March 21, 2003

Dear Mayor:

You have two questions:

1. Can the City reimburse the recorder for her legal expenses, when those expenses arose from a criminal charge against her based on the misuse of the city's money? As I understand the facts, the criminal charge was resolved by a pretrial diversion, which the recorder successfully completed. Apparently, the Board of Mayor and Aldermen has already reimbursed the recorder for the legal expenses in question, which expenses reflect the cost of her attorney and even the money she paid the city under the pretrial diversion agreement!

2. If the answer is no, who would have the right to bring a suit for the recovery of such money, and against whom would the suit be brought?

The answer to Question 1 is that the use of city money for such a purpose is clearly illegal, for at least two reasons: First, the expenditure is not for a "corporation purpose," and for that reason violates Article II, ' 28 of the Tennessee Constitution; second, there is no statute or even ordinance that supports the indemnification of city recorders against legal fees and judgments. In addition, even if the city could point to such a statute or ordinance, the indemnification would still be prohibited under the facts of this case.

The answer to Question 2 is that there are two classes of persons who could sue to recover the money:

The first class is the members of the board of mayor and aldermen, and perhaps any other city official who has the duty to insure that any expenditure of city funds is a legal expenditure. However, as I understand the facts, all the members of the board of mayor and aldermen, except the mayor, voted in favor of the payment of the money to the recorder, that the mayor refused to sign the check, and that the cive-mayor subsequently signed it. I am not certain what impact the votes in favor of the payment have on the rights of the aldermen who cast them to sue to recover the money. The mayor is clear of any potential problems on that point. In any event, from a practical standpoint, I assume it is not likely that any member of the board of mayor and aldermen who voted in favor of the payment of the money would sue to recover it.

A second class is a taxpayer or taxpayer. Ordinarily, taxpayers do not have the right to sue to recover municipal expenditures, unless they can prove an injury to them not common to citizens as a whole. That is usually a difficult hurtle for taxpayers to jump. But an exception to that general rule is in suits involving the illegal expenditure of municipal funds.

A suit for the recovery of illegal expenditures is brought against the "delinquent public officials." The delinquent city officials in the case of the City appear to be the city recorder, the members of the board of mayor and aldermen who voted for the payment of the money to the recorder, and perhaps any city official who actually paid the money to the recorder. But it also appears that where a suit is filed by either class of potential plaintiffs against a city official or officials for the recovery of expenditures alleged to be illegal, the city is joined as a defendant in the suit.

I will analyze the answer to your questions in three parts:

1. The two reasons the city's expenditure for the above purpose is illegal;

2. Standing to sue; officials subject to suit, etc.

3. The impact the pretrial diversion has on your question;

All emphases in quotations and elsewhere are mine unless otherwise noted.

1. Reasons the Expenditure is Illegal

The expenditure is not for a "corporation purpose."

Article II, ' 28 of the Tennessee Constitution provides that, "The General Assembly shall have power to authorize the several counties and incorporated towns in this state to impose taxes for County and Corporation purposes respectively, in such manner as shall be prescribed by law...." The Tennessee courts have declared that it is not possible to make any hard and fast rules with respect to what is and what is not a public purpose, that the question must be resolved on a case-by-case basis. [Edmonson v. Board of Education, 69 S.W. 274 (1902)]. But it seems clear in Tennessee, not to mention virtually every jurisdiction in the United States, that reimbursing a public official for his or her legal expenses under the facts that apply to the City are not for a "corporation purpose." Indeed, the rule in Tennessee governing the expenditure of public funds to indemnify a public official for his or her legal and other costs arising from criminal conduct in the office is extremely strict.

