

Opinion 10-05

OPINION OF: GARY K. KING Attorney General

December 3, 2010

BY: Elizabeth A. Glenn, Deputy Attorney General

TO: Jan Goodwin, Executive Director, Educational Retirement Board, 701 Camino de los Marquez, Santa Fe, NM 87502-0129; Dannette K. Burch, Secretary Designate, Department of Finance and Administration, Bataan Memorial Bldg., Room 180, Santa Fe, NM 87501

QUESTIONS:

1. Is indemnification under the Educational Retirement Act afforded to reimburse Bruce Malott, former Chairman of the Educational Retirement Board ("ERB"),^[1] for his expenses resulting from privately retained counsel where Risk Management has provided or offered to provide legal representation to Mr. Malott?
2. Does Section 22-11-13(H) of the Educational Retirement Act permit indemnification for non-legal expenses?
3. Is indemnification allowed under Section 22-11-13(H) where an entity in which an ERB member has an ownership interest is sued as a result of decisions made by the ERB member?
4. Is indemnification allowed under Section 22-11-13(H) with respect to actual or potential criminal matters?
5. Does ERB have authority to implement Section 22-11-13(H)?
6. Does Section 22-11-13(H) require ERB to contract with providers of goods or services?
7. Does Section 22-11-13(H) require ERB to follow the Procurement Code?
8. Does ERB have the right to approve an ERB member's chosen attorney under Section 22-11-13(H)?
9. Does ERB have the right to settle lawsuits brought against ERB members when settlement is in the best interest of the Educational Retirement Fund?
10. What mechanisms exist to protect the Educational Retirement Fund from requests of ERB members to be indemnified for excessive or unreasonable losses?

CONCLUSION:

Our general conclusion is that the indemnification authorized under the Educational Retirement Act, NMSA 1978, ch. 22, art. 11 (1967, as amended through 2009) ("ERA"), applies exclusively to ERB members and must be applied consistent with other New Mexico laws, the state constitution and ERB's responsibilities as trustee of the Educational Retirement Fund. We address each of your specific questions in more detail below.

FACTS:

Mr. Malott is a defendant in two lawsuits brought under the Fraud Against Taxpayers Act, NMSA 1978, Sections 44-9-1 to -14 (2007) ("FATA"). The district court dismissed one of those cases on April 28, 2010, concluding that retroactive application of FATA would violate federal and state prohibitions against *ex post facto* laws.[2] Mr. Malott is also a defendant in two class action lawsuits brought by members of the educational retirement system. The Risk Management Division ("RMD") of the General Services Department has assigned counsel to represent Mr. Malott in these actions.

A federal grand jury and the Securities and Exchange Commission ("SEC") are investigating matters regarding ERB's investments. Those investigations appear to involve investments in which investment managers made payments to third party placement or marketing agents. ERB understands that Mr. Malott may have been served with subpoenas requiring him to produce documents or provide information in connection with those investigations. ERB understands that RMD has made counsel available to Mr. Malott in connection with the SEC matter but not the federal grand jury matter.[3]

Mr. Malott has retained an attorney to represent him personally in these legal proceedings and other matters. Mr. Malott seeks reimbursement of his legal fees from the Educational Retirement Fund.[4] RMD, which has already assigned or made available counsel to Mr. Malott, indicates that it will not pay the fees of Mr. Malott's privately retained attorney.

Mr. Malott relates that he has personally incurred expenses for advice and consultation provided by an Albuquerque public relations firm. Mr. Malott has not yet requested that ERB pay those expenses, although he might later do so.

Mr. Malott's accounting firm is also named as a defendant in the two FATA suits. Mr. Malott has not requested reimbursement for legal fees on behalf of his firm, although he might later do so.

On April 20, 2010, ERB submitted to the Department of Finance and Administration a \$1.5 million budget adjustment request (BAR) for FY 10, requesting a budget increase for indemnification related fees. As justification, ERB stated that a current board member had hired legal counsel to assist in responding to litigation involving the

Educational Retirement Fund and to two federal investigations, and that three other current or former board members had been named as defendants in current litigation and might request indemnification.

ANALYSIS:

1. Is indemnification under the ERA afforded to reimburse Mr. Malott for his expenses resulting from privately retained counsel where Risk Management has provided or offered to provide legal representation to Mr. Malott?

