muscle of the pension funds in the

Item 22; Minutes, Teachers' Retirement Board Special Investment Committee Meeting, Nov. 17, 1989, Item 13.

39. It is not immediately apparent that "shareholder rights" will benefit either the corporation or the shareholders. There is no reason why investors, who provide the corporation with capital with the expectation of receiving dividends generated by the corporation's profits, should become corporate decision-makers. Most investors are willing to supply capital, instead of starting and operating their own corporations, because they trust the expertise of professional corporate management. Moreover, the risk-averse shareholder will probably diversify his portfolio by investing in a variety of corporations or mutual funds. An investor with such far-ranging holdings is unlikely to have the interest or expertise to participate in the management of one particular corporation. Barnard, supra note 15, at 1150 n.93.

40. [Public pension fund structure and investment strategies also tend to undermine traditional notions of corporate democracy. . . . Fund trustees exercise control over shares held in pension fund accounts but [the method of voting makes it] unclear who owns the companies whose shares they hold—the ultimate beneficiaries (employees) or the [state]. Thus, the applicability of shareholder rights is equally unclear.

The overall effect may be to concentrate the exercise of corporate governance in very few hands. This would discourage participation by individual investors who may see their own views as irrelevant in the context of institutional investors' voting power.


41. According to accounts of the battle between T. Boone Pickens and Phillips, the fate of the company was decided in large part by the key trustees of three large public employee pension funds: the late Jesse Unruh, California's State Treasurer, Harrison J. Goldin, New York City Comptroller, and Roland Machold, New Jersey's pension fund investment director. At a meeting to decide whether to accept management's defensive strategy, Unruh boldly, but accurately, told his fellow elected officials, "Guys, in this room we control the future of Phillips."

OUR MONEY'S WORTH, supra note 7, at 36 (citing MOIRA JOHNSTON, TAKEOVER 63 (1987)).

Sarah Teslik, Executive Director of the Council of Institutional Investors, affirmed Unruh's analysis in her testimony to the [New York] Task Force when she described the role public pension funds play in takeovers: "[W]e are in fact most powerful in hostile takeover situations . . . . Someone else has started a tender offer . . . and . . . we become the swing vote."

The Executive Committee of the CII determined the following course of action:

1. To “strengthen” boards of directors (“reform” was the original word chosen) by electing independent directors and requiring companies to establish nominating committees composed of outside and independent directors.  
2. To revise the dues plan of the council. Dues paid by public institutions like CalPERS consist of public funds.

The Strategic Planning Committee of the CII discussed the role of the committee and the balance between a purely educational role and an aggressively active role. Some members thought that the entity should educate and coordinate among members and assist individual members to draft policy and to take appropriate implementing actions. Others (including Dale Hanson, Executive Officer of CalPERS) cautioned that the CII could lose its purpose and the value of its collective clout if its functions were too tightly constrained.

III. LAWS IMPLICATED BY INVESTING IN CORPORATIONS

The plans set forth above manifest an agenda that goes far beyond obtaining the best financial return for pensioners. These agendas place the investment strategies of the pension trustees on a collision course with numerous federal and state constitutional provisions and statutes.

42. Bill Blum & Gina Lobaco, The Pension Fund Game, CAL. LAW., Sept. 1985, at 41, 76.  
43. Minutes, Executive Committee Meeting, Council of Institutional Investors Strategic Planning Committee Meeting, July 9, 1990, at 1-3.  
44. Id. at 4.  
45. Id. at 4.  

