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December 4, 1989

The Honorable Thomas E. Loehr
State Treasurer
State Capitol
Charleston, West Virginia 25305

Dear Treasurer Loehr:

We are in receipt of your letter of October 27, 1989, concerning losses to the Consolidated Fund (Fund) as well as the overpayment of interest earnings to participants in the Fund. You have requested our opinion regarding three separate questions. Specifically, you have asked:

- (1) "[S]hould the trading losses incurred by the Consolidated Fund be apportioned among all the fund participants who were participating in the fund at the time the fund incurred the losses?
- (2) "[A]re the fund participants who received an over apportionment of interest on their accounts obligated to return any over apportionment to the Fund?
- (3) "[D]o I, on behalf of the Board of Investments, have a legal obligation to attempt to recover the over apportioned interest payments from the local governments who received them?"

Our response will address each question separately.

I. Must Excess Interest Payments be Returned to the Fund by the Local Governments That Received Them?

We first address your question concerning whether local governments must return the interest overpayments that they have

received from the Fund. It is our understanding from your letter that from time-to-time during the period from April 1987 through January 1989, local government participants¹ in the Fund received in excess of \$100 million in overpayments on purported interest earnings. These payments were the result of payments made by your predecessor, whereby the treasurer's office, acting on behalf of the Board of Investments (Board) as its staff agency, paid to participating local governments purported earnings on their Fund investments when their earnings were either a lesser sum or an actual loss.

When a public official makes payment to another party which is considered beyond the scope of the official's power or authority, or is illegal or simply the result of a lack of knowledge or mistake of law, such a payment may be recovered from the recipient. Tyler County Court v. Long, 72 W. Va. 8, 77 S.E. 328 (1913); Cunningham v. County Court of Wood County, 148 W. Va. 303, 134 S.E.2d 725 (1964); State ex rel. Board of Education of County of Kanawha v. Johnson, 156 W. Va. 39, 190 S.E.2d 483 (1972); Syl. Pt. 2, W. Va. Public Employees Insurance Board v. Blue Cross Hospital Service Incorporated, ___ W. Va. ___, 328 S.E.2d 356 (1985); Syl. Pt. 3, Freeman v. Poling, ___ W. Va. ___, 338 S.E.2d 415 (1985). The rationale behind such a rule is simple and direct. When a public official acts outside of his legal authority, as in the case where unauthorized payments are made to second parties, it is in the interest of the collective good of the public at large that the illegal acts of the official be corrected. Although such a rule may work a hardship on an individual recipient of a public official's illegal generosity, the rule is necessary to ensure that the will of the Legislature, as expressed by statute, is not thwarted by a misguided public official. See Freeman v. Poling, *supra*. Indeed, unauthorized payments of public money by fiscal bodies may be regarded "as in fact no payments." Tyler County Court v. Long, 72 W. Va. 8, 14, 77 S.E. 328, 330 (1913).

In many ways, the local governments involved are in the same situation as an individual whose bank has made an error on his account that results in more money being credited to the account than that to which he is entitled. Anyone in such a situation recognizes that, although they have received the money, it is not theirs to keep since they have no legal right to it.

It is indisputable that overpayments of unearned interest constituted an illegal act on behalf of the prior treasurer, well

¹As used throughout this opinion, the term "local governments" includes counties, municipalities, or any agency, authority, board, or commission of a county or municipality, and regional councils created pursuant to W. Va. Code 8-25-5. See, W. Va. Code 12-6-2(5) and (7).

beyond the scope of his legal authority. We have found no known authority in either law or the regulations of the Board that authorizes payments in excess of actual earnings. In this particular instance, not only were the payments made as a result of improper acts on behalf of the prior treasurer's office, but also the payments were made without the Board having full knowledge of the condition of the Fund prior to authorizing the payments. Although the Board may have authorized the payments, the Board was acting in ignorance of the Fund's true financial condition since those facts were concealed from the Board by the prior treasurer's office. Therefore, under the theory that the over-allocated payments were either illegal or simply erroneous, local government units are not entitled to those payments of interest in excess of the true return on investment for the Fund.

Having concluded that local governments are not legally entitled to the excess payments, we must consider the action open to the Board. The Board has a general fiduciary duty with respect to the management of the money in the Fund. Indeed, the express purpose behind the creation of the Board is to increase the investment return of the funds of the state and its political subdivisions. W. Va. Code 12-6-1. To the extent that the overpayments frustrate the purpose of the statute, the Board is obliged to take corrective action.

