



Montana Legislative Services Division
Legal Services Office

January 15, 2014

TO: Economic Affairs Interim Committee

FROM: Julie Johnson, Legal Services Office

RE: Old Fund Liability

The most recent estimates of the outstanding Old Fund liability range from \$50 million to \$85 million, with the last benefits to Old Fund claimants projected to accrue as late as 2052. There has been some discussion as to how the State can remove the Old Fund liability from its ledger sooner than the projected expiration date. This memo is intended to address issues regarding liability for the Old Fund and avenues for addressing or resolving the liability.

BRIEF BACKGROUND

The 1989 Legislature passed Senate Bill No. 428, which created the State Compensation Mutual Insurance Fund, known as the State Fund. In a May 1990 Special Session, the Legislature passed House Bill No. 2, which segregated the revenue sources for the two funds, providing that premiums paid for wages payable prior to July 1, 1990, would fund the "Old Fund" and that premiums paid for wages payable on or after that date would fund the "New Fund". § 39-71-2352, MCA.

Since the creation of the New Fund, however, several transfers of funds have occurred between the Old and New Funds as well as the general fund.¹ Section 39-71-2352, MCA, currently provides that if Old Fund assets are insufficient to pay claims for injuries arising before July 1, 1990, "any amount necessary to pay claims . . . must be transferred from the general fund" to the State Fund. Since the end of FY 2011, monies from the general fund have been transferred to the State Fund to satisfy Old Fund benefits pursuant to § 39-71-2352, MCA.

QUESTIONS PRESENTED AND SHORT ANSWERS

1. Who is liable for the Old Fund?

While current law expressly provides that all liabilities of the Old Fund were assumed by the

¹ For a thorough summary of these transfers and other funding mechanisms for the Old Fund from 1989-2007, see Kris Wilkinson's report on the Old Fund at: http://leg.mt.gov/content/publications/fiscal/interim/financecmty_dec2007/Workers_Comp_Old_Fund.pdf

State Fund when the Old and New Funds were created in 1990, current law also provides that if the Old Fund is inadequate to pay its claims for any given year, the amount necessary to pay those claims are transferred from the general fund to the State Fund to pay those claims.

Ultimate liability for paying on these statutorily provided benefits rests with the State. However, that does not mean that the Legislature cannot legislate the transfer of the Old Fund liability to the State Fund as proposed in the 2013 Session. However, as discussed below, any such lump-sum payment cannot guarantee that the specter of the "Old Fund" will never rise again. If the Old Fund liability mushrooms, as it has before, nothing precludes the Legislature from transferring additional general fund monies to the State Fund.

2. Is the Old Fund liability a "state debt"?

Not technically. However, even though the liability is not a "state debt" and was not approved by a two-thirds vote of the Legislature as set forth in the Montana Constitution, it is still a state liability. The benefits owed to claimants are contractual in nature, similar to pension benefits, and are a liability of the State whether or not enumerated as "state debt."

3. Could the Legislature appropriate funds to pay the State Fund or a third-party reinsurer a lump sum to completely extinguish any liability associated with the Old Fund?

While the Legislature could appropriate a lump sum for the explicit purpose of extinguishing any Old Fund liability from its ledger, there is no guarantee that such a payment would be the final payment on the Old Fund. If either the State Fund or the third-party reinsurer became insolvent, claimants would have ultimate recourse with the State. The State's recourse would be to attempt to enforce an indemnification provision with an insolvent entity.

4. Could the Legislature enter into a contract with either the State Fund or a third-party reinsurer to assume liability of the Old Fund?

Yes. However, for many of the same reasons identified in Question No. 3, there is no guarantee that such a contract would eliminate the State's liability.

LEGAL ANALYSIS

1. Who is liable for the Old Fund?

Section § 39-71-2319, MCA, provides:

All assets and funds held by the state compensation insurance fund established in former 39-71-2301, 39-71-2302, 39-71-2304 through 39-71-2306, and 39-71-2324 and 39-71-2321 through 39-71-2323, 39-71-2325 through 39-71-2327, 39-71-2336, 39-71-2339, and 39-71-2340 must be transferred to the

state fund, and the state fund shall assume liability for all outstanding claims and indebtedness of the previously existing state fund. (Emphasis added).

