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November 22, 2002

The Honorable John Cornyn
Office of the Attorney General
Opinion Committee
209 W. 14th Street, Floor 6
P. O. Box 12548
Austin, Texas 78711-2548

Re: Request for Attorney General Opinion

FILE #ML-42903-02
I.D # 42903

Dear General Cornyn:

ISSUES

The Executive Director of the State Office of Risk Management (Office), pursuant to Government Code §402.042(b)(2), respectfully requests an opinion from the Office of the Attorney General (OAG) on the following issue: Whether all funds of the Employee Retirement System of Texas (ERS) and the Teacher Retirement System of Texas (TRS) are protected by Tex. Const. art. XVI, §67(a)(1) from payment of the state employee workers' compensation fund assessment under the Office's assessment program mandated by Labor Code §412.012, as implemented in 28 Tex. Admin. Code §§251.501, *et seq.* (adopted to be effective 10/08/01, 26 Tex. Reg. 7877) and as modified by the amended, adopted rules published in the 11/08/02 issue of the Texas Register to be effective 11/17/02.

If, in the opinion of the OAG, the funds of ERS and TRS are not protected under Tex. Const. art. XVI, §67(a)(1), then the Office seeks a second OAG opinion on the following question: To what extent are ERS and TRS funds subject to the assessment mandated by Labor Code §412.012, as implemented in 28 Tex. Admin. Code §251.501, *et seq.* (adopted to be effective 10/08/01, 26 Tex. Reg. 7877) and as modified by the proposed rules published in 27 Tex. Reg. 8895 (2002).

BACKGROUND

The bill analysis for Tex. H. B. 2976, 77th Leg., R.S., (2001), (codified in Labor Code §§412.012, 412.0121 – 412.0124) explains that prior to the 77th Legislature, state agencies were required to enter into interagency contracts with the Office for the administration of the risk management program and to partially fund the Office. The bill analysis voices the Legislature's concerns regarding the growth of workers' compensation

payments incurred by certain state agencies and the intent to make state agencies more responsible for accident prevention and loss control programs. The bill analysis states that H. B. 2976 requires the Office to establish a formula for allocating the state's workers' compensation costs to state agencies in order for state agencies to implement adequate risk management programs.

H. B. 2976 amended Texas Labor Code §§412.012 and 412.0121 - 412.0124 by requiring the Office to establish a formula for allocating the state's workers' compensation costs among all covered agencies based on the claims experience of each agency, the current and projected size of each agency's workforce, each agency's payroll, the related costs incurred in administering claims, and other relevant factors. Pursuant thereto the Office proposed and adopted the rules found at 28 Tex. Admin. Code §251.507, *et seq.* implementing the legislative mandate. The Office has currently proposed amendments to these rules, published in 27 Tex. Reg. 8895, to address concerns raised by certain agencies.

ERS and TRS have paid a portion of the assessments but have raised objections to the applicability of the legislation to certain funds held by each and have refused to sign the mandatory interagency contract required by Texas Labor Code §412.0121. Copies of these assessments and letters in response are attached hereto as Exhibits A (ERS assessment and letter) and B (TRS assessment and letter) and are incorporated by reference. These agencies have historically fully participated in the state's self-insured workers' compensation program and have hitherto paid the related costs as assessed.

ANALYSIS

ERS and TRS have not paid workers' compensation fund assessments for fiscal year 2002 as determined by the Office and instead have paid an amount each has individually determined to be reasonable. In letters received by the Office on May 31, 2002, TRS and ERS officially dispute the assessments and request reductions in these assessments under 28 Tex. Admin. Code §251.515. Copies of these letters are attached hereto as Exhibits C (ERS letter) and D (TRS letter) and are incorporated by reference herein. TRS and ERS assert in the letters that the statute and assessment formula as applied by the Office to these agencies raises constitutional issues of trust fund administration but fail to cite any legal authorities in support. Conni H. Brennan, General Counsel for TRS, asserts the assessment program "raises a variety of legal issues for TRS, including the constitutional and statutory prohibitions against diversion of trust assets." Sheila W. Beckett, Executive Director of ERS asserts "the assessment attributed to ERS cannot be administered in its current form without implicating constitutional trust administration issues. ERS believes that the Texas Legislature (Legislature) did not contemplate the use of public retirement trust funds to contribute for coverage of aggregated workers' compensation losses suffered by government workers."