The New York City pension funds, which are members of CII and managed by the state controller, Elizabeth Holtzman, do not feel at all constrained to restrict their activities to those which benefit their pensioners. Ms. Holtzman, in a speech to the Corporate Governance and Proxy Voting Conference in New York City, emphasized her commitment, as pension fund trustee, to support corporations that donate money to Planned Parenthood and to pressure those that do not so donate into funding that organization. Memorandum from Richard W. Koppes, General Counsel, CalPERS, to Members of the Board of Administration, Regarding Corporate Governance Speeches, attachment at 14-17 (Nov. 29, 1990) (on file with author). That a public pension fund should use its clout to extort contributions from private corporations to controversial, issue-oriented interest groups is incredible. The speech demonstrates just how far some pension plan systems are willing to go to further their social agenda.
A. Federal


Section 13(d) of the Securities Exchange Act of 1934 is a filing requirement for shareholders who have acquired over five percent of a corporation’s stock. The law indicates that an institutional investor can avoid the filing requirements only if it has no purpose of “changing or influencing control of the issuer.”

The same section, and the rules promulgated thereunder, also provide that holders of more than five percent of a class of equity securities of an issuer registered under the 1934 Act who join forces for the purpose of voting the securities held by them are regarded as a “group.” Groups are required to file a Schedule 13D setting forth considerable information including the members of the group and the purpose of their acquisition of shares, unless they can establish that they are not acting to “influence” control of the issuer. The members of the Council of Institutional Investors, therefore, must carefully watch the types of communications between its members. Otherwise, such communications may cross the line established by these rules, rendering the institutional investors liable for a violation.

2. Clayton Act

Section 7A of the Clayton Act is also a filing requirement that deters active participation by institutional investors. The statute requires a party who intends to acquire a significant amount of an issuer’s voting stock to file a long notification form and wait thirty days before actually acquiring the stock. Institutional investors are exempted from this statute if their acquisition is “solely for the purpose of investment” and involves either less than fifteen percent of outstanding stock or securities valued at less than twenty-five million dollars. “Solely for the purpose of investment” requires that the investor have “no intention of participating in the formulation, determination, or direction of the basic business decisions of the issue.”

53. Id.
If a person holds stock “solely for the purpose of investment” and thereafter decides to influence or participate in management of the issuer of that stock, the stock is no longer held “solely for the purpose of investment.” Nominating a candidate for the board of directors may constitute conduct inconsistent with an investment intent.


The Employment Retirement Income Security Act of 1974 (ERISA) protects private employee pension rights through standards for the conduct of plan trustees and asset managers who are required to invest pension funds prudently and solely in the interest of plan participants and beneficiaries. The fiduciary responsibilities set forth in ERISA are often used as the model for public pension systems. ERISA case law may be analogized to the issues here.

The Department of Labor, which enforces ERISA, addressed the implications of social investing by pension plans in the late 1970s. The Administrator of Pension and Welfare Benefit Programs at the Department of Labor, at that time Ian Lanoff, set forth the departmental position on this subject which has remained unchanged to the present time: “If the socially beneficial investment meets objective investment criteria which are appropriate to the goals of the portfolio, it may be considered in the same manner as other investments which meet these criteria . . . .”

That is, if an investment alternative meets a pension plan’s objectives for portfolio asset mix and rate of return, then the fact that it

54. Id.
56. It should be noted that the situation of officials responsible for the administration of public funds significantly differs from the private plans. Sponsors of private plans closely scrutinize the success or failure of the investment policies of their fund managers and if the policies are not as successful as the sponsor deems appropriate, the manager is often quickly replaced. Private pension fund managers are also susceptible to criticism by the sponsors regarding the manner in which they exercise their proxy votes. For public fund trustees, who are usually elected public officials or persons answerable to public officials, the fear of sudden joblessness is not nearly so pervasive. While the governmental entities contributing to such funds are obviously concerned with investment results because most public plans are defined benefit plans and poor performance requires larger contributions, performance and voting practices of trustees are not likely to be as closely monitored as their private counterparts. Therefore, public fund trustees have greater freedom to use their proxy votes aggressively without criticism and without concern for their positions. Sommer, supra note 50, at 368 n.28.
57. Public Pension Plans, supra note 1, at 46.
was also selected for noninvestment reasons would not cause its exclusion from consideration for investment. Choices of socially beneficial investments cannot override the basic imperative that a portfolio be diversified to minimize risk of market or credit losses. The basic rule on social investing, then, is this: If two investments are equal in relative risk and return, then the prudent trustee may choose the socially responsible investment. If, however, the socially responsible investment involves greater risk or smaller return, then it would be imprudent.\textsuperscript{58}