Administrative bodies, such as ERB, are “creatures of statute and can act only on matters which are within the scope of authority delegated to them.” Matter of Proposed Revocation of Food & Drink Purveyor’s Permit v. Env’tl. Improvement Div., 102 N.M. 63, 66, 691 P.2d 64 (Ct. App. 1984). A state agency “cannot amend or enlarge its authority through rules and regulations” or “through the device of regulations, modify the statutory provision.” *Id.* (citations omitted). See also Martinez v. N.M. State Eng’r Office, 2000-NMCA-74, ¶ 22, 9 P.3d 657, 662 (as a “public administrative body created by statute,” the State Personnel Board “is limited to the power and authority expressly granted or necessarily implied by statute”).

The ERA expressly provides indemnification for ERB members:

Members of the board, jointly and individually, shall be indemnified from the fund by the state from all claims, demands, suits, actions, damages, judgments, costs, charges and expenses, including court costs and attorney fees, and against all liability, losses and damages of any nature whatsoever that members shall or may at any time sustain by reason of any decision made in the performance of their duties pursuant to this section.[5]

NMSA 1978, § 22-11-13(H) (2009).[6] The language of Section 22-11-13(H) is broad, but to the extent it authorizes legal representation of ERB members at state expense, it is not exclusive.

Under the rules of statutory construction, a statutory provision is not considered in isolation. Instead, it must be read in the context of the statute as a whole, as well as with other statutes that are *in pari materia* (relate to the same class of things). See Team Specialty Products v. New Mexico Taxation & Rev. Dep’t, 2005 NMCA 20, ¶ 9, 137 N.M. 50, 107 P.3d 4. Whenever possible, statutes in *pari materia* must be harmonized, State of New Mexico v. Tafoya, 2010 NMSC 19, ¶ 10, and all their provisions given effect. State of New Mexico v. Flores, 2004 NMSC 21, ¶ 10, 135 N.M. 759, 93 P.3d 1264.

Laws other than the ERA provide a legal defense for state officers and employees, including ERB members, in various circumstances. Most significantly, the Tort Claims Act, NMSA 1978, §§ 41-4-1 to -29 (1976, as amended through 2009), requires the state

to “provide a defense, including costs and attorneys’ fees” for a state officer or employee

when liability is sought for:

(1) any tort alleged to have been committed ... while acting within the scope of his duty; or

(2) any violation of property rights or any rights, privileges or immunities secured by the constitution and laws of the United States or the constitution and laws of New Mexico when alleged to have been committed ... while acting within the scope of his duty.

Id. § 41-4-4. To fulfill its obligations under this provision, RMD contracts with and pays attorneys, with public funds, to defend public officers and employees acting within the scope of their duties. See NMSA 1978, § 41-4-23(B)(5).

State officers and employees also may seek legal representation from the Attorney General’s Office in certain circumstances. Specifically, the Attorney General:

is directed to act, if requested, as attorney for any officer, deputy, assistant, agent or employee of the state or of a state institution in the event such person is named as a party in any civil action in connection with an act growing out of the performance of his duty....

NMSA 1978, § 8-5-15. See also id. § 8-5-2(C) (attorney general shall “prosecute and defend all actions and proceedings brought by or against any state officer or ... any employee of the state in his official capacity”). The Attorney General’s obligation to represent state officers and employees does not apply when they are sued by the state. Id. § 8-5-15.

Reading Section 22-11-13(H) in light of the other statutes that provide legal representation to state officers and employees, we do not believe it requires the state to reimburse Mr. Malott and other ERB members for expenses resulting from privately retained counsel, particularly when an attorney has been made available at state expense through RMD. It seems unlikely that the legislature intended Section 22-11-13(H) to render inapplicable the Tort Claims Act’s provisions for legal representation. The more reasonable interpretation is that the indemnification authorized by Section 22-11-13(H) applies only when legal representation is not available under the Tort Claims Act or by the Attorney General’s Office. This interpretation harmonizes and gives effect to all the statutory provisions addressing the legal representation of state officers and employees.

