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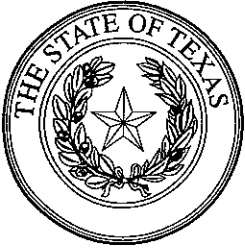
State Board of Education

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**RQ-0920-GA**

September 23, 2010



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The Honorable Greg Abbott  
Attorney General of Texas  
Office of the Attorney General  
P.O. Box 12548  
Austin, Texas 78711-2548

**RE: Request for Opinion Regarding the Authority of the State Board of Education to Use Monies from the Permanent School Fund to Meet the Management Expenses of Permanent School Fund Investments**

Dear General Abbott:

I am writing to seek your guidance regarding certain authority of the State Board of Education in its management of the Permanent School Fund ("PSF"), possibly including clarification of the scope of Attorney General's Opinion DM-316 (1995).

As you are aware, the Texas Constitution dedicates certain lands to the Permanent School Fund<sup>1</sup> ("PSF"). The PSF is managed by two entities, the School Land Board and the State Board of Education<sup>2</sup>. The School Land Board is entrusted with lands dedicated to the PSF pursuant to Article VII, Section 4 of the Texas Constitution. As proceeds from the sale of lands are transferred to the State Board of Education ("the Board"), they are invested pursuant to Article VII, Section 5 as "investment assets". The Board makes a biennial determination of a percentage of the PSF's investment assets to transfer to the Available School Fund for the support of public education. Expenses of managing the PSF are paid "by appropriation" from the PSF itself<sup>3</sup>.

<sup>1</sup> Article VII, Section 2 refers to the "Perpetual School Fund" Article VII, Section 4 refers to the "Public Free School Fund" and Article VII, section 5 to the "Permanent School Fund". While different terms are used, there is only one fund, consisting of lands dedicated to the support of public education and investments derived from the proceeds of the sale of such lands. See, Texas Attorney General's Opinion GA-617 (2008).

<sup>2</sup> The School Land Board, together with the Texas Land Commissioner, manage lands originally dedicated to the fund and acquired with proceeds from the sale of such lands under Chapter 51 of the Natural Resources Code. The State Board of Education is directly granted authority to manage the investment assets of the PSF under Article VII, section 5 of the Texas Constitution, with additional statutory guidance in Chapter 43, Texas Education Code.

<sup>3</sup> Article VII, Section 5(b), Texas Constitution.

My questions involve the ability of the Board to manage the investment assets of the PSF by contracting to monitor, investigate, and if necessary to pursue claims for recovery of amounts due to the PSF that may arise in the context of improper conduct by third parties concerning and adversely affecting the value of certain assets held by the PSF. The Board is given very broad authority in Article VII, Section 5(f) of the Texas Constitution to oversee and invest the PSF:

“(f) Notwithstanding any other provision of this constitution, in managing the assets of the permanent school fund, the State Board of Education may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment ... that persons of ordinary prudence, discretion, and intelligence, exercising the judgment and care under the circumstances then prevailing, acquire or retain for their own account in the management of their affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.”

The Board has been advised by its fiduciary counsel that ascertaining whether it suffered an economic loss, as a result of the decline in value of assets it currently holds or in the past held, caused by improper action or inaction of a third party, is a proper and necessary part of discharging its fiduciary duty in monitoring and overseeing its assets. The Board is considering a process by which its fiduciary counsel would evaluate potential claims on behalf of the PSF and recommend to the Board whether litigation is appropriate to recover amounts due to the PSF. If litigation would seem appropriate, it is likely that such litigation would be conducted, pursuant to federal securities laws, although state law claims might well also arise. Nationally, most such cases have been pursued by claimants that hold large pools of monies such as pension funds, like some of our state-wide or large municipal pension funds. The most numerous of the cases pursued in the past decade have involved contingent fee arrangements with litigation counsel. My questions involve the ability of the Board to enter into such arrangements and to pay fees from the assets recovered.

**My first question is whether the Board may contract for attorney's fees payable from amounts due to the PSF without an appropriation to pay those fees.**

This question may involve reconsideration or clarification of the scope of Attorney General Opinion DM-316 (1995). That opinion, which arose under an earlier more limited scope law that provided a “bounty” for information leading to the recover of PSF assets, determined that the comptroller could not pay consideration for information leading to the recovery of PSF assets under Section 403.0195, Government Code.

I believe that opinion has been superseded by the changes to the PSF constitutional provisions in 2003 as noted below.

First, when DM-316 was decided, the expenses of managing the PSF were required to be appropriated from the Available School Fund. The adoption of Article VII, Section 5(b) of the Constitution by the voters in 2003<sup>1</sup> evidences an expectation that costs associated with the PSF be borne by the PSF itself.

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<sup>1</sup> Art. VII, Section 5(b) “The expenses of managing permanent school fund land and investments shall be paid by appropriation from the permanent school fund.”

Second, Attorney General's opinion DM-316 construed the comptroller's statutory authority to commit funds rather than the Board's constitutional grant of authority under Article VII, Section 5. We believe that the current organic authority to manage the affairs of the PSF is inherently broader than the then applicable statutory authority of the comptroller.

Finally, Attorney General's Opinion GA-293 (2005) determined that "indirect management costs" could be deducted from a mutual fund or similar investment without a specific appropriation for those costs. By analogy, attorney's fees necessary to recover an asset for the PSF should be considered such an indirect cost and thus deductible from the PSF asset itself. The Texas Education Agency staff that assist the Board in managing the PSF Investment Assets currently join class action suits on behalf of the PSF. The net effect of joining such a suit is to receive any return net of attorney's fees with virtually the same manner and effect as had the PSF directly contracted for a contingent fee payable from assets recovered. The consequence of joining a class action lawsuit, becoming a plaintiff in a single plaintiff case or lead plaintiff in a class action should be no different.

**My second question is whether the Board may agree to a contingent fee contract without completing the process set out in Chapter 2254 of the Government Code.**

The Board anticipates that contingent fee compensation may be the best decision for a claim on behalf of the PSF. In light of the very broad authority over the PSF delegated to the Board under Article VII, Section 5 of the Texas Constitution, I believe that the Board should be able to engage litigation counsel as it deems necessary to protect the PSF. It should be noted that the decision to hire counsel to evaluate the condition of the assets that are or have been held in the PSF portfolio would be separate and distinct from any later independent decision whether to become a plaintiff in an existing class action, or to become a plaintiff or lead plaintiff and whether to use the same law firm that performed monitoring and analysis or a different law firm.

Please understand that my question does not take issue with the Texas Attorney General's constitutional role in representing the state or approving outside legal counsel. My question relates solely to the authority of the Board to negotiate a contingent fee contract by virtue of its own constitutional authority with a firm approved by the Attorney General without seeking approval under Chapter 2254 of the Government Code.

Thank you for considering these questions. Should you need any additional information, please contact me or David Anderson, Texas Education Agency General Counsel, at (512) 463-9720.

Sincerely,



Gail Lowe  
Chair, Texas State Board of Education

cc: SBOE Members  
Robert Scott, Commissioner of Education