

limitation on budget adjustment in those acts, for. It also adds the Educational Retirement Board and the Public Employees Retirement Association to the Office of Independent Counsel's jurisdiction.

FISCAL IMPLICATIONS

The amendment now specifies the amount of money to be appropriated from the permanent funds and adds ERB and PERA to the bill as contributing entities to the Office of Independent Counsel. The appropriation of \$400 thousand contained in this bill is a recurring expense to the permanent funds, ERB and PERA. Any unexpended or unencumbered balance remaining at the termination of the contract with the office of Independent Counsel shall revert to the funds from which appropriated in the same proportion as the money from the funds was appropriated.

The initial appropriation from each fund, totaling \$400 thousand, will be made in proportion to the market value of each fund as determined by the Department of Finance and Administration.”

Future appropriations would most likely be directed by the investigations undertaken by the Office of Independent Counsel and would most likely be appropriated from the fund or funds in question. Notwithstanding language is added to allow budget authority requests (BARs) over the normal 5 percent limitation in reference to this appropriation from any of the funds. It is unclear whether the bill “caps” the ability of the Office of Independent Counsel to request BAR transfers.

SIGNIFICANT ISSUES

Both PERA and ERB state that their charters only allow the agencies to expend fund money to the benefit of their members. It is unclear if appropriating fund money for the operating budget of the Office of Independent Counsel would fulfill this requirement, particularly since both have pursued legal claim on their own. The amendment also raises a constitutional issue.

ERB explains:

1. Constitutional Issues. The proposed appropriation is being made from the Educational Retirement Fund without any review or approval by the ERB which pursuant to N.M. Const. art. XX, § 20 and the Educational Retirement Act is the trustee for the Fund and has the sole and exclusive fiduciary duty and responsibility for administration and investment of the Fund. The Legislature's appropriation of the Fund is subject to challenge and may be unconstitutional. Furthermore, the Independent Counsel apparently will be authorized to act without consulting with or the approval of the ERB, giving rise to an additional constitutional and statutory questions regarding the duty of the ERB versus that of the Independent Counsel'
2. The Counsel has not legal duty to the fund.
3. As further addressed below, the ERB has joined actions to analyze investment losses and payments made in connection with investments of the Fund. The activities of an Independent Counsel will duplicate those actions and result in the Fund incurring additional expenses. This gives rise to additional questions about proper expenditures of the Fund.
4. The ERB has agreed to take the role of “representative plaintiff” in a class action lawsuit that will be filed by one of the largest plaintiffs class actions firms against Austin Capital. It is finalizing contracts with firms that have specialized expertise and

experience in dealing with this matters. These types of actions require a significant number of attorneys and support staff. The bill does not address the experience required of such counsel or make provisions for hiring staff. Such Counsel would have to contract with outside firms to secure that expertise, further increasing expenses to the ERB.

5. The bill also can very likely lead to conflicts with the ERB and its counsel over the actions to be pursued.

Synopsis of Original Bill

The Senate Rules Committee Substitute for Senate Bill 269 creates an office of independent counsel with jurisdiction to investigate loss or misuse of money from funds invested by the state investment officer in any instance involving alleged or suspected fraud or other malfeasance or negligence. If the independent counsel determines that any activity or conduct constitutes a criminal violation then, the counsel shall refer it to the Attorney General; if the Attorney General does not accept the referral, the independent counsel shall proceed in the matter within its administrative and civil jurisdiction. The Office of Special Prosecutor shall report monthly the status of its work to the Legislative Finance Committee and the Legislative Council, in writing. Prior to making a decision to take any administrative, civil, or criminal action, the office of Special Prosecutor shall report the determination to the New Mexico legislative council and to the legislative finance committee, and shall take no further action until the New Mexico legislative council reviews the determination with the Office of Special Prosecutor.

FISCAL IMPLICATIONS

The appropriation allows the Office of the Attorney General to request budget adjustment increases from the funds managed by the State Investment Officer to fund the independent counsel contract, and if approved the amount of budget increase is appropriated. The amount is not specified.

Both the STPF and LGPF make annual appropriations of 4.7 and 5.8 percent respectively to the general fund based upon their average market value for the preceding five calendar years. In FY10 the funds will distribute approximately \$624 million to the general fund combined, representing more than 10 percent of all recurring general fund revenue. Therefore any decrease in the corpus of these funds would result in a negative impact on general fund revenue. Given the probable costs of such an investigation the potential impact of this substitute would be very small.

