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FISCAL IMPACT REPORT

ORIGINAL DATE 01/25/11

SPONSOR Ryan LAST UPDATED _____ HB _____

SHORT TITLE Liability for Fraud Against Taxpayers SB 73

ANALYST Archuleta

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
	*See Fiscal Impact	*See Fiscal Impact	*See Fiscal Impact	*See Fiscal Impact	Recurring	Public Liability/Other Funds
Total	**(\$150.0 - \$200.0)	**(\$150.0 - \$200.0)	**(\$150.0 - \$200.0)	**(\$150.0 - \$200.0)	Recurring	PSIA Risk Fund
Total	***(\$20.0)	***(\$50.0)	***(\$50.0)	***(\$120.0)	Recurring	General Fund

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Attorney General's Office (AGO)
 State Investment Council (SIC)
 Public School Insurance Authority (PSIA)
 Educational Retirement Board (ERB)
 Department of Transportation (DOT)
 Corrections Department (NMCD)

NO RESPONSE RECEIVED FROM

General Services Department (GSD)

SUMMARY

Synopsis of Bill

Senate Bill 73 proposes to amend the Tort Claims Act so that the State “shall not provide a defense for a public employee or pay costs and attorney fees or any settlement or final judgment entered against a public employee when the state is the plaintiff in the action or the action is brought pursuant to the Fraud Against Taxpayers Act.”

FISCAL IMPLICATIONS

*The SIC indicates that SB 73 would undoubtedly result in short term cost savings to the Risk Management Fund at the General Services Department, but would potentially lead to long term

costs of a significant and indeterminate nature as a result of lost leadership, quality, ability, talent, and productivity across state government and its boards and commissions. However, estimated savings are difficult to determine without analysis from GSD.

**From PSIA's standpoint, the proposed changes are excellent because it would mean PSIA would not have to provide defense and indemnity for school employees who were charged with defrauding the school under the Fraud against Taxpayers Act. Without this change such a defense and indemnity would be required. The exclusion of indemnification and defense for school fraud will improve PSIA's Risk Program losses.

***NMCD indicates there could be savings related to certain litigation and related costs in these cases. However, it is very difficult to specify the amount of savings, and the estimated three year savings included above are speculative at best. Any savings, however, are likely to eventually be more than offset by the resignations of numerous skilled managers and supervisors who are sued by disgruntled current and former NMCD employees acting as qui tam plaintiffs in lawsuits those plaintiffs file pursuant to the Fraud Against Taxpayers Act.

SIGNIFICANT ISSUES

ERB suggests that SB 73 appears to be a response to the fact that former members of boards such as the ERB have been provided a defense under the Tort Claims Act to respond to lawsuits filed pursuant to FATA. Unfortunately, the bill could have the effect of discouraging qualified people from accepting appointments to serve on boards.

Also, lawsuits filed under FATA may not always have merit, however they always must be defended if the defendants are to avoid a default judgment. In addition, as was held by the District Court in the First Judicial District, application of FATA in a given case may be unconstitutional. The cost of mounting a defense in either of those situations is substantial. Private individuals may not be willing to accept a position if they potentially could be exposed to the cost of defending against such a lawsuit. Amending SB 73 to allow a defendant who prevailed in such litigation to recover the cost of the defense from the State would not remedy the problem as many private individuals would not have the resources to pay for a defense or for insurance, if it could be obtained, to provide a defense before being able to recover from the State.

SB 73 does not amend Sec. 22-11-13(H), which broadly indemnifies ERB board members in relation to decisions made in the performance of their duties or Section 8-5-15, which provides that the Attorney General shall act as attorney for representatives of the State in the event they are named as a party in a civil suit in connection with an act growing out of the performance of their duties. Some may argue that SB 73 is intended to prohibit indemnification under Sec. 22-11-13(H) or the Attorney General acting as attorney for public employees under Sec. 8-5-15. If that is the intent, SB 73 should be amended to directly address those sections.