A trustee who breaches a fiduciary duty is personally liable to make good to the plan any losses resulting from the breach and may be removed from his or her position.\textsuperscript{69} Furthermore, the trustee may be subject to criminal penalties including a $5,000 fine, a year of imprisonment, or both.\textsuperscript{60} Additionally, pension plan participants or beneficiaries may bring civil actions in federal district court\textsuperscript{61} to recover benefits due to them, to enforce their rights, or to clarify their rights to future benefits.\textsuperscript{62}

4. Internal Revenue Code

Public plans must follow the requirements of section 401(a) of the Internal Revenue Code (IRC), which states that there must be a plan, the assets of which are maintained in a trust for the exclusive benefit of the employees or their beneficiaries.\textsuperscript{63} The trust document must prohibit using any part of the corpus or income for purposes other than the exclusive benefit of the employees or their beneficiaries.\textsuperscript{64} If these requirements are not met, the Internal Revenue

\textsuperscript{58} Id.
\textsuperscript{60} Id. § 1131.
\textsuperscript{61} Id. § 1132(e).
\textsuperscript{62} Id. § 1132(a)(1)(B).
\textsuperscript{63} 26 U.S.C. § 401(a) (1988 & Supp. 1989). If a pension plan qualifies under § 401(a) of the Internal Revenue Code, three major tax benefits for employees, employers, and their pension plans result:

(1) The employer’s contributions to the plan are deductible when made, even if the employee is not vested in them at the time,
(2) the earnings of the pension trust funds are not taxed currently
(3) the contributions made by an employer to a plan on behalf of an employee are not currently imputed to the employee, even if vested.

Kathleen Paisley, Public Pension Funds: The Need for Federal Regulation of Trustee Investment Decisions, 4 Yale L. & Pol'y Rev. 188, 191-92 n.19 (1985). Also, participants who receive lump-sum distributions from a qualified plan get a tax break. \textit{Id.} Only one of these benefits applies to public plans: deferral of the recognition of income by the employee. \textit{Id.} The other benefits will inure to public pension plans in any case because they are generally exempt from federal taxes. \textit{Id. See also} New York v. United States, 326 U.S. 572 (1946).

Service (IRS) may disqualify the plan, resulting in denial to employees of tax deferrals on the employer's contributions. Disqualification is rarely invoked because the target could be only an innocent bystander, not the miscreant pension fund administrator. Furthermore, "[o]ther than requests for rulings submitted by the plans themselves, the IRS currently has no mechanism for determining if a public plan is in compliance with the rules or not."65

The IRS has stated that the exclusive benefit rule is the prime requirement for qualification under IRC section 401(a).66 The IRS lists several factors that should be considered in determining whether a trust is qualified: the cost of assets must not exceed fair market value at the time of purchase, a fair return commensurate with the prevailing rate must be provided, sufficient liquidity must be maintained to permit distributions in accordance with the terms of the plan, the safeguards and diversity to which a prudent investor would adhere must be present, and the trustees should give effect to the trust instrument.67

Social investment, including investments targeted to enhance the economic development of a state or locality, are not specifically prohibited by the exclusive benefit rule as interpreted and enforced by the IRS. The trustees may consider the general welfare or local economic benefit in an investment so long as they follow the IRS's "exclusive benefit" guidelines. Prudent investors may have a small percentage of speculative investments in a portfolio.

5. The First Amendment of the United States Constitution

Public pension fund trustees are fiduciaries acting in a situation where public employees are forced to have their pension funds placed with those fiduciaries. Should the trustees invest those funds to further ideological or political goals, such action would violate the speech and association rights of the beneficiaries.