In Smith v. Nashville, 72 Tenn. 69 (1879), citizens in the name of the state sued the mayor and city council of Nashville, the treasurer, collector and recorder, and other officers of the city, charging all of them with "the grossest malfeasance in office, and with having brought the corporation to the verge of bankruptcy." [At 70.] The mayor retained an attorney to defend the suit, and that retainer was subsequently ratified by the city council. But the trial court found as a fact that although the city was made a nominal defendant to the suit, "*no relief was sought against it, and that it had no interest in defending the bill*." [At 72] In upholding the trial court,

the Tennessee Supreme Court declared that:

> Where a municipal corporation has no interest in the event of a suit, or in the question involved in the case, it would seem clear that it could not assume the defense of the suit, or appropriate its money for the payment of the expenses incurred....Most clearly the corporation could not appropriate money to defray the costs of an official who had been prosecuted for official misconduct, *although he be acquitted*: [Citations omitted.] Nor to defray the expense of a city action for like official misconduct. A retainer for the prosecution or defense of any suit which the corporation is not directly interested would be of no avail to create a corporate liability: Daniel v. Mayor of Memphis, 11 Hum. 529. [At 72-73]

Although the Court did not expressly mention the "corporation purpose" doctrine in Smith v. Nashville, that case makes it clear that reimbursing a city recorder for funds she spent in her defense of a charge of misuse of funds, and the funds which she paid back to the city under a pretrial diversion agreement, is not a corporation purpose. Moreover, it would not have been a corporation purpose even if she had gone to trial and been found not guilty. I can see no reason why that case would not apply where the governing body of the city did not appropriate the funds in question for the defense of any criminal charge of misconduct on its part, but appropriated city funds to the city recorder for that purpose.

City of Knoxville v. Christenberry, 174 Tenn. 287 (1922), also outlines the circumstances under which a municipal governing body can compensate one of its members for activities that the member does in the city's behalf, but which are not done under a contract with the city:

> If an officer of a municipality, in the discharge of his duties incurs expenses which the municipality accepts the benefits of, there is nothing illegal in repaying to him his expenses, *if the same be fair and honest and free from suspicion and fraud*. [At 295]

Smith v. Nashville has been cited with approval by courts in other states in similar cases, including by the Supreme Court of our sister State of Alabama in City of Birmingham v. Wilkinson, 194 So. 548 (1940). In that case the Court held it within the power of the city to hire defense counsel to defend the city's governing body against charges of fraud, graft and corruption, when the peculiar facts of that case involved the "proper corporate interest" of the city. The Court, citing 43 C.J. . 890, Sec. 1620 and notes, reasoned that,

> A municipal corporation has implied power to employ counsel to render services in matters of *proper corporate interest*, including the prosecution or defense of suits against the corporation, and the defense of suits against municipal officers for acts done on behalf of the corporation while in the *honest discharge of their duties*. [At 552]

In this case, continued the Court, the city counsel had been enjoined from performing many of its financial functions, and because the charges were never proved but abandoned upon a motion by the complainant. But the city council did not have carte blanche to pay for legal counsel, declared the Court:

> That members of a governing body cannot expend the public money for counsel to shield themselves from the consequences of their own unlawful and corrupt acts goes without saying. We are in full accord with the opinion in Smith v. Mayor, etc. of City of Nashville, 4 Lea 69, 72 Tenn. 69...But the power and duty of the city to defend members of its governing body against unfounded and unsupported charges of corruption and fraud is quite another matter. The same policy which demands the holding of public officers to strict account in matters of public trust, also demands their protection against groundless assaults upon their integrity in the discharge of public duty. [At 552]

The Alabama Supreme Court again pointed to the necessity that a "proper corporate interest" must support payment of attorney's fees of municipal officers in City of Montgomery v. Collins, 355 So.2d 1111 (Ala. 1978), and Greenenough v. Huffstutler, 443 So.2d 886 (1983). In Collins, the Court upheld the right of a city to pay for the defense of police officers charged with perjury before the grand jury, concluding that it was a "proper corporate interest" of the city because under the facts in that case, had the perjury prosecutions been successful, there was a good prospect the city could have been made a party to civil litigation arising from their conduct. In Greenenough, the Court held that a city could not pay for attorney's retained by certain personnel board members because such payments were contrary to statute, and were not for a "proper corporate purpose." On the latter point, the Court pointed to Article IV, Sec. 94, of the Alabama Constitution, which provides that, "The Legislature shall not have the power to authorize any...city, town... its credit, or to grant public money or thing of value in aid of, or to any individual, association, or corporation whatsoever..."