One course of action that the Board might take is to institute suit against the respective governments for repayment. Tyler County Court v. Long, supra. Even though a local government may have already spent the erroneous payments, the Board may still successfully prosecute a suit to return the overpayments. Syl. Pt. 3, State ex rel. Board of Education of County of Kanawha v. Johnson, supra.

Another alternative would be a plan such as the one you recently proposed to recoup the losses through the purchase of bonds or other means to refinance the losses.² However, the Board also owes a fiduciary responsibility to the remaining participants in the Fund, and any proposed solution to the problem of overpayment to local governments must also pass muster in light of its impact on those other agencies to whom the Board owes a fiduciary duty. The solution to the local governments' problem cannot come at the expense of other participants. Thus, other viable solutions must be developed in order to avoid legal action against the local governments.

2A summary of that plan is appended hereto.

II. The Apportionment of Trading Losses.

We next address the issue of whether trading losses incurred by the Fund should be apportioned among all the Fund participants who were participating in the Fund at the time those losses were incurred. We conclude that these losses must be so apportioned.

The Fund was established under W. Va. Code 12-6-8 as a special investment fund to be managed by the Board. The Fund is composed of the "state account" and the "local government account," the monies from which may be combined "for the common investment of the consolidated fund on an equitable basis." W. Va. Code 12-6-8(b).

As a part of the powers granted to the Board under W. Va. Code 12-6-5, the Board has authority to "[p]romulgate and enforce bylaws, rules and regulations for the management and conduct of its affairs." However, if the Board has adopted rules and regulations, it must abide by them until they are changed. Tasker v. Mohn, 165 W. Va. 55, 267 S.E.2d 183 (1980); Trimboli v. Board of Education, 163 W. Va. 1, 254 S.E.2d 561 (1979). More specific to your question are the provisions of W. Va. Code 12-6-8(f) which state, with respect to the management of the investment funds established by W. Va. Code 12-6-8, that:

"The board shall also establish such rules and regulations for the administration of the various funds and accounts established by this section as it shall deem necessary for the administration thereof, including, but not limited to: . . . (3) provision for payment of expenses from earnings; and (4) distribution of the earnings in excess of such expenses or allocation of losses to the several participants in an equitable manner" (Emphasis added.)

Pursuant to this statutory directive, the Board has adopted rules and regulations to govern the administration of the Consolidated Fund. See Legislative Rules, West Virginia State Board of Investments, Title 113, Code of State Rules, Series I (effective March 10, 1984). Two rules adopted by the Board have direct application to the issue presented. Rules 5.1 and 5.3 provide:

"5.01. Nature of ownership. -- Each participant shall own an undivided interest in the portfolio of the Consolidated Fund based on the participant's pro-rata contribution of assets at any time. Ownership shall be expressed in terms of units. One dollar (\$1.00) shall equal one (1) unit of ownership. Each participant, by participating in the Consolidated Fund, is deemed to have consented to the methods of sharing gains and

losses and all other accounting methods required or adopted by the Board.

"5.03. Trading Gains and Losses. -- The board recognizes that it is impractical to amortize trading gains and losses over the life of all securities sold. Therefore, the board may authorize the treasurer to amortize all gains and losses over a period of time commensurate with the average life of the entire portfolio. Since the average life of short-term portfolios can vary greatly from day to day, the board may authorize the treasurer to amortize all gains and losses from the sale of securities over the month in which they are realized and the subsequent eleven months." (Emphasis added.)

As noted above, since the Board has adopted rules and regulations, it is bound by their requirements. Without modification, Rules 5.1 and 5.3 control the question of the distribution of trading losses. Because under Rule 5.1 the ownership of the portfolio of the Fund is an undivided interest, "based on the participant's pro rata contribution of assets at any time," distribution of losses cannot be arbitrarily separated from the reality of the form of legal ownership present in the Fund. In a case involving the transfer of interest earnings of the Fund, the West Virginia Supreme Court of Appeals held that "[i]n the absence of lawful separation, it is generally presumed that interest is an accretion to the fund earning it." Syl. pt. 1, Queen v. Moore, ___ W. Va. ___, 340 S.E.2d 838 (1986). As a corollary, losses should be presumed to follow principal as well.

Clearly, the Board's rules require participants to share in the Fund's losses as well as its gains. In the absence of some lawful authority to the contrary, because under Rule 5.1 the nature of the ownership of the Fund's portfolio is an undivided pro rata interest and Rule 5.3 controls distribution of trading losses until modified, it is our opinion that trading losses must be apportioned in a manner consistent with Rule 5.3 on a pro rata basis among Fund participants who were participating in the Fund at the time the losses occurred.