The United States Supreme Court in Keller v. State Bar of California68 declared unconstitutional under the First Amendment the California Bar's use of an objector's compelled dues for purposes not

65. Public Pension Plans, supra note 1, at 39.
germane to regulating the legal profession or improving the quality of legal services. Similarly, public pension fund trustees are obligated to invest the funds for the exclusive benefit of the beneficiaries and to further the integrity of the fund itself. Forays into social investing or corporate governance that do not bring the highest financial return to the pensioners, and which policies the pensioners themselves may in fact oppose, implicate the freedom of speech and freedom of association clauses of the First Amendment.

Just as prohibitions on making contributions to organizations for political purposes implicate fundamental First Amendment concerns . . . "compelled . . . contributions for political purposes works no less an infringement of . . . constitutional rights." . . . "[T]o compel a man to furnish contributions of money for the propagation of opinions which he disbelieves, is sinful and tyrannical."

Although the facts of Keller involve the compulsory contributions of attorneys to the state Bar, the holding of the case is far broader. The primary issue is not the context in which the contributions were compelled, but that the contributions were compulsory. In the context of the public pension framework, public employees do not have the option of stashing away a few dollars each week in the mattress at home; rather, they are required to contribute a portion of their salary to the state retirement system. In this way, the employees' compulsory contributions to the state are analogous to the attorneys' compulsory contributions to the Bar.

Because the employee's payment of funds into the retirement system is mandatory, those funds may not be used to further political or ideological activities. Even if political expenditures were distributed

69. Id. at 2238.
70. In the situation discussed in this article, investments are made for political or social reasons, with the incidental effect that the pensioners may get some (although probably decreased) economic gain. In the inverse case, in which pensioners who wish to invest only in companies that have political agendas with which they agree allege a violation of their freedom of speech, the Keller issue is not presented. Conversely, investments made on purely economic grounds will produce the greatest monetary gain (the purpose of a pension fund) with the incidental effect that some of the investments will be in companies which hold views antithetical to the pensioner's preferences.
71. Id. at 2234 (citations omitted).
73. The wide diversity of members in the public pension system ensures that whatever social or political positions the system supports, it will offend a certain percentage of its members. Although this certainty of offending some members all of the time builds a stronger case against the non-economic investment of pension funds, the argument is valid even if only one person disagrees with the political activities of the fund. That one person should not be forced to subsidize political or ideological activities with which he disagrees.
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in such a way as to promote all political viewpoints, Keller specifically states that no compulsory contributions may be spent on political or ideological activities. The fact that such contributions are spent on political and ideological activities of every stripe and color only compounds the offense; it does not mitigate it.74

In the pension context, the fact that investment on noneconomic bases may result in some return to the pensioner does not alter the fact that the compulsory contributions were used not solely for economic gain (as is required), but to further political views. The return on the investment is irrelevant to this argument.

B. State

Section 17, article XVI, of the California Constitution, provides that, apart from reasonable administrative costs, the only purpose for which the trust assets can be used is the delivery of retirement benefits. This provision also contains the sole and exclusive purpose rule which imposes on fund trustees the legal obligation to perform their duties solely in the interest of plan beneficiaries. Furthermore, the trustee will be held personally liable and held to a "prudent investor" standard.75 The trustee must diversify investments so as to minimize risk.76

74. The United States Supreme Court has emphatically stated that one need not object to each and every political use of the compelled contribution. An objection to any political expenditure is sufficient for First Amendment protection. Abood, 431 U.S. at 239, (citing Brotherhood of Ry. & S.S. Clerks v. Allen, 373 U.S. 113, 118 (1963)). Implicit in this rule is the Court's protection of political anonymity, a well-established subpart of the freedom of association. See, e.g., National Ass'n for the Advancement of Colored People v. Alabama, 357 U.S. 449 (1958); Bates v. Little Rock, 361 U.S. 516 (1960).

75. Section 17, article XVI, of the California Constitution was amended with the passage of Proposition 21 on June 5, 1984. The argument to the voters in favor of Proposition 21 on the sample ballot stated that it was written to give public pension assets full constitutional protection as trust funds and provide that neither the governor nor future legislatures would ever be able to use this money for other purposes. Ballot Pamp., Proposed Amends. to Cal. Const. with arguments to voters, Primary Elec. (June 5, 1984), argument in favor of Prop. 21, at 24-27. These elements of the pension trustee's duties are the same as those in ERISA.

