

October 4, 1995

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**THIS CORRESPONDENCE IS A LEGAL GUIDELINE OF THE
ATTORNEY GENERAL SUBMITTED FOR YOUR GUIDANCE**

Re: Fiduciary Liability Insurance

Dear Alan:

You have inquired whether PERSI board members and employees are covered by the Idaho Tort Claims Act for claims arising from a breach of fiduciary duty.

The Idaho Tort Claims Act ("ITCA") provides coverage to state boards and their employees. Idaho Code §§ 6-902(1) and 6-902(4). PERSI is a state board organized as part of the Governor's Office. Idaho Code § 59-1304. By definition, PERSI board members and employees are covered by the ITCA.

Allegations of a breach of fiduciary duty raise the question whether the claim arises from contract or is a tort. The Idaho Supreme Court in the case of Podolan v. Idaho Legal Aid Services, Inc., 123 Idaho 937, 854 P.2d 280 (Ct. App. 1993), held that the breach of fiduciary duty is a tort. The court said a fiduciary relationship exists between two parties "when one is under a duty to act or give advice for the benefit of another upon a matter within the scope of the relation." 123 Idaho at 946, 854 P.2d at 289. The fiduciary duties and relationship of the PERSI board exist by virtue of the statutory duty established by Idaho Code §§ 59-1301, *et seq.*

Claims for breach of fiduciary duty have arisen recently against the Oregon Public Employees Retirement Board (OPERB). The issues presented in the case of Hanggi v. Hartford Insurance Company, 132 Or. 601, 889 P.2d 365 (Or. Ct. App. 1995), parallel the concerns you have regarding the PERSI board members. In Hanggi, beneficiaries of the Oregon Public Employees Retirement Fund brought four separate derivative actions against the state, OPERB and insurers based on alleged losses suffered by the fund. The beneficiaries alleged that state employees participated in imprudent investments of the fund moneys or failed to police fund investments adequately and failed to pursue claims against "public employee dishonesty" insurers. The Oregon Court of Appeals found that the claims against the state and the Oregon Employees Retirement Board for breach of

fiduciary duty were torts falling within the purview of the Oregon Tort Claims Act. Thus, the claims were required to comply with the notice requirements of the Oregon Tort Claims Act and were dismissed for failure to do so.

Another recent case addresses similar issues relating to allegations of a breach of fiduciary duties and the application of the immunities provided by the tort claims act. In Masters v. San Bernadino City Employees Retirement Association, 37 Cal. Rptr. 2d 860 (Cal. Ct. App. 1995), a former county hospital employee sued the county employees retirement association, the association administrator, board members and the medical advisor for alleged wrongful conduct in denying and failing to promptly award a disability retirement pension. The suit sought relief under a number of legal theories including breach of fiduciary duty, promissory fraud, negligent misrepresentation, and violation of federal due process rights under 42 U.S.C. § 1983. The California Court of Appeals, in discussing the provisions of California law equivalent to the ITCA, found that the individual board members had discretionary immunity for their adjudicatory decisions on the applicant's application for disability retirement. The court held that public employees had immunity for policymaking or planning decisions, but not for operational decisions. Thus, if there was some error in processing the application there may not be qualified immunity. (The court did not review at length the substantive due process and 42 U.S.C. § 1983 claims because the court found that, under the facts, the plaintiff did not state a cause of action.)

The ITCA affords similar protection to PERSI board members and employees as the Oregon Tort Claims Act does for the Oregon Public Employees Retirement Fund and as the California act does for governmental entities and employees. The ITCA limits the liability of governmental entities and its employees to the maximum of \$500,000 (Idaho Code § 6-926), prohibits the imposition of punitive damages (Idaho Code § 6-918), and protects the public entity from the imposition of attorney fees (Idaho Code § 6-918A). The ITCA protection afforded PERSI, its board and employees makes it unnecessary to have additional insurance coverage or to self-insure against claims arising from a breach of fiduciary duty.

The ITCA also provides various immunities to the public entity and its employees against imposition of money damage claims. The immunity that would apply most frequently to claims of breach of fiduciary duty by PERSI Board members and employees is the "discretionary function" immunity found at Idaho Code § 6-904(1). The discretionary function exception applies to government decisions entailing planning or policy formulation. Sterling v. Bloom, 111 Idaho 211, 723 P.2d 755 (1986).