There was not even a remote prospect that the City's indemnification of the city recorder was essential to prevent the city from being drawn into, or held liable under, any criminal or civil litigation. Indeed, the potential threat to the city of being drawn into civil litigation arises from the fact that it indemnified the recorder.

Probably the most thorough and instructive case on the question of whether the indemnification of local government employees for legal fees and judgments involving misconduct in office qualifies as an expenditure for a "public purpose" is Wright v. City of Danville, 675 N.E.2d 110 (Ill. 1996). In that case, the city's board of commissioners and corporate counsel were convicted of criminal official misconduct and conflict of interest arising from a settlement they entered into involving some voting rights litigation. They claimed legal fees and litigation expenses under an indemnification ordinance which applied to the mayor, city

counsel and appointed officers, and under which the city:

> ....shall pay all expenses (including attorneys fees), judgments, fines, and amounts paid in settlements actually and reasonably incurred by the person in connection with such action, suit or proceedings if he acted in good faith and in a manner he reasonably to be in or not opposed to the best interests of the city. Such indemnification by the city shall apply to any criminal action or proceeding, if the indemnified person had no reasonable cause to believe his conduct was unlawful, and any act or omission within the scope of the office or employment. [At 114]

The use of the indemnification ordinance for that purpose by municipal officers convicted of official misconduct violated the "public purpose" provision of the Illinois Constitution, held the Court, reasoning that:

> Plaintiffs assert that the indemnity ordinance was enacted for a public purpose and to benefit the city. Although a legislative body may have broad discretion in determining what constitutes a public purpose [citations omitted] that discretion is not unlimited and courts will intervene when public property is devoted entirely to private use. [Citation omitted.] An unsuccessful criminal defense involving the holder of a public office, but not arising out of the lawful exercise of the duties of that office is purely private litigation [Citations omitted] and as such absorbing the costs of such litigation cannot be considered a proper public purpose. [At 115-16]

The Court spent considerable time analyzing cases in which indemnification of public officials for legal expenses, etc. in criminal prosecutions had been allowed, and concluded that those cases were limited to unsuccessful prosecutions. In addition, the Court also pointed to the numerous cases and treatises which hold that the paying of the costs of defending a public officer against charges of criminal or official misconduct is never a public purpose even where the prosecution is unsuccessful. Under Smith v. Nashville, the State of Tennessee follows the later line of cases; even an acquittal on charges of official misconduct does not permit the indemnification of a public officer.

Indemnification not supported by statute or ordinance, and even if it were, the indemnification of the recorder would still be illegal

Tennessee formerly had an indemnification statute under which cities and counties were both authorized and required to provide police officers and fire fighters with defense counsel in suits for damages brought against them in the performance of their official duties, and to indemnify them from any judgment rendered against them in such suits. [Tennessee Code Annotated, ' 7-51-202] That statute was repealed in 1987, but in City of Chattanooga v. Harris,

442 S.W.2d 602 (1969), the Tennessee Supreme Court upheld the above indemnification statute against several challenges, including the challenge that it violated the requirement of Article 2, ' 29, of the Tennessee Constitution, that county and municipal expenditures must be for a public or corporate purpose. The Court declared that:

> It is not to be questioned at this stage of the development of municipal activities that the maintenance of police and fire departments are proper corporate activities and for a public and corporate purpose. Nor, do we feel that, considering the difficulty encountered in filling and sustaining the ranks of these departments, it can be questioned that the giving of certain "fringe" benefits as well as salaries are necessary in order to effectuate these public purposes...The fact that the individual policemen and firemen do gain a benefit from the implementation of the statute does not deny that a public purpose is being served. This Court, in Pack v. Southern Bell Tel. & Tel. Co., supra, noted that the test for whether or not the expenditure of funds is for public purpose is the end or total purpose, and the mere fact that some private interest may derive some incidental benefit from the activity does not deprive the activity of its public nature if its primary function is public. [At 606].