Our conclusion that Section 22-11-13(H) does not entitle Mr. Malott to reimbursement for his privately retained attorney is supported by judicial decisions from other states. Courts addressing the issue under those states’ public liability laws have held that

public employees are not entitled to be compensated by the state for private counsel of their own choosing. See, e.g., DeGrassi v. City of Glendora, 207 F.3d 636 (9th Cir. 2000) (public officer not entitled to reimbursement for costs of privately retained legal counsel where public entity had offered to provide legal defense, which offer was refused; California Tort Claims Act grants the public entity authority to select an attorney); City of Huntington Beach v. Petersen Law Firm, 95 Cal.App.4th 562 (2002) (regardless of whether the conflicts of interest were actual or merely potential, city was not obligated to provide officers with separate defense; accordingly, city was not obligated to reimburse expenses of private counsel retained by the officers); Mothersell v. City of Syracuse, 952 F. Supp. 112 (N.D.N.Y. 1997) (law indemnifying police officer for attorney's fees incurred in defending actions arising out of official acts does not require the public entity to allow officer to select counsel of his choosing).

Evidently, ERB and counsel for Mr. Malott have argued that legal representation through RMD is insufficient because it will not protect ERB members' "individual, personal interests." This argument is unpersuasive for two reasons. First, the indemnification available to an ERB member under Section 22-11-13(H) is expressly limited to expenses that arise from decisions a member makes in his or her official capacity as a member of ERB. Section 22-11-13(H) does not authorize the state to provide legal representation to protect an ERB member's individual, personal interests.

Second, the state cannot provide a legal defense in a proceeding implicating an ERB member's personal, individual interests without violating the antidonation clause of Article IX, Section 14 of the New Mexico Constitution.[7] See N.M. Att'y Gen. Op. 07-03 (2007) (antidonation clause prohibits the use of public money to pay a public employee's personal legal expenses). See also N.M. Att'y Gen. Op. 88-61 (1988) (antidonation clause prohibited the Legislative Finance Committee from paying attorney's fees for two legislators who, in their individual capacities, filed a lawsuit challenging the governor's line item vetoes); N.M. Att'y Gen. Op. 88-18 (1988) (a conservancy district could not reimburse expenses incurred by two of its directors in a successful election contest); N.M. Att'y Gen. Op. 65-233 (1965) (a school board could not hire an attorney to defend one of its members in a quo warranto proceeding (an action to determine an officer's right to hold his office) because such proceeding is purely personal).

2. Does Section 22-11-13(H) permit indemnification for non-legal expenses?

For purposes of this opinion, we assume that "non-legal expenses" are expenses other than attorneys' fees, court costs and other expenses incurred in a lawsuit or other legal proceeding. The only concrete factual context that ERB has provided to us for this question are expenses Mr. Malott has incurred for advice and consultation provided by an Albuquerque public relations firm.

As quoted above, Section 22-11-13(H) indemnifies ERB members "from all claims, demands, suits, actions, damages, judgments, costs, charges and expenses, including court costs and attorneys fees, and against all liability, losses and damages of any

nature whatsoever ... that members ... sustain by reason of any decision made in the performance of their duties..." (emphasis added). Section 22-11-13(H), by its terms, does not limit indemnification to legal expenses per se. Nevertheless, in the context of Section 22-11-13(H) and the ERA as a whole, most expenses for which a member is likely to seek indemnification will result from defending the member against legal claims and actions. See Holt v. New Mexico Dep't of Taxation & Rev., 2002 NMSC 34, ¶ 12, 133 N.M. 11, 59 P.3d 491 (the meaning of a word that is not defined by statute "is determined by its context, the rules of grammar and common usage"), quoting NMSA 1978, § 12-2A-2 (1997).

Even assuming that Section 22-11-13(H) contemplates indemnification of non-legal expenses, we cannot conclude that the cost to Mr. Malott of hiring a public relations firm is appropriate for reimbursement. It is not enough that, but for his or her membership on the ERB, a person would not have incurred an expense. To be eligible for reimbursement, there must be a reasonably direct and necessary relationship between an expense and the decisions a person makes as a member of the ERB. Here, Mr. Malott did not sustain the expense of hiring a public relations firm because of his decisions as an ERB member. Mr. Malott incurred the expense as a result of his independent, personal decision that he required those services. As discussed previously, the antidonation clause prohibits the state from reimbursing ERB members for expenses they incur in their personal or private capacities.

It should be noted that, notwithstanding the indemnification permitted by Section 22-11-13(H), payments from the Educational Retirement Fund are strictly circumscribed by the New Mexico Constitution. Under Article XX, Section 22, expenditures from the Fund "shall only be made for the benefit of the trust beneficiaries and for expenses of administering the [educational retirement] system." Consequently, any legal or non-legal expense for which indemnification is otherwise available under Section 22-11-13(H) must also be an "expense of administering" the Educational Retirement Fund. In contrast to the costs of defending claims against ERB members that stem from their investment decisions, it is difficult to justify the costs incurred by an ERB member for the services of a public relations firm as an expense of administering the trust fund.