The agencies claim it is unconstitutional to utilize any portion of trust funds or monies derived therefrom to pay losses incurred by any agencies other than ERS and TRS. As

discussed below, the assessment program funds a statewide risk pool administered by the Office for the payment of workers' compensation benefits to all covered state agencies. ERS and TRS extend their claim of constitutional protection to the resulting workers' compensation risk pool mandated by the H. B. 2976 assessment formula and as implemented through 28 Tex. Admin. Code §251.507. The agencies assert that requiring their participation in the risk pool, and thereby potentially funding workers' compensation benefits for other agencies' employees, is an unconstitutional diversion of dedicated benefits belonging to their members.

Risk sharing is a basic tenet of insurance. In any insuring arrangement, individual risks are shared or spread among all insured participants. By sharing the risks, the costs of loss by any one member insured are spread or shared among all insureds. This is demonstrated in any commercial insurance market where individual insureds pay a set premium in order to obtain coverage for any loss(es) that may be incurred by the insured. If a loss event occurs, the costs of that loss are covered by the premiums collected by the insurance company (insurer) from all insureds. A single loss event may incur costs far in excess of the premium paid by an individual insured, and the additional costs over and above the premium amount are covered by the total premiums collected from all insureds by the insurer.

The principles of risk sharing also apply to risk pools. A risk financing pool is an association of persons or organizations that combine their resources for the common advantage of cost effective management of funds to finance recovery from accidental losses. The individual members of the risk pool individually pay contributions, e.g., - premiums to the managers of the pool in payment for coverage of all loss events during the coverage period.

In a standard insurance arrangement, the insurer has no recourse against an individual policyholder if a loss event costs the insurer more than the collected premium. The insurer pays the difference between the collected premium and ultimate loss costs from the pooled premiums of all insureds, or from accumulated reserves. If the insured does not incur a loss, or if a loss is less than the premium paid, the insured does not receive any reimbursement of the premium amount back at the end of the policy period. Similarly, the insurer has no recourse against the policyholders in cases where combined policy losses exceed premiums paid by all policyholders. In such cases, the insurer must draw down its reserves to cover losses. Likewise, in a typical risk financing pool, the collective contributions paid by the pool participants provide coverage and pay for all losses incurred. No covered entity in a risk financing pool is assured of paying a dollar of contribution (premium) in exchange for a dollar of paid expenses. However, a risk pool differs from standard insurance in that the collective members of the pool are ultimately responsible for the payment of all losses incurred by its members.

The Office's allocation and assessments program is such a risk financing pool created by the Legislature for the purpose of cost effective management of state funds to finance recovery from accidental job-related losses incurred by employees of state agencies. The

risk allocation and assessments program provides coverage to all participating state agencies for the charge of an annual assessment. In this pool, TRS and ERS are just as likely to be the beneficiaries of the pooling mechanism as any other covered state agency. This is a significant departure in the manner in which workers' compensation claims have been historically paid by the state.

In establishing the assessment program, the funding mechanism for paying workers' compensation benefits to state employees was fundamentally changed. For the biennium beginning September 1, 1999, the Office paid workers' compensation claims from general revenue (GR) appropriations and from reimbursements received from other state agencies and higher education institutions, as required by the General Appropriations Act (GAA), 76th Leg., R.S., §9-6.51. State agencies and institutions were required to reimburse the Office for 25 percent of all workers' compensation benefits paid to state employees. Agencies that funded salaries from sources other than GR were required to reimburse the GR Fund for an additional 75 percent of the benefits paid from non-GR funding sources used in payroll (see Texas State Comptroller, Accounting Policy Statement APS-017 07/01/00). In essence, if salaries were paid from funds held outside the state treasury, the agency was to reimburse the GR Fund for 100 percent of all workers' compensation benefits paid on behalf of those injuries.

