IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

PING LU; JILL MCKEON, RICHARD MCKEON, STEPHEN SPENCER, SPENCER STOPA; and JUDY C. WINNEGAR, on their own behalf and on behalf of a class of similarly situated persons,

Plaintiffs/Appellants,

v.

THE EDUCATION TRUST BOARD OF NEW MEXICO; THE EDUCATION PLAN TRUST OF NEW MEXICO; and THE STATE OF NEW MEXICO,

Defendants/Appellees.

No. 31,363

First Judicial District Court,
County of Santa Fe

The Honorable Stephen Pfeffer

BRIEF IN CHIEF OF APPELLANTS

ORAL ARGUMENT REQUESTED

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TABLE OF CONTENTS

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STATEMENT OF COMPLIANCE

This brief complies with Rule 12-213(F)(3) NMRA, in that the body of the brief contains 8,534 words, from the Introduction through the Conclusion, as determined by Microsoft Word 2003. In compliance with Rules 12-213(F) and 12-305(C)(1) NMRA, this brief has been prepared in 14-point Times New Roman font, a proportionally spaced typeface that includes serifs.

TABLE OF AUTHORITIES

New Mexico Cases

Cases

Statutes

Rules

Constitutions

INTRODUCTION

The Plaintiffs are parents (the "Parents") who have saved up money to pay for their children's college education. They—and the class of over 100,000 other people that they represent—signed written contracts with the State of New Mexico. Under these contracts, the Parents would put their college savings in the hands of the State, which agreed to invest the money in "conservative" or "ultra-conservative" holdings. The State hired Oppenheimer Funds, Inc., to manage the investments. With the State's knowledge and consent, but without the Parents', Oppenheimer invested the Parents' savings recklessly, not conservatively. As a result, the Parents lost much of their college savings.

This appeal involves a question of statutory interpretation that will determine whether the Parents will be able to recover for their losses.

The State argued, and the district court agreed, that a sentence in the Education Trust Act repeals the State's earlier waiver of sovereign immunity for written contracts. The Education Trust Act, though, says nothing about any intended repeal, and explicitly allows New Mexico's college savings program to incur contractual obligations. In interpreting the Act to shield the State from liability, the district court erred.

The district court also interpreted the Education Trust Act to prevent the Parents from recovering from any source other than the Education Trust Fund, the Fund where they had deposited their college savings. The Fund is inadequate to compensate the Parents for their loss—but only because the very reckless investments over which the Parents sue depleted the Fund of sufficient money. When a party assumes contractual duties over a pool of funds and then breaches those duties, the party cannot escape liability just because its own breach depleted the pool of sufficient money to satisfy the party's broken contractual obligations. For this reason, too, the district court erred and should be reversed.

SUMMARY OF PROCEEDINGS

I. The Nature of the Case

This is a direct appeal of the district court's June 17, 2011 order that dismissed the State of New Mexico as a defendant and ruled that "[t]he Education Trust Fund is the only potential source of recovery from State funds in this case." See Order Granting Motion to Dismiss [RP[1] 2302]

II. The Allegations of the Complaint

The allegations of the Plaintiffs' complaint, which must be accepted as true at this stage, tell the story of how the State breached its contracts. *See Forest*

[1] Citations to the Record Proper are denoted as "RP #".

Guardians v. Powell, 2001-NMCA-028, ¶ 5, 130 N.M. 368, 24 P.3d 803 (on appellate review of a dismissal, the material allegations of a complaint must be taken as true).

A. How 529 Programs Help Parents Save for College

College is expensive. Plaintiffs Ping Lu, Jill and Richard McKeon, Stephen Spencer, Judy C. Winnegar and Spencer Stopa (the "Parents") needed to save money for their children's college education. They decided to put their college savings into the "529" program maintained and marketed by the State of New Mexico. [RP 372, 385–388, ¶¶ 9, 56, 61, 64, 68, 72, 75]

A 529 program takes its name from section 529 of the federal tax code. This provision allows parents to save for college expenses by investing in a qualified program where the savings can appreciate free from federal taxes. 26 U.S.C. § 529(c). Only a state, a state agency, or an educational institution can establish and maintain a 529 program. *Id.* § 529(b). New Mexico's 529 program carries special advantages for State residents. Their contributions to New Mexico's 529 program are deductible from state income taxes. NMSA 1978, § 7-2-32. But it is only contributions to New Mexico's 529 program that are thus deductible—not contributions to any other 529 program. *Id.* So if New Mexico residents want to use

all available tools to save for their children's college education, they really have no choice but to invest in New Mexico's own 529 program.

B. The Parents Entered into Written Contracts with the State by Investing in the State's 529 Program

To participate in New Mexico's 529 program, the Parents entered into written contracts with the State. [RP 372, 374, ¶¶ 12, 17–18] Under the contracts, the Parents may contribute savings, which are then deposited in the Education Trust Fund, a separate account in the State treasury. NMSA 1978, § 21-21K-3(A). The savings are invested on the Parents' behalf. [RP 372, ¶ 12] The contracts offered the Parents and other investors two "tracks" for the investment of their savings. [RP 375, ¶ 19]

On the first track, investors are given a range of investment options, or "portfolios," that span the "risk/reward spectrum from aggressive to conservative." [RP 375, ¶¶ 20–21] Investors who can tolerate more risk can invest in portfolios weighted more heavily toward stocks, which carry "higher risk and commensurately higher potential return." [RP 375, ¶ 20] More conservative investors can invest in portfolios weighted more heavily toward fixed-income investments—treasury bonds, for example—which the State represented as carrying lower risk and commensurately lower potential return. [*Id.*]

On the second investment track, investors can invest in a portfolio tied to the current age of the child who will eventually be going to college. [RP 376, ¶ 23] This portfolio is actively managed, which means that as the child approaches college age, the portfolio buys bonds and other fixed-income securities and sheds its stocks. [RP 376, ¶¶ 23–24] The State told the Parents that this shift from stocks to bonds was designed to make the portfolio increasingly conservative and preserve existing capital. [*Id.*]