It should be noted that the Attorney General opined in NMAG Opinion 10-05, issued December 3, 2010, that Sec. 22-11-13(H) must be read in the context of other statutes addressing the same subject, including the Tort Claims Act and Section 8-5-15. The Attorney General does not believe that Sec. 22-11-13(H) requires the State to reimburse ERB board members for expenses resulting from privately retaining counsel, particularly where the Risk Management Division makes an attorney available at State expense. The Attorney General believes the most

reasonable interpretation is that indemnification is authorized only when legal representation is not available under the Tort Claims Act or from the Attorney General's Office. If the challenged and the Attorney General's Opinion

NMCD indicates the bill seems to be focused on saving money by not paying the defense and related litigation costs in those cases where the state is a plaintiff or the public employee issued pursuant to the Fraud Against Taxpayers Act. However, under the Fraud Against Taxpayers Act, NMCD current and former employees can (as qui tam plaintiffs) sue other NMCD employees even when the state is not a party to that action. Therefore, this bill is very likely to result in the scenario where a "terminated for good cause" former NMCD employee or a current disgruntled NMCD employee being appropriately disciplined for clear performance deficiencies or clearly inappropriate work behavior will sue both NMCD and his or her various individual managers or supervisors under the Fraud Against Taxpayers Act. The individual managers and supervisor will then have to pay their own defense and other related litigation costs, even though their actions were proper and even if the qui tam plaintiff does not prevail in the lawsuit. Such a scenario, which will be repeated numerous times at NMCD and other state agencies, would not only be a travesty of justice, but would ultimately chill managers from properly supervising or managing their employees and likely lead to the resignations and loss of high quality managers. Disgruntled former and current NMCD employees will offensively use this bill and the Fraud Against Taxpayers Act to avoid proper, for cause discipline or corrective action, to the detriment of the NMCD and ultimately New Mexico taxpayers.

DOT indicates that the State and its employees are frequently the targets of litigation, many with merit and many which are baseless. SB 73 assumes that all lawsuits filed under the Fraud Against Taxpayers Act, NMSA 1978, § 44-9-1, are based on merit and that the accused employee, in fact, violated the Fraud Against Taxpayers Act. Under SB 73, even if an employee is later found not to have violated the Act, the employee will likely face the prospect of paying hundreds of thousands of dollars of attorneys fees and costs. Recruitment of State employees, including vital policymakers and decision makers, will be made more difficult by the potentially inequitable circumstances created by this bill.

The SIC indicates the Attorney General is the gatekeeper on FATA lawsuits, and his office is allowed to pursue a case, or move that a court dismiss the complaint, or decline to take action and allow a case to be unsealed and move forward with a qui tam plaintiff acting on behalf of the state. In addition:

- Faced with a burdensome number of lawsuits, statutes of limitation, lack of investigative and prosecutorial resources among other variables, it is understandable that the Attorney General may be put in a position where it may be in the best fiscal interests of the state to allow cases without clear-cut merit or factual basis to move forward. Unfortunately, that potentially puts untold numbers of individuals at risk for legal action and daunting personal legal expenses for doing no more than what the state has asked of them. Such personal liability is almost certain to discourage a significant number of individuals from participating in government.
- The Attorney General's Office has indicated it has a backlog of more than 100 qui tam lawsuits which it currently does not have sufficient staff to review, assess and process for approval or rejection. There is a distinct possibility that time pressures brought forth by statute of limitations may in some cases force these suits to be brought to court, regardless of their merits. It is currently unknown, but there is probability that many of these suits are investment related, and directed at the state investment officer and investment council members.

While there is certainly a likelihood that some of these suits have valid legal claims which may result in recoveries for the state, it needs to be noted that individuals bringing these suits are at least partly motivated by the sharing any recoveries and treble damages provided for under the Fraud Against Taxpayers Act. This in itself poses the possibility that dozens of cases will be brought, regardless of legal merits or obvious conflicts of interest.

PERFORMANCE IMPLICATIONS

NMCD suggests that managers are much less likely to assertively and reasonably manage and discipline their employees if they have to pay their own litigations costs incurred in suits filed by disgruntled current or former NMCD subordinates or employees. Such managers are also more likely to resign and seek other employment where they are supported by their employer for being good supervisors.

ADMINISTRATIVE IMPLICATIONS

NMCD suggests that disgruntled, poor performing former and current NMCD employees are likely to use this bill to keep their supervisors from appropriately supervising and disciplining them.