That statute did not include the indemnification of city recorders. Even if it had, and even if it were still in existence, it provides no support for the proposition that the City could indemnify the recorder under the facts in her case. In City of Chattanooga v. Harris, the indemnification statute:

- indemnified a class of municipal employees (police and fire);

- indemnified that class of employees for suits for damages in the *performance of their official duties and while engaged in the course of their employment*;

- *exempted indemnification for damages arising out of any "wrongdoing" by employees*.

Cases in other jurisdictions indicate a split on the question of whether local governments have the right to indemnify their employees even where there is no indemnification statute. [See 47 A.L.R. 5th 553] As far as I can determine, Tennessee has not answered that question. However, as already pointed out above, it has clearly answered the question of whether a municipality can indemnify an officer charged with official misconduct, even when the officer is acquitted of that charge.

It is also the law that where a municipal officer or employee claims indemnification against a judgment under a statute that the municipality's discretion to indemnify is not unfettered. That point was made in City of Danville v. Wright, above. In addition, in Douglas v. City of Minneapolis, 230 N.W.2d 577 (Minn. 1975), a statute authorized municipalities to indemnify their employees against judgments and the legal costs of defending certain suits against them. The standard for determining how much discretion the city had in this area, said the Court, was whether the payment was "fitting and proper...assuming that the actions of the officer or employee which lead to the judgment occur in the performance of duty *and do not arise as a result of malfeasance in office or willful or wanton neglect of duty*." [At 585]

In making that determination, continued the Court, the city:

> ....may consider, among other things, whether the employee acted in good faith; whether he was acting pursuant to directions from a superior officer; whether the morale of other city employees might be significantly affected by paying, or failing to pay, the judgment; and such other facts as, in the judgment of the governing body may be reasonably relevant and helpful in reaching a conclusion that payment should or should not be made. *The important principles are: (a) The governing body must first determine that the action arose out of the performance of the employee's duties and that there was no malfeasance in office or wilful or wanton neglect of duty; (b) the municipality must then determine whether it is "fitting and proper" to pay the judgment; (c) the determination of whether it is "fitting and proper" to pay the judgment must be based upon the best interests of the municipality and the public after considering all of the facts and circumstances. [At 855-56]*

The overwhelming, if not the universal, weight of authority is that the wilful or wanton neglect of duty, malfeasance in office, the misuse of government funds, and similar conduct is not within the scope of an officer's employment. [See 47 ALR 5th 553, especially ' 25(b).]

3. Standing to Sue, Officials Subject to Suit, etc.

Standing to sue

A critical issue in suits based on an allegation that a government illegally spent money is the standing of individuals to sue. Without such standing, the persons filing the suit are not even entitled to a hearing on the merits of the suit. Apparently, two classes of persons have standing to sue to recoup the money illegally paid to the city recorder. The first class is probably any member of the Board of Mayor and Aldermen (although I repeat here that I am not sure what effect the vote of individual aldermen in favor of the payment to the recorder has on their individual rights to sue to recover the money), and perhaps any officer who has responsibility to

insure that municipal expenditures are legal. The second class is a taxpayer or taxpayers. There are a number of cases involving the question of what it takes for these two classes of persons to achieve standing to sue for the recoupment of illegally paid government funds. Cobb v. Shelby County Board of Commissioners, 771 S.W.2d 124 (1989); Badgett v. Rogers, 436 S.W.2d 292 (1969); Metropolitan Government of Nashville v. Fulton, 701 S.W.2d 597 (Tenn. 1985).]

As I read those cases, the mayor and aldermen achieve standing by virtue of their positions, because though those positions the illegal expenditures cause them damage or injury that is not common to the body of citizens as a whole. The second classBtaxpayer or taxpayers--have standing to sue, provided they do three things:

1. Show they are taxpayers;

2. Allege a specific legal prohibition on the use of funds;

3. Show that they have notified "appropriate" public officials of the illegal expenditure and have given them an opportunity to take corrective action short of litigation.