Some of the Parents chose to direct their savings to the first investment track, while others chose the second. [RP 385–388, ¶¶ 56, 61, 64, 68, 72, 75] All of the Parents, however, chose to invest in a portfolio that represented itself as appropriately conservative and as significantly or heavily invested in fixed-income securities. [RP 385–388, ¶¶ 56–59, 61–62, 64–66, 68–69, 72, 75–76 (allegations about the options the Parents chose); RP 375–376, ¶¶ 21, 24 (allegations about the nature of those options)] These representations were made as part of the written contracts between the Parents and the State. [RP 374, ¶ 17] The State was contractually obligated to invest the Parents' savings "to achieve the promised level of risk and reward." [RP 377–378, ¶¶ 29–30] The State promised to engage in certain conduct—a conservative investment strategy—even if it did not guarantee a particular result from that conduct.

C. The State Knowingly Allowed Its 529 Program Manager to Invest Purportedly Conservative Investment Portfolios in Highly Risky Ways

The State hired Oppenheimer Funds, Inc. ("Oppenheimer") to serve as 529 program manager. [RP 373, ¶ 13] Oppenheimer invested program funds under the direction, and with the full knowledge and consent, of the State. [RP 373, 381, 383, ¶¶ 13, 43, 49]

Beginning in 2007 and continuing through 2008, Oppenheimer altered the risk inherent in the program's fixed-income holdings—the holdings that made conservative investment options conservative. [RP 381, ¶ 43] Rather than diversifying those holdings—and thus reducing their risk—it concentrated them in four main areas:

(1) securities backed by mortgages on commercial property;

(2) securities backed by "jumbo" residential mortgages—mortgages too large to be guaranteed by Freddie Mac and Fannie Mae;

(3) bonds issued by financial corporations (investment banks, retail and commercial banks, mortgage lenders, and the like); and

(4) short-maturity corporate "high-yield" bonds—also known as "junk" bonds.

[RP 382, ¶ 44] These investments had something in common: they were devastated by the financial crisis and foundered throughout 2008. [*Id.*] The State knew and approved of these investments. [RP 383, ¶ 49]

Even more dangerously, Oppenheimer, with the State's knowledge, significantly increased the program's leverage: it borrowed against the fixed-income holdings and used the borrowed funds to buy more of the same investments. [RP 382, ¶ 45] By mid-2008, the fixed-income holdings had been leveraged up to more than 180% of their unleveraged value. [*Id.*] Worse, all of this leveraging was done even as the value of the fixed-income investments plunged—so that rather than pulling back, Oppenheimer and the State "doubled down" on their investment. [RP 382, ¶ 47]

This amount of leverage is the opposite of conservative, because it exposes investors to vastly more downside risk than they would otherwise face. [RP 382, ¶ 45] If a gambler has ten dollars and loses a bet, he is only broke. But if he has ten dollars, borrows ten more from a friend, wages all twenty, and loses the bet, he isn't merely broke—he's in the hole, because he now owes his friend ten dollars. The same principle holds true in investing. By leveraging, Oppenheimer and the State put investors at much more risk than they would have faced without it.

So as 2008 wore on and the economy went into crisis, the program's fixed-income holdings—and thus the Parents' savings, invested in allegedly "conservative" and "ultra-conservative" portfolios—suffered disastrous losses. [RP

384, ¶ 52] Some of the fixed-income investment options plunged almost 40% in value; none lost anything less than 19%. [*Id.*]

It was not the financial crisis that caused losses of this magnitude. Even during the crisis, other fixed-income funds, as well as the fixed-income benchmarks that the State had itself selected as fair comparisons, managed to *gain* value. [RP 381, ¶¶ 41–42] The financial analyst Eric Jacobsen investigated the "unbelievable" losses in Oppenheimer's fixed-income investments and concluded that investors had been unaware of the risks that Oppenheimer had taken and the State had knowingly accepted. [RP 383, ¶ 48] "The only thing worse than lever[ag]ing up a portfolio with 180% market exposure," he commented, "is doing it quietly." [*Id.*]

III. Course of Proceedings and Disposition Below

A. The District Court Denied a Motion to Dismiss, Certified the Proposed Class, and Then Granted a Second Motion to Dismiss

The Parents filed this lawsuit in 2009. Among other claims, the Parents asserted a breach-of-contract count against the Education Trust Board—the State instrumentality that administers the 529 program—on behalf of a class of other investors. [RP 21–22, ¶¶ 91–94]

The Education Trust Board moved to dismiss the Parents' complaint, arguing that the Parents had not asserted a valid breach-of-contract claim and that the Education Trust Act immunized the Board from contractual liability. [RP 43-49]

After briefing and argument, the district court denied the motion to dismiss. [RP 266]

Thereafter, the Parents amended their complaint. The amended complaint added the State of New Mexico as a party, and the State moved to dismiss. The State argued that the second sentence of NMSA 1978, § 21-21K-3(C) "overrides[s]" the waiver of sovereign immunity in NMSA 1978, § 37-1-23(A), and the Parents' claims were thus barred by sovereign immunity. [RP 422]

Meanwhile, the Parents had moved to certify their proposed class action. [RP 270–271; RP 414–415] On August 27, 2010, the district court granted the motion and certified the proposed class. [RP 1606-1615]

The State's motion to dismiss remained pending. The Parents opposed the motion, arguing that the State misinterpreted the Education Trust Act and noting that the district court had already rejected the argument that the Board, a State instrumentality, was immune from contractual liability. [RP 471–484]

Nonetheless, on June 17, 2011, the district court (1) granted the motion to dismiss as to the State and (2) ruled that the "Education Trust Fund is the only potential source of recovery from State funds in this case." [RP 2248–2249]

B. The Parents Appealed

The district court's order was interlocutory, so the Parents sought a discretionary interlocutory appeal under NMSA 1978, § 39-3-4. While the Parents satisfied the requirements of NMSA 1978, § 39-3-4 [RP 2248–2249], this Court noted that district court's order was appealable as of right under Rule 1-054(B)(2) NMRA (*see* Court of Appeals Order at 1 (Aug. 1, 2011)). The Court therefore treated the application for interlocutory appeal as a notice of appeal and docketing statement. (Court of Appeals Order at 1–2 (Aug. 1, 2011).)