For the biennium beginning September 1, 2001, the direct allocation of funds to the Office from GR was reallocated as required by the GAA, 77th Leg., R.S., §10.23, and the separate appropriation will be discontinued effective September 1, 2003. The funds appropriated to the Office for the current biennium were redistributed by the Comptroller of Public Accounts to participating agencies to fund the additional GR costs of the agencies' workers' compensation related annual assessments. The Office was required by the H.B. 2976 amendments to establish a formula for the assessment, based on expected aggregate workers' compensation losses, to allocate costs to each covered agency and to collect assessments from each covered agency to pay these expected aggregate losses. The GAA, 77th Leg., R.S., §6.37(g), specifically provides that:

> "Notwithstanding other provisions in this Act, participating agencies shall transfer to the State Office of Risk Management their assessed allocation amounts for workers' compensation coverage for their employees *from funding in the same proportion as their expected payroll funding, including General Revenue Funds, dedicated General Revenue Fund accounts, Other Special Funds or local bank accounts"* (emphasis added)."

GAA, 77th Leg., R.S., §6.37(g).

Similar language regarding the proportionality requirement is found in the GAA, 77th Leg., R.S., §10.23 and Texas Labor Code § 506.002.

It appears TRS and ERS may be relying on Tex. Const. art. XVI, §67(a)(1) (added April 22, 1975), entitled *State and Local Retirement Systems*, in support of their constitutional argument against payment of their assessments:

> "The legislature may enact general laws establishing systems and programs of retirement and related disability and death benefits for public employees and officers. Financing of benefits must be based on sound actuarial principles. The assets of a system are held in trust for the benefit of members and may not be diverted."

Tex. Const. art. XVI, §67(a)(1).

The Office notes, however, that the Texas Constitution specifically allows the Legislature to pass laws as necessary to provide for workers' compensation for state employees:

> "The Legislature shall have power to pass such laws as may be necessary to provide for Workers' Compensation Insurance for such State employees, as in its judgment is necessary or required; and to provide for the payment of all costs, charges, and premiums on such policies of insurance; providing the State shall never be required to purchase insurance for any employee."

Tex. Const. art. III, §59 (Added Nov. 3, 1936; amended Nov. 6, 2001).

Consistent with this constitutional authority, Texas Labor Code §412.0122 mandates that the state is self-insuring with respect to a state employee's compensable injury. Texas Labor Code §412.011 requires the Office to administer both the government employees workers' compensation insurance program and the state risk management program. Texas Labor Code §412.0121 provides that each state agency shall enter into an interagency contract with the Office to pay the cost incurred by the Office in administering Chapter 412 for the benefit of that state agency, and that the Board of Directors (Board) of the Office may by rule establish the formula for allocating the cost of Chapter 412 in such interagency contracts. Texas Labor Code §412.0123 requires the Office to establish an assessment program for the payment of workers' compensation claims and risk management services that are incurred by a state agency subject to Texas Labor Code Chapter 501 and provides that the Board has final authority to determine the assessments to be paid by the covered agencies.

For the purposes of workers' compensation, a state agency is defined in Texas Labor Code §412.001 as a board, commission, department, office, or other agency in the executive, judicial, or legislative branch of state government that has five or more employees, was created by the constitution or a statute of this state, and has authority not limited to a specific geographical portion of the state.

In Texas Labor Code §501.001(6), a state agency is defined as a department, board, commission, or institution of this state. Both ERS and TRS are state agencies. *Teacher Retirement System v. Duckworth*, 264 S.W. 2d 98 (Tex. 1954). See *Farrar v. Board of Trustees of Employees Retirement System*, 243 S.W. 2d 688 (Tex.1951). Cf. *Bolen v. Board of Firemen, Policemen and Fire Alarm Operators' Trustees*, 308 S.W. 2d 904 (Tex. Civ. App.--San Antonio 1957, writ ref'd); Op. Tex. Att'y. Gen. No. MW-276 (1980).

