No. 22574 -- State of West Virginia ex rel. Glen B. Gainer III, Auditor of the State of West Virginia v. The West Virginia Board of Investments

Neely, Senior Justice, dissenting:

The majority opinion is well reasoned and elicits great respect from me. Nonetheless, I dissent because I don't believe that our Constitution compels the majority's conclusion. As the majority opinion forthrightly recognizes, the purpose of W.Va. Const. Art. X, § 6 was to prevent state government from helping selected private businesses when those businesses had powerful political allies. W.Va. Const. Art. X, § 6 was written long before state-managed pension plans presented the problem of sustaining the inflation-adjusted value of massive amounts of accumulated capital.

The State now manages more than a billion dollars of employee money over scores of years for the benefit of both employees and taxpayers. The inflation-adjusted value of the principal must be preserved, but in addition the fund must be made to grow if the inflation-adjusted level of benefits are to be maintained at payout time. The dead hand of the past in the form of Art. X, § 6 hampers the pension fund managers from maximizing return in a safe manner in spite of the fact that such a result was not even remotely contemplated or intended by the framers.

This Court has already held in Booth v. Sims, ___ W. Va. ___, ___ S.E. ___, 456 S.E.2d 167 (No. 22464, March 24, 1995)(as modified) that pension contracts with current and former State employees are lawful debts of the State. That means that the State must come up with the money to pay state employee pensions when they come due. The pension obligations are set in stone (at least for persons currently in the system who have relied to their detriment, see Booth, supra); the only question yet to be answered is how much money will be available to pay these pension debts from cash accumulated in the pension fund itself and how much money will need to be gathered in new taxes from our yet unborn children?

I come from old money; my family has been comfortably fixed since the 19th century. In each generation some members of my family make enough money to add to their fortunes while others don't; but everybody has been taught from the cradle how to preserve whatever inheritance they may receive. To my knowledge, no one in my family has owned a bond-- government or otherwise-- since before the Great

Depression (ca. 1929) except for liquidity. If neither I nor three generations of my competent ancestors believed that bonds are worth a damn for long term investment, why would I require the people who voted for me to use bonds as their exclusive long term investment? I would do that only if our Constitution absolutely demanded it. Thus, because I believe that W.Va. Const. Art. X, § 6 was drafted to prevent an evil entirely unrelated to the unwise investment of pension funds, I conclude that our Constitution does not demand the fiscally idiotic result the majority have reached today.

The real objection that the opponents of common stock investment have to liberalizing the investment rules is that the opponents believe that the people who work for the State are dolts, simpletons and political whores who are likely to lose the State's money. Although money has been lost at the State Consolidated Investment Fund, (see, State of West Virginia v. Morgan Stanley, ___ W. Va. ___, ___ S.E.2d ___ (No. 22358, June 5, 1995)), most of the people who work in State government are pretty competent. Furthermore, the people in my class in the West Virginia Legislature (1971-73) were among the smartest and most competent people I ever

---

[1]I always keep some U.S. Savings Bonds on hand for near cash. This is simply to cover unforeseen circumstances such as a car conking out. Other members of my family also hold a few bonds for liquidity, but none holds bonds for investment.

met. Thus, I do not accede to the basic premise behind a strict construction of W.Va. Const. Art. X, § 6-- namely, that the folks we hire at the Board of Investments or the State Treasury are dolts, simpletons, or political whores. Indeed, by enlarge, I find senior government executives among the more competent people in the State. (See, Morgan Stanley, supra, for a full discussion of the facts surrounding the State's loss in 1987.)

The great jeopardy to which all saved money is exposed in the United States as we enter the 21st Century is inflation. Historically, for reasons that have to do with maintaining something approaching full employment in America (at least as economists define "full employment") the federal government will always adopt fiscal policies that guarantee an average rate of inflation of roughly five percent a year, year in and year out. That means that the real rate of return on 6 percent or 7 percent government bonds is vanishingly small: retirees and taxpayers get little more back in

[2] I so strongly believe in this number that automatic rent increases of five percent a year is what I insert into commercial leases when I am the landlord, and it is the inflation factor to which I acceded when I recently negotiated for law offices in Charleston.

inflation-adjusted dollars than the employees and the taxpayers contributed into the fund to begin with.

Of course, the best counter argument to what I have just asserted is that <u>at least</u> the retirees and taxpayers <u>will</u> get back what they put in. Well... that's fine if inflation stays at roughly

---

[3]"For the kingdom of heaven is as a man travelling into a far country, who called his own servants, and delivered unto them his goods. And unto one he gave five talents, to another two, and to another one; to every man according to his several ability; and straightway took his journey. Then he that had received the five talents went and traded with the same, and made them other five talents. And likewise he that had received two, he also gained other two. But he that had received one went and digged in the earth, and hid his lord's money. After a long time the lord of those servants cometh, and reckoneth with them. And so he that had received five talents came and brought other five talents, saying Lord, thou deliveredst unto me five talents: behold, I have gained bedside them five talents more. His lord said unto him, Well done, thou good and faithful servant: thou hast been faithful over a few things, I will make thee ruler over many things: enter thou into the joy of thy lord. He also that had received two talents came and said, Lord, thou deliveredst unto me two talents: behold, I have gained two other talents beside them. His lord said unto him, Well done, good and faithful servant; thou hast been faithful over a few things, I will make thee ruler over many things: enter thou into the joy of thy lord. Then he which had received the one talent came and said, Lord, I knew thee that thou art an hard man, reaping where thou hast not sown, and gathering where thou hast not strawed: And I was afraid, and went and hid thy talent in the earth: lo, there thou hast that is thine. His lord answered and said unto him, Thou wicked and slothful servant, thou knewest that I reap where I sowed not, and gather where I have not strawed: Thou oughtest therefore to have put my money to the exchangers, and then at my coming should have received my own with usury. Take therefore the talent from him, and give it unto him which hath ten talents. For unto every one that hath shall be given, and he shall have abundance: but from him that hath not shall be taken away even that which he hath." <u>Matthew</u> 25:14-29 (King James).

five percent a year, but if we get into a war, or some other circumstance demands great government borrowing and spending, inflation will return to the double digit levels of the late 1970's and early 80's and retirees won't get back what was contributed in inflation-adjusted dollars.

