

Approved March 4, 1987
Date

MINUTES OF THE HOUSE COMMITTEE ON PENSIONS, INVESTMENTS AND BENEFITS

The meeting was called to order by REPRESENTATIVE VERNON WILLIAMS at
Chairperson

9:00 a.m./p.m. on Wednesday, March 4, 1987 in room 527-S of the Capitol.

All members were present except:
all present.

Committee staff present:

Richard Ryan
Alan Conroy
Gordon Self
Rosalie Black

Conferees appearing before the committee: Robert Stephan, Attorney General

The meeting was called to order by Representative Williams, Chairman, for Attorney General Robert Stephan's report on recent investigation of alleged investment improprieties.

The Chairman, in introducing Mr. Stephan, indicated his reason in having the Attorney General appear before the Committee is in answer to questions he had from active members of KPERS and retirants concerned about the credibility of the fund when newspaper articles referred to KPERS investments into businesses in which Michael K. Russell, Chairman, Board of Trustees, KPERS, had an interest.

The Attorney General said he initiated an investigation in January in cooperation with the Public Disclosure Commission into allegations concerning Mr. Russell.

In question were three contracts for investment of KPERS funds in various companies. The contracts involved the hiring of J. W. O'Connor and Company as a real estate investment advisor; the investment of \$5,400,000 in Emblem Graphic Systems; and the investment of \$65,000,000 in Home Savings Association.

Mr. Stephan said a determination last month by the Public Disclosure Commission concluded that none of the above constituted violation of conflict of interest laws. In his investigation, Mr. Stephan turned over facts to the Commission, but as Attorney General made no recommendation. He added he did not state a conclusion but viewed his role as investigative and found no fault with the Commission's interpretation. Attachment 1.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON PENSIONS, INVESTMENTS AND BENEFITS,
room 527-S, Statehouse, at 9:00 a.m./p.m. on March 4, 1987

In answer to questions from the Chairman and members of the Committee concerning whether or not a change should be made in statutes regarding conflict of interest for KPERS Board members in investment matters, the Attorney General stated current statutes restrict Board members and an attempt to restrict the Board any further in their investment decisions may prove detrimental to the KPERS fund. He also noted that as a practical matter, placing successful businessmen in Board positions, which is desirable for expertise, will likely have the effect of creating borderline conflict situations.

The meeting adjourned at 9:45 a.m.

Rep. VanWallendael

Please PRINT Name, Address, the organization you represent, and the Number of the Bill in which you are interested. Thank you.

3-4-89

NAME	ADDRESS	ORGANIZATION	BILL NO.
R. W. Apple	New York	James	
Marshall Crowther	Lawrence	KPERB	
Jack Ham	Topeka	"	
W. H. Budd	Topeka	KATF	
Harold Pitta	Topeka	TARTA	
S. Mariani	Topeka	Capt of Adm.	
Barbara Allen	Topeka	A.G.	
Basil Covey	Topeka	KRTA	
John R. Pinegar	Topeka	AH. Ben	



STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 666.12-1597

ROBERT T. STEPHAN
ATTORNEY GENERAL

MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751

REPORT OF ATTORNEY GENERAL ROBERT T. STEPHAN
BEFORE THE HOUSE COMMITTEE ON
PENSIONS, INVESTMENTS AND BENEFITS
RE: KPERS INVESTMENTS INQUIRY
March 4, 1987

In cooperation with the Public Disclosure Commission, I initiated an investigation in early January into allegations that Michael K. RUSSELL, as chairman of the Board of Trustees (Board) of the Kansas Public Employees Retirement System (KPERS), participated in the making of contracts between KPERS and businesses in which he held a substantial interest in violation of K.S.A. 46-233. Background information from four articles written by Rich HOOD and Sean HOLTON and published in the Kansas City Star on December 21, 1986, was utilized. Interviews were conducted and documents were reviewed, including minutes of meetings of the Board.

In all, three contracts for investment of KPERS funds in various companies came to my attention. Those contracts are as follows:

1. The hiring of J. W. O'Connor and Co. as a real estate investment advisor on June 12, 1985;
2. The investment of \$5,400,000 in Emblem Graphic Systems in September of 1985; and
3. The investment of \$65,000,000 in Home Savings Association in October of 1986.

An encapsulation of the facts follows:

J. W. O'Connor and Co. (O'Connor) is an investment firm based in New York City. The company was hired as an investment manager on June 12, 1985 by a vote of the Board, chosen from a list of five candidate-companies presented by Ronald D. PEYTON of Callen Associates, Inc. (also an investment manager for KPERS). According to O'Connor's

Attachment 1

first quarterly portfolio report, dated October 29, 1985, the company formed a subsidiary, O'Connor Realty Advisors, Inc. and located it in the Renaissance One office building at 7007 College Blvd, Overland Park, Kansas. The report indicates that this was done to "adequately cover local market opportunities."

Although subsequent quarterly reports continued to come from O'Connor in New York, the progress described was obviously followed and performed locally. The volume of business and potential business grew to cover several pages of what appeared to be a computer print-out.

Among the potential investments listed were offerings handled by Copaken, White and Blitt Real Estate. Paul COPAKEN and Irwin BLITT are reported to be two individuals in a group of Kansas City investors who together hold a 7.5% interest in O'Connor. BLITT is reported to be one of six directors in the O'Connor firm.

At this point, however, this information is merely academic because none of the documents now available show that a contract for investment of KPERS funds was ever finalized with Copaken, White and Blitt. Further, nothing has yet come to our attention to indicate that RUSSELL holds any interest in either Copaken, White and Blitt or O'Connor. Therefore, at this time there is no information to support an allegation that RUSSELL violated K.S.A. 46-233 with regard to the hiring of J. W. O'Connor and Co.