76. All investments are made by balancing the competing factors of risk and return. Investors are presumed to be risk-averse, which means that given two investments with the same expected return, the investor will choose the one with lower risk. Investors will pay more for a stable investment, one that has very little risk, e.g., "blue-chip" stocks. There are two types of risk: systemic and unsystemic. Unsystemic risk occurs when an investor puts all his eggs into one basket. The cure is diversification. Systemic risk is correlated to market performance (as goes the market, so go individual stocks). Diversification cannot cure systemic risk, but it may help reduce that risk. Paisley, supra note 63, at 204 nn. 82-86.
The diversification language indicates that investing in-state just for the sake of doing so does not diversify to minimize risk, especially when the trustee is held to the higher prudent investor standard. In general, social investing constrains the pension fund trustees' choice of investments by disallowing investment in certain corporations for noneconomic reasons. Thus, it creates a more volatile stock portfolio and increases the risk of harm to pensioners.

California state statutes, beginning with Government Code section 20200, regulate the administration of public pension funds. The state employees retirement fund is a trust fund created solely for the benefit of the members and retired members of CalPERS and their survivors and beneficiaries. The California courts have addressed these code sections, concluding:

Once paid, appropriated employer contributions constitute a trust fund held solely for the benefit of [Cal]PERS members and beneficiaries (§ 20200). Income in excess of interest credited to employee and employer accounts is to be retained in that trust fund as a reserve against deficiencies. The reserve constitutes an integral part of that trust fund (§ 20203). Consequently, none of the funds within [Cal]PERS including those in the reserve against deficiencies, may be appropriated for a general public purpose unrelated to the benefit of [Cal]PERS members. . ., because funds received into the treasury for special trust purposes are "in their nature a continuing appropriation for a specific purpose." 78

These code sections, in conjunction with the state constitution, provide clear guidance to fund trustees as to the limits of their authority and their duties to the fund.

IV. Issues Arising Under the Laws

This section identifies some of the legal theories and issues underlying social investment policies of pension funds.

A. Fiduciary Duty

Section 17(b), article XVI, of the California Constitution expressly establishes a fiduciary standard of conduct. This constitutional dimension is controlling. The assets of a public pension or retirement system are constitutionally designated as trust funds for exclusive purposes and may not be deemed or treated otherwise by statute. 79 Under general trust principles, a violation by a trustee, whether fraudulent or through negligence, or arising through mere oversight or forgetfulness, is a breach of trust. 80 As a result, "the

77. CAL. GOV'T CODE §§ 20200, 20205.8 (Deering 1992).
trustee may be charged with the rents, profits, and income which [the trust] never in fact received, but which [the trust] might and should have received by the exercise of due and reasonable care and diligence." As applied to CalPERS, the California attorney general wrote that breach of fiduciary duty causing a loss to the fund gives rise to an action at law by the beneficiaries of the fund against the miscreant board member, officer, or employee to restore the loss.

The California Supreme Court wrote that "expenditures by an administrative official are proper only insofar as they are authorized, explicitly or implicitly, by legislative enactment. . . . [S]uch executive officials are not free to spend public funds for any 'public purpose' they may choose, but must utilize appropriated funds in accordance with the legislatively designated purpose." Furthermore, the court held the public official personally liable for improper expenditures.