The SIC suggests that there is a very high degree of probability the Council would not be able to recruit public members to serve on the board, and the Council would cease to function. The de facto result would be a Council that could never achieve quorum, and could not approve investments or investment policy. In addition:

- Qui tam plaintiffs bringing FATA lawsuits thus far name dozens of individuals without always specifically identifying their alleged crimes, culpability or malfeasance relating to investment losses. That lack of specificity does not exclude the named defendants from incurring significant legal expenses however, and cases like these can drag on for years, making legal defense an expensive proposition. In the investment world, where investment losses are not uncommon due to the risk/reward nature of the business, the environment is ripe for FATA suits, whether there is a factual basis behind them or not.
- Lacking Tort Claims Act protections against such qui tam actions, the SIC would likely be forced to seek additional insurance coverage for its members, officers and staff if it were to continue to function. It is unclear what coverage like this would cost, though for the SIC alone it would easily be in the hundreds of thousands if not millions of dollars annually. Extrapolating those costs to affected agencies across state government, there is potential for significant hidden costs under SB 77.

ERB indicates that SB 73 could dissuade some individuals from serving on the ERB for the reasons discussed above. The ERB is the trustee of the Educational Retirement Fund and has the sole fiduciary duty and responsibility for administering and investing the Fund. Neither the Executive Director nor agency staff has the legal authority to make decisions vested in the ERB by the constitution or statute. If individuals were dissuaded from serving on the ERB by the provisions of SB 73, if enacted, it would harm management of the Fund.

TECHNICAL ISSUES

Under the Fraud Against Taxpayers Act, the New Mexico Public School Insurance Authority is not included in those state agencies authorized to bring an action to recover money their members may have been defrauded of, such as the Jemez Mountain school district embezzlement of over \$3 million. Thus, we would suggest that Act be amended to specifically provide for authority of the political subdivisions and the Public School Insurance Authority to bring such actions. Use of the term “governmental entity” rather than “state”, in line 4 on page 4, of this bill would also help.

In addition, on page 4, line 2, after “employee” should be inserted or “governmental contractor” because schools sometimes use roving Superintendents, Business Managers or other professionals who are contractors, not employees and sometimes the schools agree with them to indemnify and defend them from claims. By thus including them in the exception the school would not have to give them a defense in a claim under the Fraud against Taxpayers Act.

OTHER SUBSTANTIVE ISSUES

Former state investment officer Gary Bland is named in one FATA lawsuit and is being defended by Risk Management. The SIC itself was not sued in this action, though was subsequently sued in a related Inspection of Public Records Act lawsuit, which is also being handled through Risk.

Under the SIC’s representation policy, the agency has incurred additional legal expenses in representing members of the Council during interviews, depositions, etc related to ongoing federal investigations involving placement agents and related losses. As of November 2010, the agency had been invoiced for \$356k since FY 2009. The SIC’s representation policy requires budget availability as well as approval from the Council prior to contracting with legal counsel outside Risk Management. In addition, the policy provides for a legal clawback of funds expended in the defense of anyone later convicted or removed for violating their fiduciary duties.

In addition, the Council would be impacted greatly, in part due to legislative reforms enacted in 2010 which place the Council itself as the singular decision making entity regarding all investment of the NM Permanent Funds, excluding those investment powers specifically delegated by the Council to the Investment Officer. Members of the Council, who are not paid for serving as fiduciaries for the state’s \$14.7 billion in assets, are critical to the management of these funds and it is vital to the state of New Mexico that the very best individuals available are willing to serve if selected by the legislature and executive.

SB 73 would place those individuals, as well as the state investment officer, members of the Private Equity Investment Advisory Committee and SIC staff in a position where simply doing their jobs opens them up to personal liabilities far exceeding any personal wealth they may have, in the face of lawsuits which may or may not have merit, the validity of which is to be determined at least initially by a single elected official, the Attorney General.

ALTERNATIVES/AMENDMENTS

The suggest that if SB 73 is intended to prohibit indemnification under Sec. 22-11-13(H) or the Attorney General from acting as attorney for public employees under Sec. 8-5-15, in those circumstances set forth in the bill, the bill should be amended to clearly provide that.

DOT suggests changing paragraph F of SB 73 as follows in order to accomplish the bill's goals while balancing State employee rights:

- F. A governmental entity shall not pay any final judgment entered against a public employee when the state is the plaintiff in the action or the action is brought pursuant to the Fraud Against Taxpayers Act. A governmental entity shall provide a defense for a public employee and pay costs and attorney fees associated with defending an action brought pursuant to the Fraud Against Taxpayers Act, however, such defense shall be provided under a reservation of rights authorizing the governmental entity to recover the costs and attorney fees associated with defending the claim should the public employee be found by the fact finder at trial to have violated Section 44-9-3 NMSA.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Without this bill, such a defense and indemnity would be required.

DA/bym