The test for determining the applicability of the discretionary function immunity looks at the nature of the conduct. Routine matters not requiring evaluation of broad

policy factors will likely be “operational” and not necessarily afforded immunity. Decisions involving the consideration of the financial, political, economic, and social effects of a particular plan are likely “discretionary” and will be afforded immunity. Lawton v. City of Pocatello, 126 Idaho 454, 886 P.2d 330 (1994); Ransom v. City of Garden City, 113 Idaho 202, 743 P.2d 70 (1987). The PERSI board’s acts and decisions will usually be planning and policy formulation which are discretionary functions. The implementation of board policy by PERSI’s employees may be considered an operational act and not subject to the immunity.

In other words, the PERSI board and its employees will be accorded discretionary immunity for making a prudent investment decisions, even though an investment may subsequently become worthless. For example, the PERSI Board may authorize investment in certain real estate which otherwise satisfies the statutory and fiduciary duties for a prudent investment. Subsequently, the real estate investment substantially declines in value due to a general market decline. The board will be protected by the “discretionary immunity” exemption for claims resulting from this loss. If the decline in substantial value was caused by a cloud on the title which could have been prevented had the board or its employees conducted a title search or purchased a title insurance policy, then there may be liability. The investment decision is still afforded the “discretionary function” immunity, but the negligence in failing to exercise due care in the “operation stage,” *i.e.*, not conducting a title search or obtaining title insurance, may result in liability. The state would defend the employee or board member and would pay any judgment entered against them pursuant to Idaho Code § 6-903; the amount of damages assessed, if any, would be limited to \$500,000 pursuant to Idaho Code § 6-926.

Suits brought against board members or employees arising from the course and scope of employment will be handled by the Bureau of Risk Management and the Office of Attorney General pursuant to the provisions of Idaho Code §§ 6-903 and 67-1401, *et seq.*

Acts of fiduciaries who are not employees, such as consultants or investment advisors, are not covered by the ITCA. Thus, a contract for services should require the contractor to carry for the benefit of PERSI, its board and employees, insurance covering the contractor’s fiduciary acts or omissions.

Certain types of claims may arise which are outside the coverage of the ITCA. Typically these claims arise from an alleged violation of an individual’s constitutional rights. Most frequently these constitutional torts are brought as a 42 U.S.C. § 1983 claims. Section 1983 claims permit actions only against “persons” who deprive others of any rights, privileges or immunities secured by the Constitution and laws. 42 U.S.C. § 1983. Qualified and official immunities exist for section 1983 claims, usually through

the defense that the state and its officials are not “persons” within the meaning of section 1983. Will v. Michigan Department of State Police, 491 U.S. 58, 109 S. Ct. 2304 (1989), and Arnzen v. Department of Law Enforcement, 123 Idaho 899, 854 P.2d 242 (1993). Through this defense, public entities or officials will be dismissed from the action in their official capacity. However, individuals may still be parties to the suit in their individual capacities. The state, under the provisions of Idaho Code § 6-903, will defend the individuals when they are acting within the course and scope of employment.

The state, of course, has no duty to defend public officials or employees for criminal wrongdoing or intentional torts, such as assaults or batteries. Other circumstances may arise where the state has no duty to defend or indemnify public officials. These circumstances would be highly unusual, and typically the public official’s conduct would be clearly outside the course and scope of employment or beyond a reasonable exercise of their official authority. The state will defend and indemnify individuals acting within the course and scope of their employment and acting without malice or criminal intent pursuant to Idaho Code §§ 6-901, *et seq.*, 59-1305, and 59-1308(11).

A final question addresses judgments that exceed the \$500,000 limit or that are imposed individually against a board member or employee in his or her individual capacity. If such a judgment falls under the ITCA, then the judgment is reduced to \$500,000 pursuant to Idaho Code § 6-926. If the judgment falls outside the ITCA—*e.g.*, a constitutional rights violation—then the PERSI board members and employees are held harmless pursuant to Idaho Code §§ 59-1305 and 59-1308(11). The payment of the judgment would have to come not from the trust assets of PERSI but, rather, through a new appropriation. The Idaho Tort Claims Act provides that the claim or judgment is to be paid from the next appropriation of the state instrumentality whose tortious conduct gives rise to the claim. Idaho Code § 6-922. The Idaho Constitution requires certification from the Board of Examiners before payment could be authorized. Idaho Constitution, article 4, section 18.

If you desire further information or assistance, please do not hesitate to contact me.

Very truly yours,

MICHAEL R. JONES
Deputy Attorney General
Contracts and Administrative Law Division