In New York and Wisconsin, courts have held that if the legislature appropriated any of the Public Employees' Retirement System (PERS) trust funds for purposes unrelated to the benefit of PERS members, for example, to balance the state budget and avoid a year-end deficit, this legislative action would clearly modify vested rights of PERS members. Moreover, all the profits of a trust are subject

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84. Id. at 226-27, 551 P.2d at 15, 130 Cal. Rptr. at 711. A side issue presented by this discussion is the advisability of state representatives acting in the capacity of plan trustees. Certain state officials are directly responsible to the people via the ballot box. This may or may not be in the pension plan's best interest. Because they are politically accountable, public officials may act as if their duty lay with the state or locality as a whole, rather than solely with the pensioners and beneficiaries. Although this violation of fiduciary duty should provide reason enough for their removal as trustee, there exists the possibility that the population as a whole, which has more power than public employees, would prefer to have certain non-economic benefit programs (such as in-state investing) in place. Public employees alone do not have the voting strength to oust a statewide official. An additional concern is that by the time the detrimental effects are apparent (when the employees retire), the particular public official who pursued policies adverse to the plan's interest may well have left public office. Paisley, supra note 63, at 224 nn. 222-25. The converse argument is that the pension funds are simply too massive and represent the future livelihood of too many people to permit trustees who are wholly unaccountable to the electorate to handle those funds. The solution may lay in a compromise between the two, but that is an issue beyond the scope of this article.
to the furtherance of the trust purposes. "Where a trust is constitu-
tionally established for a designated purpose, neither the principal
nor its proceeds may be statutorily diverted. Such proceeds "con-
stitut[e] a part of the fund" within the meaning of Government
Code section 20203.86

B. The New York City Catastrophe

New York state public pension plans invested heavily in New
York City municipal bonds to move the city back from the brink of
bankruptcy in 1975. After pension funds were used in such a matter,
fund trustees favoring social investing cited that event for the pro-
position that socioeconomic concerns other than the exclusive benefit
of the pensioners may be used in investment decisions. This view was
incorrect.

Repeatedly emphasizing that this was a special situation, that the
legislation was necessary for the New York bailout to succeed and
that the legislation should not be interpreted as precedent for other
governmental or private plans in similar circumstances, Congress
passed Public Law No. 94-236.87 The law provided that any pension
plan or trust which was a party to the agreement to purchase Municipal
Assistance Corporation securities would not be considered to
have violated the exclusive benefit rule or to have engaged in a pro-
hibited transaction because of actions taken pursuant to the agree-
ment.88 The report of the Committee on Ways and Means89 indicates that the bill was part of the New York City bailout, and it
was not intended as a precedent for any private pension plans or for
other governmental pension plans being exempted from the exclusive
benefit or prohibited transactions rules of the tax law.90

C. In-State Investment Policies

California and twenty-four other states have formal programs re-
quiring that a certain percentage of public pension funds be invested
in-state.91 The purpose of the programs is to shore up sagging local
economies. The trade-off is often a lower return on the investment.92

88. Id.
90. PUBLIC PENSION PLANS, supra note 1, at 41-42.
91. Boyce Thompson, Politicians Lust After the Half-Trillion-Dollar Pension
92. This phenomenon is not newly discovered. In the mid-1980s, a law review arti-

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CalPERS is required to put twenty-five percent of new funds in California residential mortgages unless better investments can be found elsewhere. The Pennsylvania State Employment Retirement System earmarks for in-state placement half of its new venture capital investment, half of its new investments in residential and commercial mortgages, and half of its new direct investments in commercial real estate, where it actually buys buildings rather than merely financing them.

The danger with in-state investing is that it amounts to a subsidy when the pension fund does not get a market-competitive yield. There may be some long-run benefit to the employee, if the investment makes the state economy more buoyant, which in turn may make for a more solvent state or local government. But in the short or intermediate run, in-state investment works to the detriment of the pension system. Investing too heavily in a single state makes a pension fund vulnerable to a regional or local recession. If assets are diversified geographically, then a downturn in one area that adversely affects the market value of investments may be offset by a strong economy and good investment results in another area.

Second, locally targeted investment may increase administrative costs, resulting in a lower net return to the fund. Third, government-sponsored securities such as municipal bonds pay lower returns because they are tax exempt. Public pension funds are also tax exempt, however, and are therefore accepting lower returns with no corresponding benefit. Fourth, to the extent that public pension plans are willing to invest in local enterprise, the market may not adjust returns to reflect investment risks.