STANDARD OF REVIEW AND PRESERVATION BELOW

I. Issues Presented

This appeal presents two questions:

(1) Does the Education Trust Act immunize the State from liability for breaching its written contract with the Parents?

(2) Does the Education Trust Act allow the Parents to recover the money that would be in the Education Trust Fund had the State not breached its promise to invest the Parents' savings conservatively?

II. Standard of Review

Both of these questions turn on the meaning and application of the Education Trust Act and whether the Act has impliedly repealed an earlier statute making the State liable on written contracts. This appeal, then, presents questions of statutory interpretation. These are "pure question[s] of law, subject to de novo review." *Bd. of*

Comm'rs of Rio Arriba Cnty. v. Greacen, 2000-NMSC-016, ¶ 4, 129 N.M. 177, 3 P.3d 672. The "district court's legal conclusions," therefore, are reviewed "without deference." *Truong v. Allstate Ins. Co.*, 2010-NMSC-009, ¶ 27, 147 N.M. 583, 227 P.3d 73 (quoting *Primetime Hospitality, Inc. v. City of Albuquerque*, 2009-NMSC-011, ¶ 10, 146 N.M. 1, 206 P.3d 112); *accord, e.g., MPC Ltd. v. N.M. Taxation & Revenue Dep't*, 2003-NMCA-021, ¶ 11, 133 N.M. 217, 62 P.3d 308.

This is an appeal from a dismissal for lack of subject-matter jurisdiction under Rule 1-012(B)(1) NMRA. In reviewing such dismissals, the Court "accept[s] as true all material allegations of the complaint and construe[s] the complaint in favor of the complaining party." *Forest Guardians v. Powell*, 2001-NMCA-028, ¶ 5, 130 N.M. 368, 24 P.3d 803; *see also Guzman v. Laguna Dev. Corp.*, 2009-NMCA-116, ¶ 16, 147 N.M. 244, 219 P.3d 12 (reviewing a judgment on the pleadings, granted on grounds of sovereign immunity).

III. Preservation Below

The issues were fully raised and argued by the parties in briefing on the State of New Mexico's Motion to Dismiss filed on January 21, 2010. [RP 417–424, 471–484, 556–565] These issues were thus preserved for review. *See* Rule 12-216(A) NMRA ("To preserve a question for review it must appear that a ruling or decision by the district court was fairly invoked . . . .").

SUMMARY OF THE ARGUMENT

The State entered into written contracts promising to invest the Parents' savings conservatively, breached those promises, and is liable for the breaches. The district court's dismissal of the State on the basis that the State is immune from a claim for breach of contract should be reversed.

Under a statute enacted in 1976, the State is liable for breaching written contracts—contracts like those the Parents signed. NMSA 1978, § 37-1-23(A). The State is liable here because it cannot shoulder its heavy burden of showing that a 1999 provision of the Education Trust Act, NMSA 1978, § 21-21K-3(C), implicitly repealed the earlier statute.

The Education Trust Act says nothing, either explicitly or implicitly, about repealing Section 37-1-23(A). Instead, the language says that the Act does not promise the Parents anything *more* than what is expressly promised in the contracts. The Legislature wanted to avoid creating an unlawful "debt" under the New Mexico Constitution. N.M. Const., art. IX, § 8. Because a prohibited "debt" in the constitutional sense is an unconditional guarantee, the Act, by specifying that it creates no such debt, merely provides that the Parents were not guaranteed a particular result for their investments. The Parents, though, have never asked for a guaranteed result. The State promised certain *conduct*—namely, that it would invest

the Parents' savings in a conservative way. The State breached that promise of conduct, and it is liable.

In holding that the State is immune from liability, the district court also held that the Parents' only source of recovery is the Education Trust Fund—the Fund where their savings were deposited, and the Fund that lost value because Oppenheimer and the State invested the Parents' savings recklessly. But even if the Education Trust Act made the Education Trust Fund the only source of recovery, the State would still be fully liable to the Parents. For when a contracting party agrees to pay money out of a certain fund, but by its own breach of contract depletes that fund until it does not hold enough money to satisfy the contractual liability, the contracting party is still liable in full. The contracting party, in other words, is liable for what *would* be in the fund had it not breached its contract. That is the teaching of both common sense and precedent.

Recognizing the State's liability avoids absurdity and furthers public policy. If the district court is affirmed, the State could simply *take* the Parents' savings and the Parents would have no contractual recourse. What is more, imposing liability is wholly appropriate. The State voluntarily established its 529 program, voluntarily entered into written contracts with the Parents, and knowingly consented to

Oppenheimer's reckless investment strategy. The State is not a hapless victim. It is a sophisticated party to enforceable contracts.

Finally, the State argued to the district court that it cannot satisfy a judgment entered against it. It is not clear whether or not the district court's decision was based on this contention, but in any event, the contention finds no support in precedent, creates an unnecessary conflict between statutes, and raises a question of fact unresolvable at the pleading stage.

ARGUMENT

I. The Court Erred in Dismissing the State on the Basis of Sovereign Immunity Because the Education Trust Act Does Not Repeal an Earlier Statute Making the State Liable When It Breaches a Written Contract.

NMSA 1978, § 37-1-23(A), enacted in 1976, provides that "[g]overnmental entities" are not immune from "actions based on a valid written contract." Because there is a valid written contract between the Parents and the Board, *see supra* pp. 4–5, this statute permits the Parents to sue the Board for breaching its contract. The State, however, argued, and the district court agreed, that a 1999 provision of the Education Trust Act immunizes the State from the Parents' contract action. The district court concluded that that provision, Section 21-21K-3, "is a specific statute regarding liabilities of the State which overrides any general provision such as

[Section] 37-1-23." [Tr-19[2]] In other words, the district court held that this later statute impliedly repeals the earlier statute, even though the Education Trust Act says nothing about any such repeal.