3. Is indemnification allowed under Section 22-11-13(H) where an entity in which an ERB member has an ownership interest is sued as a result of decisions made by the ERB member?

As quoted above, Section 22-11-13(H) provides indemnification for covered expenses sustained by "members of the board." This necessarily excludes from indemnification persons and entities that are not ERB members, regardless of their relationship to a member.

4. Is indemnification allowed under Section 22-11-13(H) with respect to actual or potential criminal matters?

We discuss actual criminal matters first, although we understand that the availability of indemnification for criminal defense fees is not an issue for ERB at this time because no ERB member has been charged with a crime.

Section 22-11-13(H), in pertinent part, broadly indemnifies ERB members “from all suits, actions ... and against all liability, losses and damages of any nature whatsoever” that the members may sustain because of their investment decisions. (Emphasis added.) Although it concerns us, we believe the language of Section 22-11-13(H) is sufficient to permit indemnification if an ERB member is charged with a crime, provided the charges result from a decision the member made in the performance of his or her duties and the member successfully defends against the charges.

Past opinions of this Office have addressed this issue in other contexts. See N.M. Att’y Gen. Op. 07-03 (concluding that a public school district could legally provide a defense for its officials and employees in lawsuits alleging misconduct, subject to certain limitations); N.M. Att’y Gen. Advisory Letter No. 85-23 (Sept. 16, 1985) (concluding that public bodies might, in certain circumstances, pay the expenses of an employee’s successful criminal defense). Generally, absent a controlling statute, the use of public money to defend public employees against allegations of criminal wrongdoing is permissible when:

- (1) the charges arise from the discharge of an official duty in which the government has an interest;
- (2) the public employee was acting in good faith when the alleged wrongful conduct occurred;
- (3) the employing government entity has express or implied legal authority to pay the employee’s legal expenses;
- (4) the employee is exonerated of the charges; and
- (5) the decision to pay the fees was made by an impartial official or official body.

Id.

As applied to ERB, the fourth criterion – the employee’s exoneration – is most critical. As discussed in this Office’s previous opinions, the exoneration requirement ensures that public funds are not improperly used to defend a public employee or officer who is convicted of a crime. Att’y Gen. Op. No. 07-03; Att’y Gen. Advisory Letter No. 85-23. Criminal acts, by definition, are not within the scope of an officer’s public duties or employment. Id. See also Wright v. City of Danville, 675 N.E.2d 110, 118 (Ill. 1996) (even if officials’ “public employment provided the opportunity for their misconduct,” their actions could not “be deemed an extension of their legitimate duties”). As discussed above, the state may not provide a defense at public expense in personal legal proceedings. See also Wright, 675 N.E.2d at 116-117 (citing multiple cases for the

proposition that indemnification of public officials' unsuccessful criminal defense does not serve a public purpose).

These principles clearly limit ERB's authority to spend trust funds to defend ERB members in criminal proceedings. In our view, ERB should refrain from adopting any policy or procedure that provides a defense upfront or advances payment for expenses of an ERB member who is charged with a crime. Indemnification under Section 22-11-13(H) for expenses a member incurs in his or her criminal defense should be strictly limited to reimbursement and only if the member is exonerated of the charges.

Turning to "potential criminal proceedings," we assume your question refers to the federal grand jury and SEC investigations described in ERB's opinion request. We understand that Mr. Malott has been or may be subpoenaed by or asked to provide information to the grand jury and SEC. As noted above, no ERB member, including Mr. Malott, has been arrested or charged with a crime at this time.

An ERB member's entitlement to indemnification for legal representation in "potential" criminal proceedings depends on the analysis discussed above for noncriminal matters. Specifically, the availability of indemnification under Section 22-11-13(H) would depend on ERB's determination that (1) the member's involvement in the proceedings stem from decisions made in the performance of his or her duties, (2) the member's official interests or those of ERB require legal representation, and (3) an attorney to represent the member is not available from RMD or from the Attorney General's Office. Again, we emphasize that Section 22-11-13(H) does not entitle a member to make an independent assessment of his or her need for an attorney, hire a private lawyer of the member's choice and seek indemnification from the Educational Retirement Fund.