Emblem Graphic Systems is a labeling company based in Denver, Colorado with sales offices in Kansas City, Kansas, Denver, Colorado and Salt Lake City, Utah. It is a wholly owned subsidiary of Emblem Tape and Label Holding Company in Kansas City. KPERS investment in Emblem Graphics was handled through Reimer and Koger Associates, Inc. of Shawnee, Kansas.

A Kansas City Star article of December 21, 1986, states that RUSSELL was, until just prior to the KPERS investment, a director and stockholder in Emblem Tape and Label, the parent company of Emblem Graphics. The article also stated that RUSSELL had given a "specific endorsement" in favor of investing in Emblem Graphics to Ken KOGER of Reimer and Koger. KOGER was contacted for further details.

KOGER advised that RUSSELL was approached by him as a reference for the management of Emblem Graphics. KOGER explained that when his firm considers companies for investment, the standard procedure is to request four to six references -- RUSSELL was one of those references. KOGER described RUSSELL's comments on the quality of the

management of Emblem Graphics as a "strong, positive response." KOGER added that if any of the references give anything less than a "strong, positive response," then his firm will generally not place the investment.

KOGER provided copies of a letter and internal memoranda concerning the KPERS investment in Emblem Graphics. He confirmed that he knew at the time that RUSSELL was the chairman of the KPERS Board. He also confirmed that he knew at the time that RUSSELL was a director and a 3% stockholder of Emblem Tape and Label and that the stock holding was worth between \$18,000 and \$30,000. KOGER further confirmed that the investment was placed "sometime in September" of 1985. Attached is a chronology of events surrounding the investment in Emblem Graphics as we presented it to the Public Disclosure Commission.

Simply stated, RUSSELL had a substantial interest in Emblem Tape and Label within the definition provided by K.S.A. 46-229(a). As we saw it, the question which would be decided by the Public Disclosure Commission was whether being approached as a reference for the management of Emblem Graphics and giving a "strong, positive response" constituted participation in the making of the investment contract.

Home Savings Association is a savings and loan based out of Kansas City, Missouri. It was reported that KPERS loaned Home Savings \$65,000,000 on October 24, 1986. It also was reported that RUSSELL had been a "paid director" at Home Savings just months prior to the deal. This investment also was handled by Reimer and Koger.

According to the minutes of a June 6, 1986, "telephone poll meeting" Reimer and Koger had a "guideline limitation" of \$15,000,000. By reason of the amount of the investment, Reimer and Koger was obliged to obtain a waiver from the Board in order to allocate such a large sum of money to a single investment. The minutes state simply that the "members of the board were polled" as to whether to waive the limitation and provide the additional \$50,000,000. The minutes show that RUSSELL participated in the poll and that he voted in favor of extending the limit.

Leland R. GERHART, President of Home Savings, was contacted to ascertain how much RUSSELL was paid during his tenure as a director. GERHART advised that RUSSELL held the title of director from October 9, 1985 to February 12, 1986, during which time he attended two regular monthly meetings and one special meeting. GERHART continued that Home Savings pays its directors \$500 per regular meeting attended -- thus RUSSELL was paid a total of \$1,000. GERHART provided written verification of these facts.

It appears that RUSSELL did not fall within the definition of an individual with a substantial interest with regard to Home Savings at the time of the contract. Although he may have participated in the making of the contract, in that he took part in a vote (or "poll") that was necessary to finalize the deal, his income earned as a director did not exceed the statutory \$2,000 limit set in K.S.A. 46-229(b), nor did he hold the position of director at the time of the vote as defined in K.S.A. 46-229(d).

It apparently was decided last month by the Public Disclosure Commission, after reviewing our investigation and any inquiry conducted by its own staff that none of the above constituted violation of conflict of interest laws. In fact, as I believe is clear from the above report, the only real question before the commission was whether the recommendation provided on the Emblem Graphics investment by RUSSELL constituted participation in the making of a contract. It would appear the commission determined it did not. In that interpretation of the state conflict of interest laws is generally reserved to the commission, I made no recommendation on this matter and did not state a conclusion. I viewed our role as investigative and find no fault with the commission's interpretation.

In the process of our investigation, I had the opportunity to consider the appropriateness of Kansas statutes dealing with KPERS investments and conflict of interests as they apply to KPERS board members. The Kansas statutes pertinent to KPERS investment procedures require that the board exercise "the judgment and care under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital." K.S.A. 74-4921. An attempt to restrict the board any further than this in their investment decisions may prove detrimental to the program.

Individual board members are limited in their involvement in KPERS' investments by the conflict of interest statutes. These statutes may not cover every conceivable situation; however, they should take care of the most egregious of circumstances. As a practical matter, placing successful businessmen in board positions, which is desirable for expertise, will likely have the effect of creating borderline conflict situations. Thus, a balancing of the pros and cons is necessary to determine whether this practice should continue.

Investment in Emblem Graphics

- Sept. 11, 1985 Memorandum from Ken Koger to File indicating that private placement in Emblem Graphics was being contemplated at that time. Also indicates belief that Russell's resignation and sale of stock in Emblem Graphics were necessary to avoid conflict.
- Sept. 12, 1985 Letter to Tom Olofson (major shareholder in Emblem Graphics) from Russell tendering Russell's resignation.
- Sept. 24, 1985 Sale of Russell's shares in Emblem Graphics and acceptance of resignation.
- Sept. 30, 1985 Investment deal closed .

Russell's endorsement of Emblem Graphics must have been given either while he was a director and shareholder in that company, or within 12 months after his resignation and sale of stock. In either event, if his endorsement is deemed to have been "participation" in the making of the contract, his actions are covered by K.S.A. 46-233.