Paisley, supra note 63, at 198-99 (citations omitted). The author concluded that “although local investments may serve an arguably legitimate political purpose, they generally either subject fund participants to additional risk or result in lower returns.” Id. at 199. The same article conceded that local investments may result in some non-economic benefits, but concluded that non-economic returns are inappropriate for a public pension fund because there is no reasonable way to calculate non-economic benefits in a way that can be analyzed as against economic benefits. The article also concluded that public pensions are not the appropriate vehicles for non-economic policy decisions. Id.

93. Thompson, supra note 91, at 50.
94. Id.
95. Some may question whether the needs of general taxpayers should alter this analysis because taxpayers ultimately bear the costs of providing for public pension funds. On the one hand, if pension benefits are deemed deferred compensation, then the public pension funds held in trust for participants are of no relevance to the general taxpayer. On the other hand, if the needs of taxpayers are to be considered, it is not in their best interest for public pension funds to select locally targeted investments that increase risk or lower return for the fund, resulting in higher funding needs which must be met through taxation. Taxpayers would be better off if social policies were accomplished through the political process in which they have a direct voice. It is not a valid function of public pension funds to make policy decisions about which social goals to pursue with taxpayer dollars. Marcia Gaughan Murphy, Regulating Public Employee
V. RESPONDING TO SOCIAL INVESTMENT

Those affected by public pension systems' social investment may challenge these activities on two fronts. First, a pensioner or other party directly harmed by the decrease in investment return may commence litigation to redress the harm and prevent it from occurring in the future. Second, because pension system administration is lodged in the executive branch of state government, alarmed pensioners may address their concerns to the governor of their state. Because laws prohibiting the kinds of social investment described in this article already exist, lobbying for more stringent controls is always a viable option.

A. Legal Action

Pensioners, beneficiaries, or taxpayers may pursue legal action against the public pension funds to enjoin them from making investments that are not for the exclusive benefit of the retirees. Such suit could be brought under one or more of the federal or state constitutions or statutes set forth above.96

In California, CalPERS pensioners or beneficiaries have standing to sue any CalPERS board member, officer, or employee who can be traced to have caused a loss to the fund to restore that loss. They may also sue CalPERS for injunctive relief, to enjoin CalPERS from engaging in certain kinds of investments, or from taking an active shareholder role. A class action may be appropriate here, although given the different interests of certain pensioners or beneficiaries, subclasses may be advisable.97 A pensioner suing on the constitutional fiduciary duty cause of action would have to show that CalPERS actions are not those of a “prudent investor” and that the pension fund has lost money or security on the investments. Taxpayers may also sue on a theory that the investment of pension funds in certain projects is little more than a mechanism for circumventing

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96. As yet, there have not been any prosecutions or suits on behalf of fund members for violations of the constitutional and statutory provisions set forth in this article. The reason may be simply economic. Whether a fund is achieving the maximum return on its investments is a question that is not easily answered, especially in times of recession. Furthermore, a suit would be prohibitively expensive for virtually all private plaintiffs. The actual economic stake a pensioner would have in the litigation would be insufficient to warrant challenging such a powerful and well-financed foe.

97. Plaintiffs bringing a suit would have to be aware of different interests or goals that may exist among themselves. The interests of current employees may conflict with the interests of retirees; younger employees may differ with older employees. For instance, a proposal to loan a city some money to prevent insolvency may be opposed by retirees, who are concerned with the short-term goal of receiving their pensions, but favored by current employees, who see the preservation of pension funds as a useless goal if they lose their jobs.

an electorate that is reluctant to commit current or future tax dollars to those projects.

Federal law causes of action may also be pursued. Because the corporate governance policies of the public pension funds emphasize influencing the management of the company and repudiating any notion that they have bought stock solely for the purpose of investment, the pension systems are not entitled to exemption from the 1934 Act or Clayton Act reporting and filing requirements. Private claims may be brought under the 1934 Act by shareholders or the issuing corporation. Section 7 of the Clayton Act provides that any person injured in his business or property may sue in any Circuit Court of the United States. However, the Supreme Court has formulated a series of factors to determine standing. These factors make it more difficult, though certainly not impossible, for a pensioner to possess standing to sue the pension system.

