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## FISCAL IMPACT REPORT

ORIGINAL DATE 01/25/11  
 LAST UPDATED 03/08/11    **HB** \_\_\_\_\_

**SPONSOR**    Muñoz

**SHORT TITLE**    Investment Council Legal Service Contracts    **SB** 86/aSJC/aSFL#1

**ANALYST**    Hoffmann

### APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY11	FY12		
	NFI	N/A	None

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to House Bill 38.

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Attorney General's Office (AGO)

State Investment Office (SIO)

### SUMMARY

#### Synopsis of Senate Floor Amendment #1

Senate Floor Amendment #1 to Senate Bill 86 as amended by the Senate Judiciary Committee makes the following changes to the process the SIC would use to obtain legal services on a contingency fee basis.

- The requirement for a request for proposals for legal services is replaced with an "expedited solicitation process devised and approved by the council."
- Each proposed contract would be submitted to the Attorney General and the Department of Finance and Administration for review of the contingency fee. The review must take into consideration the complexity of the factual and legal issues to be pursued under the contract. If the AGO or the Department of Finance and Administration advise the proposed contingency fee is not reasonable, the SIC could approve the contract and contingency fee by a majority vote of its members.
- Prospective legal services contractors seeking to represent the SIC on a contingent or

partly contingent fee bases would be required to file with the SIC the disclosure required by Section 13-1-191.1 NMSA 1978 disclosing all campaign contributions made to the Governor, Attorney General, State Treasurer or any member of the SIC, or to a political committee intended to aid or promote the nomination or election of any candidate to a state office if the committee is established by any of the foregoing persons or their agents, established in consultation with or at the request of any of the foregoing persons or their agents, or controlled by one of the foregoing persons or their agents.

A new section of Chapter 6 Article 8 NMSA 1978 is added that states that nothing in the 2011 Act shall prejudice or impair the rights of a qui tam plaintiff pursuant to the Fraud Against Taxpayers Act.

#### Synopsis of Senate Judiciary Committee Amendment

The Senate Judiciary Committee amendment clarifies the process and controls that would be used to manage recoveries and fees payable as a result of successful litigation with contingent fee legal services.

The amendment would create the “state investment council suspense fund.” All amounts received by the legal services contractor as satisfaction of a claim would be transferred to the SIC and deposited in the fund. At the direction of the SIO the fees due the legal services contractor would be disbursed from the suspense fund to the contractor. The balance of the deposit would be distributed to the appropriate permanent fund or other fund from which the loss occurred that originated the claim pursued by the legal services contractor.

#### Synopsis of Original Bill

Senate Bill 86 would give authority to the State Investment Council to enter into contingency fee agreements with private counsel to pursue state investment losses. The contingency fee contract would be subject to an RFP process.

### **FISCAL IMPLICATIONS**

The appropriation table above shows no fiscal impact since no appropriation is included in the bill.

However, there are two significant and desired fiscal impacts which are not estimated in tables: (1) the proposed contingent fee legal services contracts for litigation services would not require an increase in the SIC’s operating budget, and (2) certain losses to the state’s permanent funds might be recovered by settlement or court judgments.

### **SIGNIFICANT ISSUES**

By way of background, the SIC offers the following information: In mid-2010, the Council sought and received approval from the NM Attorney General to issue a Request for Proposal (“RFP”) for recovery legal services. An assistant AG served on the RFP selection committee, which chose the New York-based Day Pitney law firm.

Day Pitney has extensive experience in the area of securities-related loss recoveries, most recently representing the New York State Common Retirement Fund in enforcement and

litigation matters arising from the same hedge fund and private equity pay-to-play scandal which has tainted New Mexico. New York achieved a \$150-plus million recovery.

On the day that Day Pitney representatives arrived in Santa Fe to sign the contingency fee agreement, the terms of which were overseen and agreed to by the AG's office, Attorney General King for the first time indicated a concern about the constitutionality of contingency fee contracts and suggested that the SIC seek legislative authority.

The basis of the AG's reversal is a 1983 advisory opinion, authored by then Attorney General Paul Bardacke's office, addressing a proposed contract between the Department of Finance and Administration and Western Assurance for the recovery of FICA taxes. Nearly 30 years ago, in a much better economy, the AG's office suggested that the proposed compensation provision would violate Art. IV, § 30 of the NM Constitution and § 6-4-2 NMSA 1978 because it potentially authorized an expenditure of funds from the State Treasury without requisite legislative appropriation. Today, the AG's office is looking to establish its own contingent fee authority.

Facing public outcry to commence recovery efforts in New Mexico, as well as timing issues related to statutes of limitation, the SIC hired Day Pitney on an hourly fee contract in August 2010. Since that time, SIC has been forced to use limited available SIC budgeted funds to continue basic recovery work.

If the SIC does not receive contingent fee authorization, there is a substantial possibility that tens of millions of dollars in recoverable assets will never be returned to the state's permanent funds. Accordingly, Day Pitney is currently drafting an omnibus federal complaint naming multiple high-profile defendants.

The rationale for giving the authority for contingent legal fee contracts to the SIC is stated clearly by the AGO as follows.

“Contingency fee authority is important to ensure that SIC has the ability to hire private counsel to pursue claims that the State lacks the resources to pursue. Contingency fee arrangements are common in private practice and are the industry standard in securities litigation. Without this authority, it is difficult to engage private counsel on terms that private counsel find agreeable. The principle alternative – paying attorneys on an hourly basis – is unfeasible because it requires budget allocations that many agencies, including SIC, often cannot make. In short, without contingency fee authority, several of the State's investment losses will go unprosecuted.”

Permitting an agency to enter into contingency fee contracts for litigation services also presents the risk of abuse through law firm selection or case selection (or non-selection) involving “pay to play” schemes for favorable settlement terms to parties other than the state. There would also be opportunities for frivolous lawsuits against political targets.

There is a clear need for both transparency and strong oversight to avoid the above and other possible risks from having this method of litigation available. Including language in the bill to specify that procurement of services in this way be subject to SIC review and approval, along with concurrent approval by an outside entity such as the Department of Finance and Administration's Contracts Review Bureau or the State Purchasing Agent might help insure that this procurement method only be used for appropriate cases and maximizing possible returns to the state.

## **PERFORMANCE IMPLICATIONS**

The SIO states it is difficult to estimate the significance and volume of agency resources being diminished due to issues surrounding placement agents and related investment losses directly attributable to the allegations first made public in 2009. Impact includes everything from lost investment opportunities due to reputational damage, to intensive efforts to prevent reoccurrence through policy procedure and legislative change, to administrative burdens placed on agency assets by additional demands for records from investigators and or the public. There is a very long road to redemption following this type of scandal, and recovery of state funds is a critical step and will only help speed improved performance.

## **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

Senate Bill 64 also proposes to amend this section of the statutes more extensively to include commercial liability insurance coverage for official actions by council members. It includes the specific language found in Senate Bill 82.

House Bill 38 is related to Senate Bill 86 which also proposes the procurement of legal services on a contingency fee basis for the State Investment Council.

## **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

Contingency fee authority is important to ensure that SIC has the ability to hire private counsel to pursue claims that the State lacks the resources to pursue. Contingency fee arrangements are common in private practice and are the industry standard in securities litigation. Without this authority, it is difficult to engage private counsel on terms that private counsel find agreeable. The principle alternative – paying attorneys on an hourly basis – is unfeasible because it requires budget allocations that many agencies, including SIC, often cannot make. In short, without contingency fee authority, several of the State's investment losses will go unprosecuted.

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