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A Ransacked Endowment at New York City Opera

By JAMES B. STEWART

A fundamental premise of successful investing is “sell high, buy low.” So what explains the New York City Opera board’s decision to do the opposite?

In what appears to have been panic selling, the City Opera board sold all the equities in the opera’s endowment and moved to cash in October 2008, as the stock market was plunging to new lows, and stayed in cash during 2009, as the market recovered and surged upward. The opera recorded an eye-popping $9.5 million investment loss for fiscal year 2008, ending in June 2009.

There are surely many people responsible for the sad fate of New York City Opera, a much-loved cultural treasure that filed for bankruptcy last week after years of mounting deficits, management turmoil and bad decisions. But the fate of the endowment, established to ensure the existence of City Opera in perpetuity, is a stark measure of the management failure. City Opera had an endowment of $51.6 million in 2001. By June 2013, the market value had dwindled to just $5.2 million through both additional investment losses and the board’s decision to invade the endowment to cover huge operating deficits.

Nor did the City Opera board act alone. It had to obtain court approval and the imprimatur of the New York attorney general at the time, Andrew M. Cuomo, whose office was charged with protecting the public’s interest and the interest of donors to charities, before it twice invaded the endowment — for $17.5 million in 2008 and $6.6 million in 2009. The attorney general did not intervene before City Opera’s deteriorating finances reached the point of no return.

Both Mayor Michael Bloomberg and New York’s commissioner of cultural affairs, Kate D. Levin, served on the board in an ex officio capacity for more than a decade, and City Opera said their representatives attended board meetings.

Endowments exist to generate cash for current operations and, even more important, to ensure an institution’s survival, especially in difficult times. The Lila Acheson and DeWitt Wallace Fund for Lincoln Center, the source of most of the City Opera’s endowment, stated explicitly that the funds must be maintained “in perpetuity as an endowment fund.” Courts usually at least pay lip service to the notion that invading a restricted endowment is a grave step that should be granted only in rare circumstances.

Raiding the endowment “was a suicidal thing to do,” Manuela Hoelterhoff, a Pulitzer Prizewinning opera critic; executive editor of Muse, the arts and culture section of Bloomberg News; and author of “Cinderella & Company: Backstage at the Opera With Cecilia Bartoli,” told me this week. The board “made reckless decisions without thinking of the lives of the artists they were ruining.” The opera’s musicians, singers and stagehands “don’t have trust funds,” she said. “Most don’t have pensions. They have nothing but their memories. It makes me angry that there’s no accountability.”

That lack of accountability is hardly unique to City Opera. Last summer, Long Island College Hospital, one of Brooklyn’s largest employers, announced that it was closing its doors after running through a $135 million endowment that was to be “held in perpetuity,” according to the wills of the donors, Donald and Mildred Othmer, who were early investors in Berkshire Hathaway, the conglomerate run by the billionaire investor Warren Buffett. A judge approved all of the withdrawals, some of which were used to cover malpractice claims against the hospital.

“In my opinion, endowments should never be invaded,” said Jack B. Siegel, author of a widely used guide for nonprofit directors, whose subtitle is “Avoiding Trouble While Doing Good,” and an expert on nonprofit governance. Yet “judges almost never say no,” he said. “The decision is precooked by the time an application gets to court. If the attorney general agrees, the court just goes along with it, since it doesn’t want to second-guess the attorney general. He’s supposed to be the expert. Maybe if the donors were there, there’d be some different outcomes. But the donors are usually dead.”

In City Opera’s case, financial documents indicate an astonishing lack of financial discipline leading up to the opera’s 2008 request to invade the endowment, a period when the board’s chairwoman was Susan L. Baker and the general and artistic director was Paul Kellogg. Ms. Baker, who had joined the board in 1999 and became chairwoman in 2004, worked briefly at Goldman Sachs early in her career. Mr. Kellogg, unfailingly described as a gentleman, nonetheless clashed with Ms. Baker, according to a 2012 account in Opera News, and he left in 2007 with no successor in place.

The next year, fiscal year 2008, the opera reported an annual deficit of nearly $20 million, which included the $9.5 million investment loss. According to City Opera’s court submission, it had run up deficits of $3.3 million in 2002, $6.3 million in 2003, $3.9 million in 2004, $5.6 million in 2005, and nearly $3 million in 2006. To pay its bills, City Opera borrowed $9.4 million from one of its investment managers (in itself a questionable practice) by the end of fiscal 2008, using the endowment as collateral. As of October 2008, the endowment value was just over $27 million, barely half its value in 2001.

Reached by phone, Ms. Baker said she had no comment. Mr. Kellogg did not respond to requests for comment. City Opera’s spokeswoman also declined to comment.

According to people with knowledge of the board's operations, there was no investment committee on the board that oversaw the endowment — a basic requirement of good governance. Nomi P. Ghez, a top-ranked food industry analyst and a former Goldman partner, created such a committee when she joined the board in 2003 and became finance committee chairwoman, according to these people. She also insisted that more than the one money manager then handling the investments manage the endowment. She also warned repeatedly about the unsustainable deficits, and asked that her objections be noted in minutes of board meetings.