However, the necessity for taxpayers to do No. 3 is excused where the notice and demand would be a formality. In Badgett v. Rogers, above, the taxpayers suing for the recovery of money alleged to have been illegally paid from city funds were excused from the requirement of notice and demand for corrective action because the suit involved the claim that the mayor was illegally being paid an expense account in addition to his salary by the city's finance director. In that instance, said the Court, "The Mayor and Finance Director patently have interests contrary to this action. Demand upon them would have been a vain formality." [At 295]

Similarly, the notice and demand ordinarily required by No. 3 is probably a formality in the case of the City. Where the City Recorder requested, and the Board of Mayor and Aldermen approved, the payment of the city recorder's legal fees and other costs she incurred in a criminal action brought against her for the misappropriation of city funds, the notice and demand would probably be in vain.

However, it seems to me that whether a suit for the recovery of the money at issue in the City is brought by a member of the board of mayor and aldermen, or by a taxpayer or taxpayers, it seems relatively easy for both classes of potential plaintiffs to avoid any standing issue by doing No. 3.

Officials subject to suit

The suit itself is brought against "delinquent public officials." [Cobb v. Shelby County Board of Commissioners, at 126] It appears that the "delinquent public official/s" in the case of the City would include the city recorder, the board of mayor and aldermen, and perhaps the city official who made the payment to the recorder. [As I understand the facts, the mayor refused to sign the check and the vice-mayor signed it.] The board of mayor and aldermen approved the

expenditure, presumably a city officer signed the check, and check was paid to the city recorder. However, the case law supports the logical proposition that where there is an illegal expenditures made to a public official, recovery of the money is actually sought from that public official. In addition, the case law also supports the proposition that in a suit brought by either potential class of plaintiff, the Board of Mayor and Aldermen would apparently be joined as a defendant.

In Badgett v. Rogers, above, suit was brought against Knoxville Mayor Leonard Rogers and Finance Director Snoddy, alleging that the $3,000 expense account paid annually to Mayor Rogers in addition to his salary was an illegal expenditure of city money. It claimed that Finance Director Snoddy's payment of that expense account to Mayor Rogers was a "misappropriation of the funds of the City, *for which defendant Rogers is personally liable*." [At 293] Although the Court dismissed this case because the plaintiff failed to allege any specific facts supporting his argument that the $3,000 expense account was illegal, there appears to have been no dispute that the suit was properly brought against the mayor and the city finance director individually, and that it properly claimed restitution of the alleged illegal expenditures from the *mayor*. Likewise it appears that in Cobb v. Shelby County Board of Commissioners, the suit was brought against the county commissioners, the mayor and two finance commissioners for the recoupment of parts of salaries claimed to have been illegally paid to the commissioners. The plaintiff lost the case on its merits, but the case implies that the persons from whom recovery of the alleged illegally paid salaries were sought were the county commissioners. The mayor and the finance commissioners appear to be "delinquent public officials" to the extent that it was they who either refused to stop the payment of the salaries when requested to do so, or who actually paid them.

If a suit against the "delinquent public officials" in the City seeks recovery of the illegally paid funds from the city recorder, what is the purpose of the requirement that a taxpayer or taxpayers who file/s the suit give the city prior notice of the illegal payment and an opportunity to take corrective action? Apparently that purpose is to permit the board of mayor and aldermen itself to attempt to recoup the money illegally paid, apparently including by the filing of a suit against the person to whom the payment was made.

