



**TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
THIRTIETH LEGISLATURE, 2019**

ON THE FOLLOWING MEASURE:

S.B. NO. 1514, RELATING TO STATE AGENCIES.

BEFORE THE:

SENATE COMMITTEE ON GOVERNMENT OPERATIONS

DATE: Tuesday, February 12, 2019 **TIME:** 2:50 p.m.

LOCATION: State Capitol, Room 225

TESTIFIER(S): Clare E. Connors, Attorney General, or
Stella M.L. Kam, Deputy Attorney General

Chair Thielen and Members of the Committee:

The Department of the Attorney General provides the following comments on this bill.

This bill would prohibit state agencies from creating corporations without legislative approval. This bill would also require any corporation created by a state agency to provide a detailed accounting, upon request, to the Legislature, the Attorney General, and the Auditor, and would allow appropriations to an agency to be withheld if any corporation created by the agency fails to provide a timely accounting upon request. Finally, the bill establishes that any employee, officer, agent or contractor of a state agency who improperly creates a corporation and transfers moneys, property, or interest in property to such corporation is guilty of theft.

Although the bill defines "state agency" to include "any department, officer, board, agency, authority, instrumentality, public corporation, or other governmental organization of the State or of any political subdivision of the State," this new section would be placed in chapter 26, Hawaii Revised Statutes (HRS), which is applicable to State executive branch agencies, and which does not cover all state agencies, such as the Office of Hawaiian Affairs or legislative and judicial agencies. For example, OHA is governed by chapter 10, HRS, and, according to section 10-4, HRS, is "a separate entity independent of the executive branch."

We also believe it is unnecessary to create a prohibition to prevent State executive agencies creating unauthorized corporations. First, executive branch agencies can only exercise the authority given them by the Legislature. Second, we are not aware of any statutory authority given to executive branch agencies to create corporations. To our knowledge, the existing corporations that are under the auspices of executive branch agencies have been created by specific statute. Third, the Legislature, the Attorney General, and the Auditor already have subpoena powers to compel the production of documents such as accounting records. Finally, we have concerns about the theft provision because intent still must be established under the criminal theft statutes.

DAVID Y. IGE
GOVERNOR



THOMAS WILLIAMS
EXECUTIVE DIRECTOR

KANOE MARGOL
DEPUTY EXECUTIVE DIRECTOR

**STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM**

TESTIMONY BY THOMAS WILLIAMS
EXECUTIVE DIRECTOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII

TO THE SENATE COMMITTEE ON GOVERNMENT OPERATIONS
ON
SENATE BILL NO. 1514

**February 12, 2019
2:50 P.M.
Conference Room 225**

RELATING STATE AGENCIES

Chair Thielen, Vice Chair Inouye and Members of the Committee,

The Employees' Retirement System of the State of Hawaii (the "ERS") appreciates the intent of S.B. No. 1514 (the "bill") but must respectfully oppose it in its current form.

This bill would prohibit any state agency from creating any corporate entity without the approval of the legislature. This bill would require any corporate entity created by a state agency to provide a detailed accounting to the legislature, attorney general, and auditor upon request; and if the corporate entity fails to provide a timely accounting, the bill allows appropriations to the related agency to be withheld until the accounting is provided. Pursuant to this bill, any employee, officer, agent or contractor of an agency which creates a corporate entity without the legislature's approval, and who transfers any money or property to the corporate entity shall be guilty of theft.

ERS respectfully opposes this bill for the following reasons:

First, this bill would unduly hamper ERS' statutory investment functions. The ERS Board of Trustees is authorized to invest the ERS trust funds pursuant to § 88-110, Hawaii Revised Statutes ("HRS"). A substantial part of the funding for ERS benefit payments comes from investment income. By statute, ". . . to address outstanding unfunded pension obligations" as of



Employees' Retirement System
of the State of Hawaii

fiscal year 1999, “one hundred percent of the investment earnings shall be deposited in the pension accumulation fund.” §88-107(b), *HRS*.