Still, Ms. Ghez presided over the committee's 2008 decision to bail out of stocks. Her defenders note that there were other experienced market professionals on the committee who endorsed the decision, and that the board was facing continuing deficits and market turmoil and needed to protect what few assets remained. But, with the benefit of hindsight, the opera should have reinvested the proceeds in stocks in 2009, or shouldn't have sold at all. Ms. Ghez left the board in 2010 after expressing frustration with the board's leadership. She declined to comment.

With financial markets in turmoil, on Oct. 28, 2008, City Opera asked to invade the restricted endowment financed by the Wallaces, which constituted about 80 percent of City Opera's endowment. Paula Gellman, an assistant attorney general in the charities bureau, said in court papers she had "carefully reviewed" City Opera's request, reviewed financial documents, and "conducted discussions with representatives of City Opera and its counsel." While she raised no objection to City Opera's petition, she did attach some conditions, which included the requirement that the opera hire "an independent financial adviser" and develop a "viable financial plan" by December 2008. She also took aim at the board's sloppy financial management, insisting the board evaluate " the effectiveness of City Opera's governance, financial and risk management, investment practices and systems of internal controls."

No one at City Opera or in the attorney general's office contacted the Wallace Foundation, according to Lucas B. Held, the director of communications there, even though invading the endowment contradicted the express terms of the Wallace's original gift. To the extent practicable, courts are supposed to honor the intent of the donors when granting requests to invade an endowment. Had City Opera not been able to take money from the endowment, and if it subsequently failed, the proceeds would probably have been returned to Lincoln Center and its resident companies, including the Metropolitan Opera, which was a favorite beneficiary of Lila Acheson Wallace.

The Wallaces' original gift was to the Wallace Fund for Lincoln Center — not to the New York City Opera itself. The fund was subsequently dissolved when its assets were distributed in 2001 to the six resident companies at the West Side campus. The Wallaces could have given the assets directly to City Opera, as they did to the Metropolitan Museum of Art, but did not. Moreover, the attorney general's office and court allowed City Opera to tap the endowment just as it was vacating its location at Lincoln Center, although it returned for two abbreviated seasons before vacating the

State Theater in 2011.

“We grieve over the loss of any arts organization that has been a joy to listeners over so many years,” Mr. Held said, but “Lila’s generosity lives on” at the five surviving organizations at Lincoln Center.

Had the attorney general turned down City Opera’s request for relief, it would almost surely have forced the company into bankruptcy and set off a storm of criticism. Still, the endowment would have been preserved. Mr. Siegel, the charities expert who has tracked the decline of City Opera, said he was “very troubled” by the court’s decision and the attorney general’s support for invading the endowment. “This was given to Lincoln Center for its constituents,” he said. “It could have been reallocated and that would have been more consistent with the gift. I would have said ‘no.’ It was just throwing good money after bad.”

Just six months later, City Opera was back, this time asking for another $6.6 million from the endowment. This time the petition extolled the board’s decision to liquidate the stocks in the endowment and move to cash, saying the move had “helped City Opera stabilize its finances.” The $17 million it withdrew in October was already gone, having been used to pay off debt and to meet current expenses. In support of its need for additional endowment funds, City Opera cited the abrupt withdrawal of Gerard Mortier as its new director, and the loss of revenue from its decision to leave the New York State Theater during renovations and not mount any productions — both self-inflicted wounds. Nonetheless, the attorney general’s office again agreed to the request, concluding that the City Opera had met its previous conditions, including a viable financial plan. A judge again granted the request.

That financial plan projected an operating surplus of “more than $1.1 million for 2010-2011.” It also promised to “restore as much as $2,000,000 to the Wallace Fund by the end of 2009-2010 — and annually thereafter.” The reality was that City Opera, even under its new director, George Steel, lost another $5.9 million in fiscal 2010 and $752,000 in 2011, as it became an itinerant company with a dwindling number of performances. It never returned to Lincoln Center. Needless to say, it repaid nothing to the endowment.

A spokeswoman for New York attorney general’s office, Melissa Grace, said: “The attorney general’s office supported City Opera’s application to access its endowment at a time when the Opera was experiencing financial hardship, in order to give this unique and historic New York institution a chance to succeed. And we did so on the condition that City Opera take certain steps to strengthen its financial controls and internal governance. Unfortunately, their efforts did not succeed.”

A spokesman for Mr. Cuomo, now New York’s governor, deferred to the statement from the attorney general’s office.

Mr. Siegel said he saw the collapse of City Opera “as a warning for the rest of the country’s cultural institutions.” He added, “If it can happen to New York City Opera, it can happen anywhere.”

This article has been revised to reflect the following correction:

Correction: October 24, 2013

The Common Sense column on Oct. 12, about the depletion of an endowment that supplied most of the funds for the New York City Opera, misstated part of the name of the organization that created the endowment. It is the Wallace Foundation, not the Wallace Fund. (The endowment itself is formally called the Lila Acheson and DeWitt Wallace Fund for Lincoln Center.)