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FISCAL IMPACT REPORT

ORIGINAL DATE 02/06/10

SPONSOR Ryan LAST UPDATED HB

SHORT TITLE Defense of State Investment Officers SB 262

ANALYST White

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY10	FY11	FY12	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	Indeterminate	Indeterminate	Indeterminate	Indeterminate	Recurring	SIC Operating Fund

(Parenthesis () Indicate Expenditure Decreases)

Relates to SB 18, SB 19, SB 218, and SB 238
 Duplicates parts SB 220

SOURCES OF INFORMATION

LFC Files

Responses Received From

Attorney General's Office (AGO)
 General Services Department (GSD)
 State Investment Council (SIC)

SUMMARY

Synopsis of Bill

Senate Bill 262 amends the Tort Claims Act by prohibiting the state from providing a defense, paying costs, attorney fees, or any settlement of final judgment for the State Investment Officer (SIO) or any other member of the State Investment Council (SIC) when the State is the plaintiff in an action or an action is brought pursuant to the Fraud Against Taxpayers Act.

FISCAL IMPLICATIONS

Defenses, relative to the types of litigation outlined in the proposed legislation, for the SIO and members of the SIC are currently paid from the Risk Management Fund (RMF) within the General Services Department (GSD). The RMF is funded through risk premiums paid from the individual state agencies. In the case of the SIC these premiums, like everything else in the agency's operating budget, are paid with other state funds and therefore the proposed legislation carries no direct general fund fiscal impact, but will have an indeterminate impact on the SIC operating fund.

SIGNIFICANT ISSUES

The Fraud Against Taxpayers Act (44-9-1 NMSA 1978), was enacted in 2007 and provides for the recovery of state monies for payments that were obtained under a fraudulent or false claim submitted to a state agency. Either the Attorney General, or a “qui-tam” plaintiff, can file suit pursuant to this Act. If such as suit is brought by a “qui-tam” plaintiff then the Attorney General can intervene, within a specified time period, and pursue the action. Individuals who violate this section are liable for treble the damages lost by the State as a result of the fraud, and the costs and fees spent to bring the civil action.

State Investment Council (SIC):

Currently the State Attorney General’s Office has indicated it has a backlog of more than 125 qui tam lawsuits and does not have staff to review, assess and process even a fraction of that amount. There is a distinct possibility that time pressures may force these suits to be brought to court, regardless of merits. It is unknown, but a probability that many of these suits are investment related, and directed at the state investment officer and/or investment council members.

Currently the state is defending one Educational Retirement Board member and the former State Investment Officer related to a Fraud Against Taxpayer’s Act suit. The suit has been brought by former ERB chief investment officer Frank Foy, on behalf of New Mexico taxpayers. The suit alleges a pay-to-play scheme related to \$90 million in combined SIC and ERB investments in Vanderbilt Financial collateralized debt obligations (CDO). The suit was subsequently unsealed in the spring of 2009, after these investments had become virtually worthless. As a direct result of this lawsuit, the Risk Management Division (RMD) within GSD had incurred more than \$438,000 in legal fees defending public employees in the case as of December 18, 2009.

The rewards of the lawsuit for the state, if Mr. Foy is successful, could be substantial. In addition to the \$90 million of Vanderbilt investment losses originally alleged to have been tainted by pay-to-play, further analysis has determined that more than \$145 million in losses related to Vanderbilt products had actually been incurred as of November, 2009. This means that once the suit is amended for the additional losses, Mr. Foy and the state could possibly be entitled to more than \$435 million in combined damages.

RMD and SIC note in their analyses that New Mexico citizens would most likely be reluctant to serve on the SIC if they become personally liable for legal fees related to suits brought under the Fraud Against Taxpayers Act.

State Investment Council (SIC):

“It is difficult to quantify the overall impact of SB 262, as it would basically result in the ultimate departure of the Council and in all likelihood, the investment officer as well. In the case of the Council, the question would be immediately asked by any prospective member, as to why they would want an unpaid volunteer job, in exchange for opening themselves up to personal liabilities far exceeding any personal wealth they may have, in the face of lawsuits which may or may not have merit, to be decided by a single elected official.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 262 duplicates part of Senate Bill 220 which would prohibit any governmental entity from providing a defense, or paying any costs, attorney fees, settlement or final judgment for any public employee when the State is the plaintiff in the action or the action is brought pursuant to the Fraud Against Taxpayers Act.

TECHNICAL ISSUES

GSD Risk Management Division (GSD/RMD):

“Rather than amend the Tort Claims Act, amend the FATA (Fraud Against Taxpayers Act) to exclude the state and public employees as “persons” under the act.

§ 44-9-2. Definitions

As used in the Fraud Against Taxpayers Act:

A. “claim” means a request or demand for money, property or services when all or a portion of the money, property or services requested or demanded issues from or is provided or reimbursed by the state;

B. “employer” includes an individual, corporation, firm, association, business, partnership, organization, trust and the state and any of its agencies, institutions or political subdivisions;

C. “knowingly” means that a person, with respect to information, acts:

(1) with actual knowledge of the truth or falsity of the information;

(2) in deliberate ignorance of the truth or falsity of the information; or

(3) in reckless disregard of the truth or falsity of the information;

D. “person” means an individual, corporation, firm, association, organization, trust, business, partnership, limited liability company, joint venture or any legal or commercial entity; but not including the state investment officer or any member of the state investment council; and

E. “state” means the state of New Mexico or any of its branches, agencies, departments, boards, commissions, officers, institutions or instrumentalities, including the New Mexico finance authority, the New Mexico mortgage finance authority and the New Mexico lottery authority.

California has a similar statute to the New Mexico FATA. In the case of *Dockstader v. Hamby* 162 Cal.App.4th 480, 75 Cal.Rptr.3d 567, the California Court of Appeals interpreting the California FATA, judicially reached the conclusion which would be achieved by amending the FATA in the manner suggested above.”

OTHER SUBSTANTIVE ISSUES

Various federal investigations have come to light since the Foy lawsuit was unsealed. As a result of these investigations the SIC has approved a new representation policy for the agency. The new policy provides legal representation to council members, committee members, and employees of the State Investment Office if the need for legal representation has arisen in connection with their scope of duty. Under the new policy a request for legal representation must be approved by the agency's ASD Director, General Counsel, and the State Investment Officer and the attorney's fees in question may not exceed \$500 per hour. If approval is not received from these three individuals an employee or council member may petition the full council to override the staff objection. Furthermore an employee or council member must reimburse the agency if at any time they are found or plead guilty to "a criminal violation of the law" in connection with the legal representation provided.

The agency has thus far contracted with 6 law firms under this policy for a combined total of \$160,000. Additionally the agency anticipates approximately \$100,000 in additional legal contracts will be awarded during FY10 related to this policy. These contracts were not anticipated as part of the agency's FY10 operating budget. Furthermore all of these contracts were sole-sourced due to the fact that the SIC is exempt from the procurement code when contracting for investment related services.

The SIC raises questions in its analyses regarding the equity of the proposed legislation, particularly as to why the SIC is the only investing agency denied legal defense. Other agencies, most notably ERB, have also been involved with recent qui-tam suits and federal investigations into state investment practices.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If Senate Bill 262 is not enacted the state may no longer provide a defense to the SIO or members of the SIC in suits brought by the State or under the Fraud Against Taxpayers Act as well as pay any settlement amounts or penalties and judgments related to such suits.

DMW/mew