"Repeal by implication," however, "is disfavored." *Clothier v. Lopez*, 103 N.M. 593, 595, 711 P.2d 870, 872 (1985). There is a good reason for that disfavor: it is "presume[d] that the Legislature was fully aware of the existing law." *Id.* Courts also "presume that the legislature did not intend to enact a law inconsistent with existing law." *State ex rel. Quintana v. Schnedar*, 115 N.M. 573, 575, 855 P.2d 562, 564 (1993). Thus courts will recognize an implied repeal "only where such construction is absolutely necessary in order to give the subsequent statute effect." *Rader v. Rhodes*, 48 N.M. 511, 514, 153 P.2d 516, 518 (1944). Far from being absolutely necessary to give the Education Trust Act effect, an implied repeal is ruled out by the plain language of the Act. *See infra* Part II.A.

The district court concluded that the "specific" re-enactment of sovereign immunity in the Education Trust Act controls the earlier-enacted "general" waiver of sovereign immunity against written contracts, but this conclusion puts the cart before the horse. [Tr-19] The rule that specific statutes trump general ones "only applies when two or more statutes have conflicting provisions concerning the same matter."

[2] All references to "Tr-#" are to the Transcript of Proceedings, April 15, 2010.

Fernandez v. Farmers Ins. Co. of Ariz., 115 N.M. 622, 627, 857 P.2d 22, 27 (1993). If "there is no conflict," the "rule of construction advanced by the [State] is inapplicable." *Id.* The Education Trust Act's language, which is "the best indicator of legislative intent," *ERICA, Inc. v. N.M. Regulation & Licensing Dep't*, 2008-NMCA-065, ¶ 17, 144 N.M. 132, 184 P.3d 444, shows that there is no conflict. *See infra* Part II.A.

II. The Plain Language of the Act Makes the State Liable for Its Broken Promise to Invest the Parents' Savings Conservatively.

In granting the State's motion to dismiss, the district court relied on a provision of the Education Trust Act (the "Provision"). This appeal turns on the proper interpretation of that Provision. More particularly, this appeal turns on the differences in language between the Provision's first and second sentences. The Provision is reprinted below, with numerals inserted to mark each of its two sentences:

> **[1]** In no event shall any liability of, or contractual obligation incurred by, the program established pursuant to the provisions of the Education Trust Act obligate or encumber any of the state's land grant permanent funds, the severance tax permanent fund or any money that is a part of a state-funded financial aid program. **[2]** Nothing in the Education Trust Act creates any obligation, legal, moral or otherwise, to fulfill the terms of any college investment agreement or prepaid tuition contract out of any source other than the education trust fund.

NMSA 1978, § 21-21K-3(C).

The Provision's first sentence applies to the kind of obligation the Parents seek to enforce: a *contractual* obligation incurred by New Mexico's 529 program. The first sentence demonstrates that the State can indeed incur liability on that kind of obligation.

The second sentence, by contrast, addresses whether the Education Trust Act itself imposes obligations on the State *above and beyond* those explicit in the Parents' contracts. The second sentence makes clear that the Act does not impose any such obligations. The Parents, however, merely seek to enforce an explicit obligation in their contracts, and the State is liable on that obligation.

By stating that the Act itself creates no obligations, the Provision's second sentence was intended to ensure the Act's constitutionality under Article 9, Section 8 of the New Mexico Constitution, which restricts State indebtedness. To put it in practical terms, the second sentence of the Provision makes clear that the Act does not create a guarantee of investment results. The Parents, however, seek to enforce the State's promise of particular conduct—a conservative investment style. They have never claimed that they were guaranteed a particular result.

A. The Act Does Not Immunize the State from Contractual Liability, but Merely Creates No Obligations *Beyond* Those in the Parents' Contracts.

In applying statutory language, New Mexico courts "look first to the plain language of the statute, giving the words their ordinary meaning, unless the Legislature indicates a different one was intended." *N.M. Indus. Energy Consumers v. N.M. Pub. Regulatory Comm'n*, 2007-NMSC-053, ¶ 20, 142 N.M. 533, 168 P.3d 105. Here, the plain language of the statute demonstrates that the State is not immunized from liability for breach of contract.

The first sentence of the Provision addresses "any liability of, or contractual obligation incurred by, *the program established pursuant to the provisions of the Education Trust Act*." NMSA 1978, § 21-21K-3(C) (emphasis added). The second sentence, by contrast, addresses whether certain liabilities may arise from the Education Trust Act *itself*. It provides that "[n]othing *in the Education Trust Act* creates any obligation, legal, moral or otherwise, to fulfill the terms of any college investment agreement or prepaid tuition contract out of any source other than the education trust fund." *Id.* (emphasis added).

The second sentence of the Provision specifies that it is "the Education Trust Act" that does not create obligations. *Id.* Therefore, the second sentence permits things *other* than the Education Trust Act to "create[]" an obligation to "fulfill the

terms of any college investment agreement" out of sources "other than the education trust fund." *Id.* Here, the Parents do not point to the Education Trust Act as the source of the obligation they now seek to enforce. That obligation—the obligation to invest the Parents' college savings conservatively—arose from an investment contract between the Parents and New Mexico's 529 program. To put it in statutory terms, the obligation the Parents seek to enforce is a "contractual obligation incurred by[] the program established pursuant to the provisions of the Education Trust Act." *Id.* In short, the second sentence of the Provision does not even apply to—let alone limit—the kind of contractual obligations asserted in this case.