Bayless v. Knox County, 286 S.W.2d 579 (1955) points to the reason that the taxpayers in that case were entitled to file a suit against individual county commissioners for the recovery of salaries and other benefits illegally paid to them, and the reason Knox County was a defendant in the case:

> *The bill [complaint] alleges that these taxpayers unsuccessfully requested the Quarterly Court to institute this suit to enjoin allegedly unlawful appropriations and to collect county funds alleged to have been illegally paid to certain of the defendants. Knox County was made a party defendant to the end that judgment might be rendered in its favor for such amounts as it may be due from the respective defendants. In view of the refusal of the county, though requested to institute this suit, the proceedings by the taxpayers seems to be authorized by Peeler v. Luther, 175 Tenn. 454, 135 S.W.2d 926. [At 582]*

I mentioned above the good prospect that no potential class of plaintiffs need give the notice and make the demand required by No. 3 under **Standing to Sue**, above, prior to the filing of a suit to recover the funds illegally paid by the Board of Mayor and Aldermen to the city recorder. But again I also suggest that such notice and demand is relatively easy to make by either class of potential plaintiffs, and that it may help eliminate any possibility that a suit might be dismissed for their failure to make it.

3. The Impact of the Pretrial Diversion

There are two kinds of diversion in Tennessee: Pretrial [Tennessee Code Annotated, ' 40-15-105] and judicial. [Tennessee Code Annotated, ' 40-35-313] As I understand the facts, after the city recorder was criminally charged with the misuse of city funds, she was granted pretrial diversion. Pretrial diversion permits the state and the defendant in a criminal case to enter into a memorandum of understanding under which the state agrees that the prosecution will be suspended for a specified period, not to exceed two years, during which the defendant agrees to abide by the conditions laid out in the memorandum. At the end of the defendant's successful compliance with the memorandum of understanding, the court is required to dismiss with prejudice any warrant or charge against the defendant.

Where a defendant has successfully completed pretrial diversion, the records of the case are expunged under Tennessee Code Annotated, ' 40-32-101 et seq. It is said in Pizzillo v. Pizzillo, 884 S.W.2d 749 (Tenn. Ct. App.), that:

> The effect of expunging the records of a criminal charge is to restore the person to the position he or she occupied prior to the arrest or charge. State v. Sims, 746 S.W.2d 191, 1999 (Tenn. 1988). Thus, persons whose records have been expunged may properly decline to reveal or acknowledge the existence of any charge. [At 754]

The same case further says that:

> Even though the pretrial diversion statute does not prevent the document's use as evidence, we must also weigh the effect of the criminal court's order directing that all public records with regard to the charge connected with the memorandum of understanding be expunged in accordance with Tenn. Code Ann. ' 40-32-101. We find that the expunction of this record rendered it inadmissible in any subsequent criminal or civil proceedings. [At 754]

In the face of the pretrial and expunction statutes, how does a person claiming that the city has illegally paid a city officer's attorney's fees and the money she reimbursed the city under the pretrial diversion agreement introduce proof of the misuse of funds?

At least one answer is that State v. Dishman, 915 S.W.2d 458 (Tenn. Ct. Crim. App.

1995), declares that the expungement statute is restricted to "public records," and precludes the testimony only of any arrest, indictment, information or trial. For that reason, declares Dishman, even where a person has successfully completed pretrial diversion and the records of the criminal charge have been expunged, and that person is a witness in another proceedings, evidence of that person's offense may, on cross examination, be admitted as a "prior bad act." That case is important in two respects:

First, if the expungement statute is restricted to public records, and precludes the testimony only of arrest, indictment, information or trial, I can think of no reason a person challenging the legality of the expenditures could not attempt to make his case through the testimony of persons who have knowledge of the facts of the case, including private auditors and auditors from the state comptroller's office. It appears to me that such testimony could be handled without touching on the city recorder's arrest, indictment, information or trial.

Second, if the city recorder herself testified in order to rebut the testimony of any such witnesses, it appears to me that she is subject to cross examination on "prior bad acts" for the purpose of impeaching her testimony, including the particular criminal charges that led to the pretrial diversion.

My opinion is that a solid case can be made that the money appropriated to the city recorder to pay her legal expenses, including the money that she previously paid to the city under her pretrial agreement, was an illegal expenditure. But if anyone decides to file a suit to recover the money, they will need the assistance of an attorney to help them pursue the case. In fact an attorney may disagree with some of my conclusions and analyses. In that case, the attorney's advice should be followed.

Sincerely,

Sidney D. Hemsley
Senior Law Consultant

SDH/