By statute, ERS is authorized to invest in a wide variety of investments, including real estate and private equity placements, which are often done through pooled funds involving limited partnerships (“LPs”), limited liability companies (“LLPs”), corporations, or trusts. §88-119(9), (11), *HRS*. Such business entities are used to structure these statutorily authorized investments for various reasons, including: (1) Shielding ERS funds from liability; (2) protection and segregation of assets invested; (3) accounting and recordkeeping; and (4) tax-planning.

Based on due diligence and prudent investment industry standards, in a substantial number of such statutorily authorized investments ERS will structure the investment by creating an LLC, LP, corporation or other appropriate business entity. Such real estate, private equity, and other investment opportunities must be quickly evaluated and committed to, within deadlines dictated by the marketplace. Otherwise, the investment opportunity will be lost. Moreover, ERS’ investment activities are necessarily year-round. Based on professional investment intelligence, ERS will likely need to continue to use, and increase its use of such investment structuring, in order to fund the retirement system.

The bill does not define “corporate entity.” The term would certainly include corporations, but it is not clear whether it is intended to include entities such as LPs and LLCs. Without such clarity, ERS employees would not be able to safely use such business structuring without legislative approval. ERS employees should not be subject to theft charges due to otherwise legitimate and prudent investment structuring.

Based on the foregoing, if ERS is required to obtain approval of the legislature before creating any “corporate entity,” it will likely be hampered in its efforts to timely commit to, and structure many such investments, especially when the legislature is not in session. ERS will lose the opportunity to make such investments, frustrating its statutory, fiduciary investment activities. This will burden ERS’ efforts to eliminate unfunded liabilities and fund its member benefits.

Second, the ERS and its trustees and employees are already prohibited from having any personal interest in the gains or profits of any ERS investments and are prohibited from using ERS funds except to make necessary payments. § 88-33, *HRS*. The ERS trustees are sworn to diligently and honestly administer the affairs of the board. §88-27, *HRS*. All funds of the retirement system are held in trust by the board for the exclusive use and benefit of the system and for its members. §88-127, *HRS*. Therefore, the board of trustees has instituted its own schedule of internal and external audits to ensure that its fiduciary duties are fulfilled, and that there is no misuse of funds.

Third, ERS investments involve confidential, proprietary financial and business information. The ERS board already has an exemption from the Sunshine law for its meeting discussions involving such confidential information. § 88-27.5(a), *HRS*. If the ERS were required to comply with additional detailed audits of investment corporate entities, this would entail significant

additional administrative burdens. This would include careful segregation and protection of confidential investment information, to prevent negative effects to ERS' investment activities.

Therefore, due to the foregoing unintended consequences, ERS must respectfully oppose the bill as now written. As an alternative, ERS respectfully requests that the bill include an exemption to allow ERS to continue to create and use corporate entities for purposes of making investments as authorized under Chapter 88, HRS. A draft of such an exemption is enclosed as Exhibit "A" .

Thank you for this opportunity to testify on S.B. 1514.

Exhibit A

S.B. 1514 Relating to State Agencies

ERS Testimony to the Senate Committee on Government Operations

February 12, 2019 at 2:50 PM in Conference Room 225

Suggested Exemption language:

(e) This section shall not apply to the creation or use of any corporate entity by the Employees' Retirement System of the State of Hawaii, including its officers, employees, contractors, partners, or agents, in exercising its investment functions authorized by chapter 88 or other chapters or sections of the Hawaii Revised Statutes.



SB1514
RELATING TO STATE AGENCIES
Ke Kōmike Hana Aupuni

Pepeluali 12, 2019

2:50 p.m.