<u>Historical GF Distributions</u>		
	<u>LGPF</u>	<u>STPF</u>
FY09	\$433.2	\$191.3
FY08	\$390.5	\$177.2
FY07	\$364.7	\$171.0
FY06	\$354.2	\$171.8
FY05	\$350.3	\$173.2
FY04	\$292.2	\$172.4

According to the State Investment Council’s analysis to the original bill, the potential fiscal impact of a special prosecutor is significant, but indeterminate. SB269 indicates that the special prosecutor would be independent of the Attorney General’s Office, though the AG would approve her/his budget, which would be drawn from the state’s permanent funds. There is not a cap indicated on the cost, so assuming approval, the budget is potentially limitless. The budget of the Special Prosecutor would ultimately impact distributions from either the Severance Tax or Land Grant Fund, depending on the source.

It is possible that the Office of Independent Counsel can hire a staff, which would likely be a necessity. Financial fraud cases are among the most complex, requiring lots of time, expertise, resources and money leading up to recovery. The bill appears to draw line of separation, making the special prosecutor independent of the AG’s office, which means he or she will realistically require support staff, office space and infrastructure. It is highly likely that an effective Special Prosecutor would hire an outside specialist law firm for securities fraud cases to seek to obtain recovery, as the SIC and AG currently do. If that is the case, would this office serve as the best recovery vehicle or simply a reporting arm to the legislature.

SIGNIFICANT ISSUES

As noted by SIC to the original bill, both the SIC and AG have active efforts to recover securities losses and have seen a significant measure of success as both lead plaintiff and participant in class action lawsuits. A current lawsuit outside of the class action against Countrywide financial has a potential nine-figure recovery. This case is being handled by a law firm hired by the SIC to pursue a New Mexico-specific argument which has greater standing and better chance of recovery. The validity of recovery potential must be determined through a legal assessment on a case by case basis – just because there are investment losses, does not alone mean that there is a legitimate legal avenue for recovery.

In addition, the state’s fraud against taxpayers act may ultimately prove to be a legitimate course of recovery in which the state may participate, assuming the merits of the case exist and that there are monies to recover and share with the litigants bringing the qui tam case.

Above all, on the criminal side, there is a significant potential for the work of the Special Prosecutor to be duplicative to and potentially interfere with existing investigations being performed by the FBI, US Attorney, SEC, and State Attorney General’s office.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The substitute relates to the SFC substitute for Senate Bills 18, 218, and 238 which provides for a restructuring of the State Investment Council’s membership and responsibilities.

OTHER SUBSTANTIVE ISSUES

As the independent counsel will be delivering monthly reports to the legislature, there would be a question whether the information shared with the legislature through reports would be subject to disclosure under the NM Inspection of Public Records Act. Even if such reports were deemed excludable under NM IPRA, there is a greater possibility for accidental or even intentional disclosure of sensitive information to inappropriate parties, even information only provided verbally, which could potentially damage civil or criminal recourse being sought by the Special

Prosecutor. One of the keystones of legal theory is to not divulge your legal strategies, and this requirement under SB 269 has the possibility to run contrary to that effort.

The Attorney General’s office has indicated it has more than 125 “fraud against taxpayers” or qui tam lawsuits currently on backlog, waiting processing. While undoubtedly some of those cases are lacking in merit, there is certainly a potential for some recoveries should the AG have the resources to process cases with merit.

The SIC has indicated that due to the potential for tens of millions of dollars in securities recoveries of permanent fund investment losses, additional legal expertise has been sought in pursuit of those recoveries. These legal cases are not inexpensive, but potentially could pay for themselves 50-times over.

However, the budget necessary to pursue those actions has been frozen, and appears unlikely to be approved by the legislature. As the SIC has actual case standing and intimate knowledge of the most legitimate claims, additional budgetary authority should be considered, though understandably with additional reporting or other legislative oversight as suggested by this bill.

ALTERNATIVES

Budget adjustment language in HB2 indicates that an agency may request budget increases in an amount not to exceed five percent of its appropriation. Therefore, it may be necessary to include notwithstanding language as related to budget adjustment authority.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Civil recoveries will continue to be executed by the SIC, the Attorney General, and potentially through taxpayer “whistleblower” lawsuits.

The Securities and Exchange Commission will continue to pursue regulatory action and civil fines against those accused of securities fraud and other wrongdoing.

Criminal penalties will continue to be pursued as appropriate by the NM Attorney General and the FBI/United States Attorney.

EO/mew