The distinction between the Act itself and the program the Act establishes is rooted in the statutory language. It would ignore that language to protest that the Act was "ultimately" responsible for creating the 529 program's contractual obligations to the Parents because the Act created the program. The statute distinguishes between an obligation "create[d]" by "the Education Trust Act" and "any liability of, or contractual obligation incurred by, *the program established pursuant to the provisions of the Education Trust Act*." *Id.* (emphasis added). The ponderousness of that last italicized phrase shows just how carefully the Legislature distinguished between the Act and the program. "If the legislature had intended the [second sentence] to be identical to the [first], it could have used the same language in both.

It chose, however, to use different language . . . ." *State ex rel. Udall v. Colonial Penn Ins. Co.*, 112 N.M. 123, 129 n.7, 812 P.2d 777, 783 n.7 (1991). So the kind of obligation in this case is governed by the first, not the second, sentence of the Provision.

There is another key distinction between the Provision's first and second sentences. The first sentence prospectively limits the 529 program's liabilities or obligations from "obligat[ing] or encumber[ing]" three specifically identified sources: (1) the state's land grant permanent funds, (2) the severance tax permanent fund, and (3) any money that is part of a state-funded financial aid program. NMSA 1978, § 21-21K-3(C). The first sentence, however, does not *immunize* the State from the program's obligations. For if the Legislature had wanted to prohibit the program's future contractual obligations from encumbering or obligating any other fund, it would have included that other fund in the first sentence's enumeration. *See State v. Nick R.*, 2009-NMSC-050, ¶ 23, 147 N.M. 182, 218 P.3d 868 ("The age-old Latin phrase *inclusio unius est exclusio alterius* is applicable here. It means the inclusion of one thing is the exclusion of the other." (quoting *City of Santa Rosa v. Jaramillo*, 85 N.M. 747, 749–50, 517 P.2d 69, 71–72 (1973))).

In sum, the Provision's first sentence governs the obligation in this case, and the State is liable under the language of the first sentence. The first sentence

contemplates that New Mexico's 529 program will "incur[]" "contractual obligation[s]." NMSA 1978, § 21-21K-3(C). While it prevents three discrete sources from paying for those obligations, the Parents do not seek to encumber any of the three excluded sources. They seek a recovery from sources other than those three—a recovery that the first sentence permits.

The second sentence, in contrast to the first, makes clear that the Act does not affirmatively "*create*" any obligations that would not otherwise exist through explicit provision in an investment contract. *Id.* (emphasis added). In other words, the second sentence prevents investors like the Parents from claiming that the Act itself promised them more than what was promised in the investment contracts. But the second sentence's language does not *abrogate* any of the 529 program's contractual obligations, including those owed to the Parents—a result confirmed by a quick look back at the first sentence, which explicitly contemplates the existence of "contractual obligation[s]." *Id.* Thus, the second sentence does not immunize the State from its contractual obligation to the Parents.

The table on the next page summarizes the relevant differences between the first and second sentences of the Provision, and shows how the Provision makes the State contractually liable to the Parents.

HOW THE FIRST AND SECOND SENTENCES OF THE PROVISION ARE DIFFERENT

	Which putative liabilities or obligations is this sentence talking about?	**How does this sentence affect those putative liabilities?**	**What is the sentence's application to this case?**
First sentence	Liabilities or obligations incurred by New Mexico's 529 program	Liabilities or obligations incurred by New Mexico's 529 program cannot encumber three enumerated funds	The obligation over which the Parents sue was incurred by the 529 program, and the Parents do not seek to encumber the three enumerated funds. The State is therefore liable here.
Second sentence	Obligations arising from the Education Trust Act itself	The Education Trust Act itself creates no obligations—i.e., the only promises are those made in the 529 program's contracts	The Parents' contractual claim asserts the breach of a contractual promise, rather than the breach of an obligation arising from the Education Trust Act. Thus the second sentence is irrelevant here.

B. Rather Than Shielding the State from Contractual Liability to the Parents, the Language of the Act Simply Ensures That No Unconstitutional "Debt" Is Created Under Article 9, Section 8 of the New Mexico Constitution.

The Provision's second sentence does not govern the State's obligation to invest the Parents' savings conservatively. What then *is* the purpose of the second sentence? Its purpose is to ensure the Education Trust Act's constitutionality by

providing that the Act provides no guarantees to investors above and beyond the terms of the contract.

In interpreting statutory language, New Mexico courts look not just to the language itself, but also to the legal background against which the statute was enacted. Courts presume that the legislature knew the relevant law and did not intend to enact a law inconsistent with it. *State ex rel. Quintana v. Schnedar*, 115 N.M. 573, 575, 855 P.2d 562, 564 (1993). Here, older decisions on the meaning of Article 9, Section 8 of the New Mexico Constitution, as well as other statutes, help to elucidate the Legislature's intent in enacting the Education Trust Act.

The New Mexico Constitution provides that the State can contract "[n]o debt" above $200,000 unless the majority of the electorate approves of the debt. N.M. Const., art. IX, § 8. In *State ex rel. Capitol Addition Building Commission v. Connelly*, 39 N.M. 312, 46 P.2d 1097 (1935), the Supreme Court held that under this provision, a "debt" means an unconditional guarantee of a sum certain. Relying on cases decided under an analogous constitutional restriction on municipal indebtedness, the Supreme Court held that

> a "debt" in the constitutional sense is . . . an *obligation* [that] has arisen out of contract, express or implied, which entitles the creditor unconditionally to receive from the debtor a sum of money, which the debtor is under *a legal, equitable, or moral* duty to pay without regard to any future contingency.

39 N.M. at 318, 46 P.2d at 1100 (emphasis added) (quoting *Seward v. Bowers*, 37 N.M. 385, 386, 24 P.2d 253, 253 (1933)). Thus, a debt in the constitutional sense is a guarantee because it promises a certain "sum of money . . . without regard to any future contingency." *Id.* (quoting *Seward*, 37 N.M. at 386, 24 P.2d at 253).