Since both ERS and TRS are state agencies subject to Chapters 412 and 501 of the Texas Labor Code and neither agency is excepted from participation in the government employees workers' compensation insurance program under Texas Labor Code §412.053 or any other provision, there is no indication the Legislature intended to except ERS and TRS from the same requirements as all other covered state agencies. Indeed, historically both ERS and TRS have been full participants in the state's self-insured program and have paid all amounts required by the Legislature prior to the enactment of H.B. 2976. The agencies' suggestions that it is unconstitutional to utilize any portion of non-GR funds to any agencies other than ERS or TRS and that the Legislature did not contemplate the effect of its legislation appear to be wholly unsupported. The Code Construction Act, found in Government Code §311.021, specifically provides that, in enacting a statute, it is presumed that:

(1) Compliance with the constitutions of this state and the United States is intended;

(2) The entire statute is intended to be effective;

(3) A just and reasonable result is intended;

(4) A result feasible of execution is intended; and

(5) Public interest is favored over any private interest.

Had the Legislature intended to exclude the ERS and TRS from either the definition of a state agency subject to the government employee workers' compensation insurance program or from the provision requiring that specific types of funds be used for the calculation and payment of assessments under the program, the Office respectfully submits that it would have done so.

Both agencies profess in the letters referenced herein the willingness to pay actual claims costs. This, however, is not an alternative or election authorized by the Legislature. First, Labor Code Chapter 412 mandates that the Office administer the government employee workers' compensation program, and to do so according to the specific provisions of that chapter, including the allocation program. Second, to provide for a reimbursement scheme specifically discontinued by the Legislature and make the agencies individually self-insured would expose ERS and TRS to large claim payouts and catastrophic losses. Third, excluding ERS and TRS from contributing to the risk pool on the same basis as all other state agencies as mandated by statute would increase costs to all other system

participants.

The Office notes that the claim of constitutional prohibition advanced by ERS and TRS would also prohibit those agencies from purchasing any insurance under a policy that included any other entities in the risk pool in addition to ERS or TRS; that is, premiums expended by ERS or TRS in a given year for which claims recoveries do not exceed the premium amount would be "diverted" under the agencies' rationale, as those funds would be expended on behalf of other policy holders in the form of payment of claims, or simply represent profit for the involved carrier.

The agencies' constitutional rationale is applied only to the instant case of the government employee workers' compensation insurance program mandated by the Labor Code and does not contemplate the logical consequences of the argument being advanced on such other forms of insurance purchases. Both ERS and TRS have represented to the Office that each obtains other insurance policy coverage for the protection of its members, whether for property or person, from dedicated funds. Should losses arise, recovery from such policies would confer a benefit upon their members. Should such losses not arise, the logical result of the ERS and TRS constitutional argument is that an unconstitutional "diversion" will have occurred. In essence, the constitutional argument then becomes relative to recoveries in a given year. For years in which payouts exceed premium, the premium payment is constitutional. For years in which payouts do not exceed premium, the premium payment is unconstitutional. This relative analysis is clearly not indicated by Tex. Const. art. XVI, §67(a)(1).

Even if this were the case, the statutorily-mandated government employee workers' compensation insurance program provides coverage for both existing and future work-related injury losses and provides protection via the risk pooling mechanism against catastrophic losses. The benefit of coverage is not relative to payout amounts.

CONCLUSION

The Office believes that ERS and TRS are not precluded by Tex. Const. art. XVI, §67(a)(1) from participation in the state employee workers' compensation program, including payment of workers' compensation assessments to, and as determined by, the Office under the authorities cited herein. ERS and TRS, as state agencies, are required to provide workers' compensation insurance to their employees under the formula required by Labor Code Chapter 412 and established by duly promulgated rules made applicable to those agencies pursuant to Tex. Const. art. III, §59 and Labor Code Chapter 501.

On behalf of the State Office of Risk Management, I respectfully ask that the Office of the Attorney General issue an opinion on the two issues as outlined in this request.

Sincerely,

Clarence R. Josselet, ARM, CPCU
EXECUTIVE DIRECTOR

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