As I wrote in footnote 24 of Morgan Stanley, supra:

> After all, if there had been a Dow Jones Index Fund in September, 1929, the prudent investor who had heavily invested in such a fund as the quintessential exercise in "modern portfolio management" would have been a hurt'n cowboy by January, 1930. Indeed, it is wonderful fun to watch young instructors in economics wax eloquent about the intersection of supply and demand curves for endless weeks in basic economics courses while spending but a bare moment discussing what happens to markets when entire curves shift right or left (as the result, for example, of war, technological innovation, shifts in taste, or price shifts in substitute goods.) In the real world, of course, rightward and leftward shifts in supply and demand functions are the primary jeopardy to which business is subject. Bonds can be wiped out by inflation; land values can be destroyed by depression; common stocks can be devalued by international competition that eliminates barriers to entry and destroys oligopolies; and, a "balanced" portfolio does little for a person in a country ravaged by a shooting war. [Emphasis added.]

[4]Unless, of course, the Board has taken very low yields by buying only short term notes so that when inflation pushes interest rates up (if the Federal Reserve allows interest rates to go up) the Board can take advantage of new, higher interest rates.

Morgan Stanley, ___ W. Va. at ___ n.24, ___ S.E.2d at ___ n.24, Slip op. at 25 n.24.

The point to be made, of course, is that ultimately all investments-- especially government bonds-- bear some risk. It's just that in different investment vehicles the risks are different: in stocks the risk is of a stock market crash followed by a depression; in bonds the risk is of inflation.

If I were managing a pension fund and not my own portfolio, I would keep some substantial part of the pension fund assets in bonds simply because I would then be covered if I am wrong about the risk of inflation versus the risk of depression. And, indeed, that is what the legislature did in W. Va. Code 12-6-9(j) [1990]; the legislature did not direct the Board to invest all of the money in the consolidated pension fund in common stocks, but simply authorized investment of up to 20 percent in common stock.

Opponents will argue, of course, that Code 12-6-9(j) [1990] is simply the camel's nose under the tent, and that eventually much larger proportions of the fund would be invested in stocks. But for my money it's a nice camel and the legislature is perfectly capable of determining just how much tent it wants to share with that particular camel. At the end of the day, I should repeat, it is the legislature and the taxpayers-- not the pension funds-- that must come up with the money to pay employee pensions. See Booth, supra.

The reason that I take the time to write this dissent is that I believe that the legislature should try again; new courts mean new law! This time, however, I would not give the Board general discretion to invest in listed stocks, but rather would authorize the Board to purchase only a Dow Jones Industrial Average index fund whose value is linked directly to the Dow Jones Industrial Average. This would allow investment in something that has a proven track record going back well before the Great Depression and, as a long term investment, looks almost as secure as a bond for capital safety while giving a much higher overall long term return-- a proposition vindicated by history. Furthermore, such a statute would not look like a camel's nose under the tent because a new court could carve a narrow exception under W.Va. Const. Art. X, § 6 that would allow continuing court review of any further liberalization-- a technique similar to the one we adopted in the recent bond cases. See State ex rel. Lawrence v. Polan, ___ W. Va. ___, 453 S.E.2d 612 (1994) (park development revenue bonds violate W.Va. Const. because the park system operates at a deficit and the only way the bonds could be liquidated is from the state general revenue fund); State ex rel. Marockie v. Wagoner, 190 W. Va. 467, 438 S.E.2d 810 (1993) (School Building Authority bonds to be liquidated by dedicating a portion of existing consumer sales tax, a general revenue tax, created a new state debt in violation of W.Va. Const.); Winkler v. State School Bldg. Authority, 189 W. Va. 748, 752, 434 S.E.2d 420, 424 (1993) (School Building Authority bonds to be liquidated by a "building capital improvement fund . . . 'created in the state treasury'" violate W.Va. Const.); State ex rel. Clarksburg Mun. Bldg. Com'n v. Spelsberg, 191 W. Va. 153, 447 S.E.2d 16 (1994) (lease agreement between City of Clarksburg and Clarksburg Municipal Building Commission to finance a new municipal building through the issuance of bonds without voter approval, and allowing the Building Commission to lease the building to the City using the monthly rental payments to retire the bonds, does not violate W.Va. Const. Art X, § 8 or W. Va. Code 11-8-26 when the amount to be repaid is limited by the pre-determined cost of the building and it is clear that the agreement imposes no legal obligation on the City to make appropriations to be used to pay for the bonds); State ex rel. Marockie v. Wagoner, 191 W. Va. 458, 446 S.E.2d 680 (1994) (school building debt service fund to be liquidated by funds allocated from the net profits of the West Virginia Lottery does not violate W.Va. Const. Art. X, § 4, since the designated lottery profits constituted a new revenue source, and W. Va. Code 29-22-18 specifically provided that net profits from West Virginia Lottery not be treated as part of the general revenue of the State); Bd. of Educ. of County of Hancock v. Slack, 174 W. Va. 437, 327 S.E.2d 416 (1985) (issuance of refunding bonds to retire existing bonds do not create a new debt and, therefore, voter approval is not needed and this refunding plan is lawful).