III. The Treasurer's Obligation Concerning Interest Overpayments.

As your final question, you asked whether you, on behalf of the Board, have a legal obligation to recover the excess interest payments from the local governments that received them. We conclude that you do not have any personal legal obligation to act in your capacity as treasurer.

At the time the excess payments were made, the then

treasurer was both executive secretary of the Board as well as legal custodian of all those monies under the control of the Board. W. Va. Code 12-6-4 (1978). However, the 1989 amendments removed both of these responsibilities from the treasurer, placing custodianship of Board funds with the governor and creating an independent executive director. W. Va. Code 12-6-4(a) (1989). The treasurer's office remains as the staff agency for the Board and the treasurer remains as an individual member of an expanded Board. W. Va. Code 12-6-4(a); (1989) W. Va. Code 12-6-3(a).

As far as the personal obligation that you, as treasurer, may have to recover excess interest payments, our opinion is that your obligation is no greater than that of any other member of the Board. Because the treasurer no longer acts as custodian of the investment funds, and the treasurer's office functions only in the capacity as staff for the Board, it is our opinion that the treasurer, in his personal capacity, lacks sufficient standing to individually bring an action against the local governments to recover the overpayments. The legal obligation that you owe to the Board and the state is satisfied by the work that your office has performed in identifying the problems of the Fund and advocating solutions to the Fund's problems. By advocating solutions that take into account the fiduciary responsibility the Board owes to all participants in the Fund, the treasurer has met those fiduciary duties he owes as a member of the Board.

In summary, we conclude that:

(1) Fund participants who received excess interest payments are not legally entitled to those monies and the excess payments may be recovered by the Board of Investments if it elects to do so, even if the money has already been spent. However, the Board may use alternative means to deal with the lost funds, such as the present plan adopted by the Board, as long as those solutions reflect the Board's fiduciary responsibility to present Consolidated Fund participants.

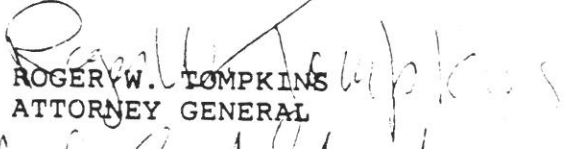
(2) Trading losses incurred by the Fund must be apportioned among all Fund participants in a manner consistent with the rules and regulations of the Board.

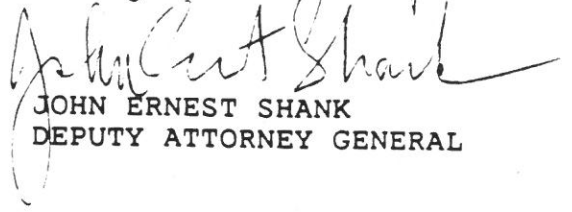
(3) The treasurer has no personal legal obligation to attempt to recover the excess interest payments from the local governments who received them. The treasurer's obligations are

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those general fiduciary duties which he owes as a member of the Board and do not have an independent basis.

Very truly yours,


ROGER W. TOMPKINS
ATTORNEY GENERAL


JOHN ERNEST SHANK
DEPUTY ATTORNEY GENERAL

APPENDIX

Under the new plan presented by you and approved by the Board, two new investment pools will be created. One pool will be comprised of state agency trust funds that are now included in Pools 100 and 140. In order to protect the solvency of the pool, investments in this new pool will be restricted to United States Government obligations. These restrictions to the new fund, which will comprise about \$30 million, are designed to protect the special fiduciary relationship attendant with monies held in trust.

The second new fund will be a separate fund for local and county government entities. The purpose behind the creation of this fund is to segregate these monies from state funds and avoid the sort of confusion that has been created because of the mingling of state and local monies in Pool 100.

Pool 100 will become the state's liquidity fund. It will no longer contain any local government monies. Pool 100 earnings will first be dedicated to meeting fiscal year 1990 revenue estimates which project a transfer of \$16 million from the Fund to the General Revenue Fund. After the estimate is met, Pool 100 earnings will be dedicated to the purchase of zero-coupon bonds, which will be used to amortize Fund losses. These funds will be in addition to a portion of \$15 million that has already been set aside from Pool 100 earnings. Of that \$15 million, \$6 million will be used to purchase \$20.7 million of discounted zero-coupon bonds, which will go toward amortizing losses suffered by Pool 140, the restricted pool containing proceeds of state bond issues and funds deposited by the Municipal Bond Commission. The additional \$9 million will be transferred to the General Revenue Fund. Pool 140 will remain unchanged. As before, the investments will be restricted to United States Government securities in order to comply with standard bond covenants and protect the solvency of the pool.