Lumi 225

The Office of Hawaiian Affairs (OHA) offers the following **COMMENTS** on SB1514, which would prohibit any state agency from creating a corporate entity without the approval of the Legislature; require any such corporate entities to provide detailed accountings upon request; and establish penalties for non-compliance. OHA has concerns that, as applied to OHA, **the legislative approval process for corporate entities may expose Native Hawaiian trust assets to unnecessary risk and may hamper the ability of OHA's Board of Trustees to act as fiduciaries for Native Hawaiians' trust assets.**

Article XII, section 6 of the State Constitution provides that OHA's Board of Trustees is entrusted with managing and administering the proceeds from the sale or disposition of land (including public land trust land) and exercising control over real property transferred to OHA for Native Hawaiians and Hawaiians. This responsibility and authority is markedly independent from the executive and legislative branches of state government, providing the Board of Trustees with the autonomy necessary to allow for the fulfillment of its fiduciary obligations.

The proposed legislative approval requirement in SB1514 could hamper our Board of Trustees in the exercise of their constitutional, statutory, and fiduciary duties. Any future decision by OHA's Board to create a corporate or other subsidiary entity as the best means of managing or protecting an asset entrusted to it would be subject to an unclear legislative approval process. Even when the creation of a subsidiary would be a clearly prudent or necessary move to manage or protect trust assets, OHA would be forced to hold and maintain its assets in a state of limbo, and defer deploying or otherwise assigning its assets until such legislative approval is received.

Should the Legislature seek to impose such an approval requirement, OHA respectfully requests an amendment to Section 2 that would clarify that legislative approval applies only to state agencies that desire to organize corporate entities that use appropriated funds or property purchased with appropriated funds, by amending page 2, line 11 through page 3, line 6, to read as follows:

"§26- Formation of corporate entities by state agencies; legislative approval; required disclosure.
(a) No state agency shall create or cause to be created any corporate entity that will use

appropriated funds or property purchased with appropriated funds without the approval of the legislature.

(b) Any corporate entity created by, within, or under the supervision of a state agency shall, upon request, provide a detailed accounting of the use of appropriated funds to the legislature, attorney general, and auditor. If any corporate entity fails to provide a timely accounting pursuant to this subsection, appropriations to the state agency to which the corporate entity is subservient may be withheld until such time as the accounting is provided.

(c) Any employee, officer, agent, or contractor of a state agency who creates or causes to be created a corporate entity that will use appropriated funds or property purchased with appropriated funds in violation of subsection (a) and who transfers or causes to be transferred any appropriated moneys, property, or interests in property to that corporate entity shall be guilty of theft as provided in section 708-830, 708-830.5, 708-831, 708-832, and 708-833."

Mahalo nui loa for the opportunity to testify on this measure.



HAWAII GOVERNMENT EMPLOYEES ASSOCIATION
AFSCME Local 152, AFL-CIO

RANDY PERREIRA, Executive Director • Tel: 808.543.0011 • Fax: 808.528.0922

The Thirtieth Legislature, State of Hawaii
The Senate
Committee on Government Operations

Testimony by
Hawaii Government Employees Association

February 12, 2019

S.B. 1514 – RELATING TO STATE AGENCIES

The Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO supports the purpose and intent of S.B. 1514 which prohibits any state agency, including departments, offices, boards, agencies, authorities, instrumentalities, public corporations, other governmental organizations, and political subdivisions, from creating any corporate entity without the approval of the Legislature, requires any corporate entity created by a state agency to provide a detailed accounting the Legislature, Attorney General, and Auditor upon request, and allows appropriations to a state agency to be withheld if a corporate entity within the state agency fails to provide a timely accounting.

The Constitution of the State of Hawaii provides the Legislature with the authority to approve the state budget, appropriate public funds, and to enact laws, thereby empowering the Legislature to set policy for our state. Granted this authority, it is only appropriate that the Legislature have the exclusive power to approve the creation of corporate entities. Further, we support the provisions of this measure that would require detailed accounting upon request, as it ensures transparency and accountability.

Thank you for the opportunity to provide testimony in support of S.B. 1514.

Respectfully submitted,

Randy Perreira
Executive Director