The case law's definition of a constitutional debt—"an obligation . . . which the debtor is under a legal, equitable, or moral duty to pay"—closely resembles the language in the Education Trust Act, which disavows the creation of "any obligation, legal, moral, or otherwise." NMSA 1978, § 21-21K-3(C). This linguistic echo shows that the Legislature intended for the language not to limit the State's contractual liability but rather to forestall any claim that the Act created a constitutional debt—a guarantee to the Parents of a certain amount of money.

This inference is confirmed by almost identical language in various statutes authorizing the issuance of revenue bonds. Several of the statutes creating flood control authorities have such language, for example. *See, e.g.*, *id.* § 72-16-78 (bonds issued by local authority "shall not create or constitute *any indebtedness, liability or obligation* of the state or of any . . . municipality or other public body, either *legal, moral or otherwise*" (emphasis added)); *id.* § 72-17-78 (same); *id.* § 72-19-78 (same); *id.* § 72-20-78 (same). The statute authorizing solid waste authorities contains almost identical language as well. *See id.* § 74-10-75 (bonds issued by

authorities "shall not create or constitute *any indebtedness, liability or obligation* of the state or of any . . . municipality or other public body, either *legal, moral or otherwise*" (emphasis added)). These provisions unmistakably intend to conform to the State Constitution's restrictions on indebtedness, and the similarity of their language to the language of the Education Trust Act confirms that that is the Act's intent too.

This legal background corroborates what already appears on the face of the statutory language: the Provision merely disavows the affirmative "creat[ion]," by the "Education Trust Act" itself, of extra guarantees on top of the 529 program's "contractual obligations." *Id.* § 21-21K-3(C). This statutory disclaimer was necessary to prevent investors from arguing that despite what the investment contracts may say, the Act itself promises a guaranteed result. For if the Act did make such a promise, it would prevail over a contract that provided otherwise. *See Aguilera v. Bd. of Educ.*, 2005-NMCA-069, ¶ 22, 137 N.M. 642, 114 P.3d 322 (to the extent that a contract between board of education and teacher conflicted with a statute, the statute prevailed), *aff'd*, 2006-NMSC-015, 139 N.M. 330, 132 P.3d 587.

The Parents, however, do not seek to hold the State to any guarantee of a certain sum of money. Rather, they seek only to enforce contractual duties that govern the management of their investments—duties that promise certain conduct,

rather than guaranteeing a result from that conduct. Nothing in the Act immunizes the State from liability for breach of such contractual duties.

III. Even If the Act Required That Contractual Liability to the Parents Be Satisfied out of the Education Trust Fund, the State Would Still Be Liable in Full.

The second sentence of the Provision does not address, let alone limit liability for, the State's contractual obligation to invest the Parents' savings conservatively. *See supra* Part II. But even if the second sentence of the Provision were to *apply* to that obligation, it would not *immunize* the State from full liability for it.

A. The Language of the Act Does Not Allow the State to Breach Its Contractual Obligation to the Parents, Thereby Deplete the Education Trust Fund of Sufficient Funds, and Then Claim Immunity Because of Its Own Breach.

Even if the second sentence is read to apply to the contractual obligation to invest the Parents' savings conservatively, then at most the statute merely designates the source from which that obligation must be paid. *See* NMSA 1978, § 21-21K-3(C) (no "obligation . . . to fulfill the terms of any college investment agreement . . . out of any source other than the education trust fund"). But even if the second sentence applies to the conservative-investment obligation, it does not disavow or abrogate it. Otherwise, the statute would not have to designate a source from which liability for that obligation must be satisfied.

The State contends that this distinction is illusory, and that designating a source of funds that is insufficient to satisfy a liability—here, the Education Trust Fund—is tantamount to immunizing the State from liability. [Resp. to Application for Interlocutory Appeal at 8-9] The district court agreed, stating, "I agree with the state that there's no purpose in that second sentence [of the Provision] other than to make it clear that it is only the educational trust fund that is a source of recovery." [Tr-19]

The Parents do not dispute that the Education Trust Fund currently has insufficient funds to pay any liability owed to them. The value of the Trust Fund is equal to the value of the contributions paid into it, plus or minus any investment gain or loss. *See* NMSA 1978, § 21-21K-3(A).[3] The damages that the Parents seek are equal to the amount of money that the Trust Fund lost because the State and Oppenheimer invested the Parents' money recklessly. So the Trust Fund currently lacks the funds to pay the State's liability to the Parents only because the State breached its obligation to invest the Parents' savings conservatively and, by doing so, depleted the Trust Fund.

[3] In addition, any appropriations that the Legislature makes to the 529 program go into the Education Trust Fund. NMSA § 21-21K-3(A). The State has claimed, however, that the Legislature has appropriated no money to the program, and the Parents have no reason to doubt that claim. [RP 419-420]

Thus the district court's conclusion that the Act effectively immunizes the State from liability makes little sense. If the State were allowed to rely on its own breach of contract in order to limit its liability for that breach, then as a practical matter it would *not* have an obligation to obey the Parents' investment directive. Yet as the Parents have just noted, the Provision's second sentence cannot be read to abrogate any obligation to invest the Parents' savings conservatively. *See supra* p. 26. The conclusion that the State is effectively immunized from liability cannot be squared with the language of the Provision's second sentence.

In sum, if the Provision's second sentence were to apply to this case, it would require both (1) that the State's contractual liability to the Parents be honored, *and* (2) that the liability be satisfied solely out of the Education Trust Fund. These two requirements can be reconciled only if the second sentence's reference to the Trust Fund means not just what the Trust Fund *currently* contains, but what it *would* contain if the State had not breached its promise to the Parents. In this way, the State cannot escape from its contractual obligation to the Parents simply by breaching that obligation and depleting the Trust Fund.

B. Precedent Also Demonstrates That the State Cannot Escape Its Contractual Obligation to the Parents Precisely by Breaching It.