5. Does ERB have authority to implement Section 22-11-13(H)?

Section 22-11-13(H) is part of the ERA. ERB is charged with "properly and uniformly enforc[ing] the [ERA]" and "adopt[ing] regulations pursuant to the [ERA]." NMSA 1978, § 22-11-6(A), (E) (1967). ERB members are expressly prohibited from using the Educational Retirement Fund "except to make current and necessary disbursements authorized by the [ERB]." *Id.* § 22-11-14(B) (1967). We believe that these powers provide sufficient authority to ERB to implement Section 22-11-13(H).

6. Does Section 22-11-13(H) require ERB to contract with providers of goods or services?

Section 22-11-13(H) does not specify the procedures or process for implementing the indemnification of ERB members authorized under that provision.

7. Does Section 22-11-13(H) require ERB to follow the Procurement Code?

Again, Section 22-11-13(H) is silent on this issue. It neither requires ERB to follow the Procurement Code nor exempts ERB from the Code's coverage. Whether the

Procurement Code applies will depend on the procedures or process ERB adopts to implement Section 22-11-13(H).

8. Does ERB have the right to approve an ERB member's chosen attorney under Section 22-11-13(H)?

As discussed above, Section 22-11-13(H) does not entitle ERB members to choose and hire their own attorneys. ERB, as trustee of the Educational Retirement Fund, is obligated to oversee expenditures from the Fund and to ensure that they are appropriate and consistent with the interests of the Fund's beneficiaries. Regardless of the specific procedures ERB adopts to implement Section 22-11-13(H), ERB has the right and duty to approve attorneys who represent its members under that provision.

9. Does ERB have the right to settle lawsuits brought against ERB members when settlement is in the best interest of the Educational Retirement Fund?

We do not have sufficient facts to provide an answer to this question. ERB has no express, statutory right to settle lawsuits brought against ERB members. However, this does not mean that ERB would not have the right or obligation under any set of circumstances to settle a lawsuit brought by an ERB member if necessary to protect the interests of the Educational Retirement Fund's beneficiaries.

10. What mechanisms exist to protect the Educational Retirement Fund from requests of ERB members to be indemnified for excessive or unreasonable losses?

As trustee, ERB has "the sole and exclusive fiduciary duty and responsibility for administration and investment of the [Educational Retirement Fund]." N.M. Const. art. XX, § 22(B). See also NMSA 1978, § 22-11-11(B) (designating ERB as trustee of the Educational Retirement Fund). As noted previously, the state constitution limits expenditures from the Fund to those "made for the benefit of the trust beneficiaries and for expenses of administering the [educational retirement] system." N.M. Const. art. XX, § 22(A). The ERB's fiduciary duties are set out more fully in the ERA, which requires the ERB to "invest or reinvest the fund in accordance with the Uniform Prudent Investor Act." Id. § 22-11-13(A). The Uniform Prudent Investor Act requires a trustee to "invest and manage the trust assets solely in the interest of the beneficiaries" and provides that "[i]n investing and managing trust assets, the trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust and the skills of the trustee." Id. §§ 45-7-606, 608 (1995).

ERB's fiduciary duties under the state constitution and statutes require it to protect the Educational Retirement Fund from unreasonable or excessive losses. Nothing in the ERA allows ERB to abdicate this responsibility in the case of its members' requests for indemnification under Section 22-11-13(H). ERB must implement and apply Section 22-11-13(H) so that any expenditures made from the Educational Retirement Fund to indemnify ERB members are reasonable, necessary and appropriate.

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[1] Mr. Malott resigned from the ERB while this opinion was pending.

[2] See Order of Dismissal entered in *State of New Mexico, ex rel. Frank C. Foy v. Vanderbilt Capital Advisors, LLC, et al.*, No. D-101-CV-2008-1895.

[3] Counsel for Mr. Malott, in correspondence with this Office dated May 14, 2010, disputes ERB's statement that RMD offered to provide counsel with respect to the SEC investigation.

[4] We do not address the merits of the pending litigation, but because the questions posed involve matters that may become issues in pending or future litigation, we caution that the courts may ultimately resolve these issues.

[5] The phrase "this section" means Section 22-11-13, which authorizes ERB to invest the Educational Retirement Fund.

[6] The Public Employees Retirement Act contains a virtually identical indemnification provision applicable to members of the Public Employees Retirement Board. See NMSA 1978, § 10-11-132 (2005).

[7] The antidonation clause, in pertinent part, prohibits the state from "mak[ing] any donation to or in aid of any person, association or public or private corporation...." N.M. Const. art. IX, § 14.