Although ERISA and IRC may have some bearing on the issue of public pension funds, the IRC remedy harms rather than benefits individual pensioners and ERISA can only be used by analogy. However, ERISA case law is directly analogous to public pension fund issues and strongly supports the concept that investments should be made for the exclusive benefit of the pensioners. Neither ERISA nor the IRC recognize public pension funds as a means for curing societal ills.

Finally, as noted above, individuals objecting to the use of their retirement funds for social investments have standing to sue under the First Amendment of the United States Constitution.

B. Gubernatorial or Executive Action

Each state has its own method of appointing trustees to the board of its statewide public pensions. In most states, the governor appoints

100. The factors are: (1) the motive of the defendant—whether defendant specifically intended to cause plaintiff harm; (2) the nature of plaintiff's injury—whether the harm was of a type the antitrust laws were designed to prevent; (3) the directness of the causal connection between the violation and the injury; (4) the extent to which abstract speculation underlies the allegations of injury and of their causation by defendant's antitrust violations; and (5) the risk of duplicate recoveries or complex apportionment of damages if these plaintiffs are permitted to recover. Associated Gen. Contractors v. California State Council of Carpenters, 459 U.S. 519, 537-45 (1983).
101. See supra part III.A.3.
some, if not all, of the pension fund trustees. Regardless of the appointing body, once the board of trustees is formed, the oversight of the pension system resides in the executive branch. Therefore, pensioners and beneficiaries may look to the governor, the head of the executive branch, to respond to the public pension systems' improper investment of funds. The focus of any gubernatorial action must be to pull the systems back into line with their duties, as required by the United States Constitution, federal statutes, and applicable state law.

To this end, governors have two main methods to implement this policy. The first is to draft an Executive Order that exposes the social investment policies of the pension systems, lists the various state and federal laws that such policies violate, and orders cessation of the activity. The second is to approach this problem publicly. Public statements from the governor will make the systems aware that their activities have not gone unnoticed. The governor or others in the executive branch may pressure pension fund administrators to keep their investments within the letter of the law by using methods such as press conferences, letters to pensioners and beneficiaries explaining the potential harm being done to their retirement funds, and appointing members to the pension system board of trustees who adhere to the philosophy that it is their sole function to protect and increase the retirement funds.

VI. CONCLUSION

The state originally conceived of the corporate form of organization as an effective and efficient way to promote economic growth. This growth created higher standards of living, employment opportunities, and the ability to attract the financial and organizational human resources needed to continue the growth. The economic freedom provided by the corporate charter is a fundamental underpinning of the political freedom we enjoy in the United States. It is a simple matter to observe the various economic and political systems around the world to confirm the close connection of political and economic freedom.

In contrast to this line of thought, some public pension fund trustees believe their social agenda is also good economics. They are mistaken. Non-economic issues should be decided on election day by the

102. Public Pension Plans, supra note 1, at 23-25; Our Money's Worth, supra note 7, at 52.

103. Appointments may be made by the legislature, the governor (or some other member of the executive branch), or some combination of the two.
voters' choice of legislators or initiatives. Public pension fund trustees must not be allowed to determine on their own what they consider to be proper social use of public retirement funds which are composed of the taxes that everyone must pay. Pension fund managers do not have the accountability of elected officials, and individual pensioners are disenfranchised because they have no vote in the political decisions issued by their boards using the power of the massive accumulation of money earmarked for member retirement.

Responsible elected officials and individuals (whether pensioners, beneficiaries, or taxpayers) must make a concerted effort to hold the public pension fund trustees in check. The stakes are simply too high to permit retirement funds to be used to promote a social agenda which places the financial returns in jeopardy and implants unacceptable governmental intervention into the workings of private corporations.