The Parents' reading of the Provision's second sentence adheres to a venerable line of precedent. Like any other statute, the Provision should be

interpreted in the light of existing case law on the same subject. *See, e.g.*, *Doe v. State ex rel. Governor's Organized Crime Prevention Comm'n*, 114 N.M. 78, 80, 835 P.2d 76, 78 (1992). For decades, the law has been well settled: when a party has assumed contractual obligations over a source of money, it cannot escape those obligations by mismanaging the money until there is not enough left to satisfy the contractual liability. "Upon this point a page of history"—and a jot of common sense—"[are] worth a volume of logic." *N.Y. Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921) (Holmes, J.).

The New Mexico Supreme Court reached this result over 60 years ago. In *Crist v. Town of Gallup*, Gallup issued bonds to fund road paving, levied an assessment against the property abutting the paved road, and made the bonds "payable out of the proceeds of the assessment." 51 N.M. 286, 288, 183 P.2d 156, 157 (1947), *partial abrogation on other grounds recognized by Hoover v. City of Albuquerque*, 58 N.M. 250, 252, 270 P.2d 386, 387 (1954). Gallup, however, breached its duty to pay the bonds in their numerical order, and by paying them out of order, made certain of the bonds "worthless." *Id.* A bondholder sued, seeking damages, but the trial court dismissed his complaint, holding that foreclosure on the assessment liens—i.e., payment out of the designated source—was the sole remedy available. The Supreme Court reversed, holding that the bond owner could recover

more money than what was available from the designated source, because Gallup's breach of contract had made that source insufficient to satisfy the contractual liability. *Id.* at 289, 183 P.2d at 158. As the Court said:

> [A bond] owner . . . c[an] maintain an action for damages resulting from the failure of the treasurer of the municipality to pay the bonds in their numerical order as required by statute, which caused depletion of the fund out of which the bonds were payable to such extent that it did not contain money for payment of the owner's bonds.

Id.

Crist states the rule that applies to this case: even if the Education Trust Act made the State's liability payable solely out of the Education Trust Fund, the State is still liable for damages resulting from a breach that "caused depletion of the fund . . . to such extent that it did not contain money for payment" of the obligations. *Id.* Here, the State's breach of its duty of conservative investment depleted the Education Trust Fund so as to prevent full compensation for that breach. Under *Crist*, the State is liable in damages for that breach.

The Tenth Circuit, applying New Mexico law, reached the same result over 70 years ago in *Gray v. City of Santa Fe*, 89 F.2d 406 (10th Cir. 1937). *See id.* at 411 n.5 (surveying out-of-state authorities only after noting that there was "no decision on the question [presented] by the Supreme Court of New Mexico"). In *Gray*, Santa Fe issued bonds. The bond contract provided that the bonds were "payable solely out

of a special fund" collected from assessments on property. *Id.* at 408. The contract also made clear that "for the payment of this bond the city of Santa Fe assumes no obligation whatsoever" except for certain contractual duties, among which were the collection and enforcement of assessments levied to fund the bonds. *Id.* Thereafter, bondholders sued for breach of contract, alleging that Santa Fe had breached its duty to enforce and collect delinquent assessments. *Id.* at 409. The Tenth Circuit ruled that forcing the city by mandamus to collect the assessments and thus pay out of the designated fund was usually the sole remedy—but the court included an important proviso. Where a city has, "by its neglect of duty, permitted a valid assessment to expire and become uncollectible, the City is liable for breach of duty or contract to pay the debt evidenced by the certificate or bond." *Id.* at 411. The Tenth Circuit directed the district court to allow the bondholders to replead in accordance with this holding. *Id.* at 412.

Circumstances analogous to *Gray* are present here: the State, by its "neglect of duty," has dissipated the source of funds from which the Parents could be made whole. *Id.* at 411. Under *Gray*, the State is "liable for breach of . . . contract." *Id.*

If the Legislature had wanted to override this result, it knew how to do so. In 1992, as part of the Ground Water Protection Act, it enacted a provision enacting just such a limitation:

> Nothing in the Ground Water Protection Act establishes or creates any liability or responsibility on the part of the department or the state to pay corrective action costs from any source other than the corrective action fund, in the manner described, *nor shall the department or the state have any liability or responsibility to make any payments for corrective action costs if the balance in the fund is insufficient to cover those costs.*

NMSA 1978, § 74-6B-14 (emphasis added). In designating a source from which certain costs must be paid, this language closely tracks the second sentence of the Provision, which states that the Education Trust Act creates no obligation "to fulfill the terms of any college investment agreement or prepaid tuition contract out of any source other than the education trust fund." *Id.* § 21-21K-3(C). The Ground Water Protection Act goes further, however. Besides designating a source for costs, it goes on to provide that the State and the Environment Department will have no "liability or responsibility to make any payments . . . if the balance in the fund is insufficient to cover those costs." *Id.* § 74-6B-14. The Education Trust Act could have used similar language if the Legislature had wanted to immunize the State from liability for a breach of duty that depletes the Education Trust Fund. Because the Legislature did *not* use similar language, the Legislature did not intend a similar result. *State ex rel. Udall v. Colonial Penn Ins. Co.*, 112 N.M. 123, 129 n.7, 812 P.2d 777, 783 n.7 (1991). The State is thus fully liable for its breach.

IV. Imposing Liability Against the State Is Consistent with Public Policy.

To the district court, the State argued that "public policy" prevented contractual liability from attaching here. [RP 421-422] According to the State, the potential liability would simply be too great. This argument is unpersuasive.

A. The Unambiguous Language of the Statutes Should Be Faithfully Applied

Section 37-1-23(A) unambiguously makes the State liable for breaches of written contracts, and the Education Trust Act does nothing to repeal that statute. *See supra* Parts I–II. And "[w]hen a statute contains language which is clear and unambiguous," the courts "give effect to that language and refrain from further statutory interpretation." *State v. Jonathan M.*, 109 N.M. 789, 790, 791 P.2d 64, 65 (1990) (citing cases); *see also State ex rel. State Eng'r v. Lewis*, 1996-NMCA-019, 121 N.M. 323, 327, 910 P.2d 957, 961 ("[T]he consequences of a legislative policy embodied in an unambiguous statute are matters for the legislature, not this Court.").