This statute was enacted in 1989 when the State Compensation Mutual Insurance Fund was created and has never been amended. While the language of the statute is clear and unambiguous, the assets of the Old Fund were transferred to the general fund and its liabilities are presently being paid with a transfer from the general fund as provided in § 39-71-2352(6), MCA, in subsequent years.

From 1990 until 1999, an Old Fund Liability Tax was assessed to Montana employers for the payments of bonds, loans, and other costs associated with the Old Fund. During that same time period several transfers were made from the New Fund to the Old Fund for the same purpose. When the Old Fund Liability Tax was repealed in 1999, it was anticipated that the corpus of the Old Fund would be sufficient to pay its future costs and that thus the Old Fund was adequately funded. In the Special Session of August 2002 and in the 2003 Session, the Legislature passed Senate Bill No. 19 and House Bill No. 363, respectively. Both bills transferred funds considered to be surplus funds from the Old Fund to the general fund, totaling \$27 million.

In the 2002 Special Session, the Legislature also amended § 39-71-2352, MCA, to provide that if Old Fund assets are insufficient to pay its claims, "any amount necessary to pay claims . . . must be transferred from the general fund" to the State Fund. Since the end of FY 2011, funds have been transferred from the general fund to the State Fund to pay for Old Fund benefits.

Despite the language of § 39-71-2319, MCA, that the State Fund is responsible for all liabilities of the previously existing state fund, referred to now as the Old Fund, the ultimate liability for Old Fund claims currently rests with the State. These claims are statutory benefits² that the Legislature offered prior to the creation of the State Compensation Mutual Insurance Fund in 1989.

Nevertheless, the Legislature still has the authority to enact legislation similar to that which was proposed in 2013, in Senate Bill No. 173, to transfer any and all of the State's liability to the State Fund for a lump-sum payment.³ However, it must be recognized that a lump-sum payment to the State Fund is not a guarantee that the Old Fund will not need to be revisited by future Legislatures. If the Old Fund liability mushrooms, the State Fund may argue the need to obtain additional funding given the constraints on raising premiums to pay for old liabilities outlined in § 39-71-2320, MCA. The Legislature may wish to appropriate funds to the State Fund to prevent a rate hike on small business. This will remain the Legislature's prerogative as long as

² Buckman v. Montana Deaconess Hosp., 224 Mont. 318, 325, 730 P.2d 380, 384 (1986).

³ In order to make this transfer of liability successful, §§ 39-71-2320 and 39-71-2352, MCA, should be amended to allow State Fund to spend premiums received for the New Fund in case the lump sum is insufficient to pay the Old Fund liabilities.

the State Fund remains under the control of the State.⁴

2. Is the Old Fund liability a "state debt"?

According to Article VIII, section 8, of the Montana Constitution "No state debt shall be created unless authorized by a two-thirds vote of the members of each house of the legislature or a majority of the electors voting thereon." This provision does not mean, however, that the State has no liability if there has not been a 2/3 vote to assume liability of the Old Fund. Similar to the State's defined benefits pension, whether its unfunded liability can simultaneously be defined as a "state debt" does not alter its status as a liability.

In 1987, Attorney General Mike Greely authored an opinion that specifically addressed whether the unfunded liability in the Industrial Insurance Expandable Trust Fund, now known as the Old Fund, constituted a "state debt" within the scope of Article VIII, section 8, of the Montana Constitution. 42 A.G. Op. 46 (1987). At the time, the fund's unfunded liability was estimated to be \$81 million and expected to not be able to meet its accruing benefit obligation by July of 1990. Attorney General Greely concluded that the unfunded liability was not "state debt" for two reasons. First, he opined that a "state debt" as contemplated under Article VIII, section 8, cannot be created by "unanticipated consequences of otherwise validly adopted legislation." Because the liability was not created by a "conscious act" of the Legislature, but rather due to "a mismatch between liability incurred and trust fund deposits" it was not "state debt." Id.

Secondly, because the fund was sufficient to pay anticipated claims during the current biennium, the Attorney General concluded that it was speculative to assume that the fund would not be able to pay anticipated claims for future biennia. Id. This opinion is controlling unless overruled by a District Court or the Supreme Court. § 2-15-501(7), MCA.