B. It Is Immunizing the State from Liability Here, Not Imposing Liability on It, That Would Lead to Absurd Results

There is no need to go beyond the statutory language, because its result in this case is wholly fair. Statutory language is disregarded only if its literal application "would be 'absurd' or 'unreasonable.'" *Lion's Gate Water v. D'Antonio*, 2009-NMSC-057, ¶ 23, 147 N.M. 523, 226 P.3d 622 (quoting *D'Antonio v. Garcia*, 2008-

NMCA-139, ¶ 6, 145 N.M. 95, 194 P.3d 126). Far from causing absurdity, application of the statutory language avoids it.

If the State were shielded from liability, it could appropriate the Parents' savings and deplete the Education Trust Fund for any purpose whatsoever (or for no purpose at all), and the Parents would have no recourse against such a breach of contract. The Education Trust Fund should not be interpreted to lead to absurdities like this.

Moreover, imposing liability is a just result in its own right. The State was never forced to establish and maintain a 529 program. It was never forced to market the program to the Parents. It was never forced to make contributions to its 529 program deductible for purposes of the New Mexico income tax. It voluntarily entered into written contracts with the Parents, who then put their money in investment options that the State claimed were appropriately conservative. In truth, the options were highly risky, and the Parents lost money they had been saving for their children's education. In these circumstances, recognizing that the Parents have a contractual remedy against the State is only just.

C. Oppenheimer's Liability Limits the State's Liability

On June 16, 2010, the State and Oppenheimer agreed to a settlement under which the State would recover $67.31 million for the losses flowing from certain of

Oppenheimer's fixed-income holdings, to be distributed to the 529 investors in proportion to their losses. [RP 892–926] This figure represents some, but by no means all, of the 529 investors' losses. [RP 389, ¶ 81]

That settlement reduces the potential liability of the State by the amount it has agreed to accept from Oppenheimer. Because the Parents cannot recover more money than they actually lost, any award against the State would have to be offset against the Oppenheimer settlement. *See Summit Props., Inc. v. Pub. Serv. Co. of N.M.*, 2005-NMCA-090, ¶ 46, 138 N.M. 208, 118 P.3d 716 ("[A] contracting party is not entitled to double recovery. New Mexico does not allow duplication of damages or double recovery for injuries received." (citations and quotation marks omitted)).

Moreover, the State has specifically retained its right of indemnification against Oppenheimer for any liability to the Parents or other investors in the 529 program. [RP 912] Accordingly, it is within the State's power to protect the public treasury by seeking indemnification from Oppenheimer.

V. The State's Claimed Inability to Satisfy a Judgment Does Not Immunize the State from Liability, and in Any Event Raises a Question of Fact Inappropriate for Resolution at the Pleading Stage

The State argued that it is immune because the legislature has not appropriated funds to the Education Trust and therefore it cannot satisfy a judgment entered

against it. [RP 419–421] To the extent the district court accepted that argument [Tr-19], it erred as a matter of law, and for three reasons.

First, the inability to satisfy a money judgment does not create sovereign immunity. Sovereign immunity is immunity from facing a possible judgment. *See, e.g., Lucero v. Richardson & Richardson, Inc.*, 2002-NMCA-013, ¶ 7, 131 N.M. 522, 39 P.3d 739 (doctrine of sovereign immunity provides for "immunity from suit"). Inability to satisfy a money judgment, by contrast, simply prevents collection of a judgment.

Second, to the extent the district court accepted the State's argument that the appropriations statute, NMSA 1978, § 6-4-2, makes it immune in this case, the district court has created yet another statutory conflict. *See also supra* Part I. To accept that argument is to conclude that—even though Section 37-1-23(A) has waived sovereign immunity for written contracts—Section 6-4-2 implicitly limits that waiver. This conflict is unnecessary, since it can easily be avoided by recognizing that sovereign immunity and inability to satisfy a judgment are two different things. *See Rader v. Rhodes*, 48 N.M. 511, 514, 153 P.2d 516, 518 (1944) (implied repeals are recognized only where "absolutely necessary").

Third and most importantly, whether the State can or cannot pay a money judgment is a question of fact. It is evidence, not mere conjecture, that will

determine whether the State can pay a money judgment out of insurance, indemnity claims, the general fund, or other sources.[4] Questions of fact are not resolved on motions to dismiss under Rule 1-012(B) NMRA, and thus the State must, at the very least, *prove* its inability to satisfy a judgment. *See N.M. Life Ins. Guar. Ass'n v. Quinn & Co.*, 111 N.M. 750, 757, 809 P.2d 1278, 1285 (1991) (refusing to dismiss a complaint on the basis of a question of fact); *RIO Grande Kennel Club v. City of Albuquerque*, 2008-NMCA-093, ¶¶ 18–19, 144 N.M. 636, 190 P.3d 1131 (reversing dismissal because of the existence of a factual question).

CONCLUSION

The State knowingly consented to investment of the Parents' savings in unduly risky, rather than conservative, holdings. In so doing, the State breached its contracts with the Parents. Like any other party, the State is liable for this breach, and the Education Trust Act, far from immunizing the State, explicitly recognizes that the State is liable for its contractual obligations.

The district court erred in dismissing the State from this suit and holding that funds currently held in the Education Trust Fund are the only available source of recovery. This Court should reverse the dismissal of the State, hold that funds currently held in the Education Trust Fund are not the only available source of

[4] The State has marshaled no evidence that it cannot pay a money judgment.

recovery for the Parents, and remand to the district court for further proceedings consistent with those rulings.

Respectfully submitted,

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STATEMENT REGARDING ORAL ARGUMENT

Because this appeal presents questions of first impression, counsel for the Parents believe that oral argument will aid the Court's decision-making.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 19th day of January, 2011, I caused to be delivered a true and correct copy of the foregoing on the following counsel by U.S. mail, postage prepaid:

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