Regardless of whether the liability is considered "state debt" or not, the unfunded liability is a liability. In the same way that the pensions funds' unfunded liability may not qualify as state debt within the scope of Article VIII, section 8, it cannot be argued that this means that it is no less of a liability for the State. Again, while in both cases the unfunded liabilities did not arise from a "conscious act" of the Legislature, but rather due to "a mismatch between liability incurred and trust fund deposits", the unfunded liability of the Old Fund is a liability even if it is not a "state debt."

3. Could the Legislature appropriate funds to pay a lump sum to completely extinguish any liability associated with the Old Fund?

⁴ The Legislature cannot appropriate funds for a private corporation not under control of the state. Art. V, sec. 11(5), Mont. Const.

As it currently stands, the liability for the Old Fund will remain on the ledger until such time as all claimants under the Old Fund have stopped generating claims and collecting benefits under the Old Fund. The question of whether the State can appropriate a lump-sum to remove the liability on a permanent basis has been presented. One concept involves paying the State Fund a lump sum for it to assume the Old Fund liability in full. A second concept involves paying a third-party reinsurer to assume the liability. Such a transaction is referred to as a Loss Portfolio Transfer.

“The power to appropriate is a long established, well-recognized power of the legislature.” State ex rel. Judge v. Legislative Fin. Comm., 168 Mont. 470, 477, 543 P.2d 1317, 1321 (1975). Under §17-7-304, MCA, Montana law specifically provides that an appropriation of funds is good for only 2 years.⁵ Given that the discussions to date regarding a Loss Portfolio Transfer involve the payment of a lump sum, it seems that the Legislature could appropriate a lump sum to the State Fund for the purpose of it either accepting the State's remaining liability or obtaining reinsurance with a third party.

Regardless of whether paying the State Fund or a third-party reinsurer a lump sum to assume the State's liability for the Old Fund is financially prudent, the real question is whether such an assumption of liability would guarantee that the State's liability is actually dissolved and not subject to resurrection. Put another way, in the event either the State Fund or the third-party reinsurer became insolvent and unable to pay claims on the Old Fund, would the State still be liable for paying on Old Fund claims?

The answer is most likely yes. The Old Fund claims are statutory benefits, similar to pension benefits. Buckman v. Montana Deaconess Hosp., 224 Mont. 318, 325, 730 P.2d 380, 384 (1986).⁶ Article II, section 31, of the Montana Constitution prohibits the state from passing a law that impairs a contract. In Buckman, the Montana Supreme Court applied the U.S. Trust Co. case, *infra*, to the question of impairment of a contract regarding worker's compensation benefits.

The United States Supreme Court, in U.S. Trust Company of New York v. New Jersey, 431 U.S.

⁵ However, appropriations for capital projects (17-7-212), long-range information technology capital projects (2-17-560), and energy conservation projects (90-4-618) are reappropriated for the purposes of the original appropriation until the projects are completed.

⁶ "The liability of an employer to an injured or deceased employee arises out of the contract between them; the terms of the workmen's compensation statute are embodied in the contract. The substantive rights between the parties are determined by the law in effect on the date of the injury. However, the rights under the contract vest when the cause of action accrues, and the cause of action accrues on the date of injury or death." Buckman, citing Estate of Baker, 222 Kan. 127, 563 P.2d 431 (1977).

1 (1977), has held that a contract impairment will be held unconstitutional if: (1) the impairment is a substantial impairment; and (2) the government enacting impairing legislation does not first at least seriously consider nonimpairing or lesser impairing legislation. In Buckman, the Montana Supreme Court concluded that not letting a claimant receive a lump-sum settlement instead of a monthly benefit impaired the claimant's contract rights. Were the State Fund or a third-party reinsurer to become insolvent and not able to pay the claimant his or her statutory benefits under the Old Fund, the State most likely would have to pay those claims. The State's recourse would be to try to enforce the contractual indemnification provisions against the insolvent entity.

4. Could the Legislature enter into a contract with either the State Fund or a third-party reinsurer to assume liability of the Old Fund?

There is nothing in law that prohibits the State from entering into a contract with the State Fund or a third-party reinsurer to assume complete liability for the Old Fund. However, as discussed in Question No. 3, there is no guarantee that any contract would completely extinguish the State's liability.

CONCLUSION

This memo is not exhaustive in terms of analyzing the most effective and palatable ways in which to address the Old Fund liability. I am happy to research and analyze other concepts as they arise.

If you have any additional questions, do not hesitate to contact me.