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OPINION COMMITTEE

November 29, 2007

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Via Hand Delivery

The Honorable Greg Abbott  
Attorney General of Texas  
c/o Opinion Committee  
Office of the Attorney General  
Price Daniel, Sr. Building  
209 West 14th Street  
Austin, Texas 78701

FILE # ML-45468-07

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**EMPLOYEES  
RETIREMENT  
SYSTEM OF TEXAS**

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Re: Request for Attorney General's Opinion

Dear General Abbott:

The Employees Retirement System of Texas ("ERS") respectfully submits the following formal request for your legal opinion interpreting Texas Law.

**Background**

**The Role of ERS in this Question**

Texas Government Code Chapter 606 authorizes the state of Texas to enter into agreements with the federal government for social security coverage for employees of state and political subdivisions.

§ 606.003. AGREEMENTS WITH SECRETARY. (a) The retirement system may enter into agreements with the secretary to obtain social security coverage for employees of the state or a political subdivision.

(b) An agreement between the retirement system and the secretary may contain any appropriate provision, including a provision relating to coverage, benefits, contributions, effective date, modification, and administration.

The Executive Director of ERS, the retirement system referred to in Chapter 606, is authorized to direct and administer this process for the state:

§ 606.002. ADMINISTRATION OF CHAPTER. The executive director of the retirement system shall direct and administer the functions of the retirement system under this chapter.

Additionally, an ERS employee, Carolyn Fry, has been named by the governor as the State Social Security Administrator. A copy of her appointment letter from Governor Rick Perry is attached hereto as Exhibit No. 1. Such an appointment is authorized under federal law in § 218(d) of the Social Security Act, 42 U.S.C. § 418(d). All 50 states have similarly named State Social Security Administrators, and the federal Social Security Administration ("SSA") has recognized Carolyn Fry as the State Social Security Administrator for the state of Texas. A copy of the SSA's letter is attached hereto as Exhibit No. 2.

The Code of Federal Regulations, in implementing 42 U.S.C. § 418(d), states:

(a) Each State which enters into an agreement shall designate the official or officials authorized to act on the State's behalf in administering the agreement. Each State shall inform SSA of the name, title, and address of the designated official(s) and the extent of each official's authority. For example, a State may indicate that the State official is authorized:

- (1) To enter into an agreement and execute modifications to the agreement; and
- (2) To carry out the ministerial duties necessary to administer the agreement.

The various State Social Security Administrators have formed a National Conference of State Social Security Administrators ("NCSSSA") which has issued a handbook containing recommended practices for its members. A copy is attached hereto as Exhibit No. 3.

### Section 218 Agreements

A Section 218 Agreement is a voluntary agreement between a state of the United States and the SSA to provide Social Security and Medicare Hospital Insurance ("HI") or Medicare HI-only coverage for state and local government employees (Note that Medicare HI is mandatory for employees hired after 1986). These agreements are called "Section 218 Agreements" because they are authorized by Section 218 of the Social Security Act (even though that law is now codified as 42 U.S.C. § 418). Section 218 Agreements are irrevocable. All states, including the 50 states, Puerto Rico, the Virgin Islands, and approximately 60 interstate instrumentalities, have a Section 218 Agreement with the SSA. The state of Texas has had a Section 218 Agreement since the early 1950s, a copy of which is attached hereto as Exhibit No. 4. Section 218 Agreements cover positions, not individuals. If the position is covered for Social Security and Medicare under a Section 218 Agreement, then any employee filling that position is subject to Social Security and Medicare taxes. Public employees are brought under a Section 218 Agreement in groups known as coverage groups. A retirement system coverage group is composed of employees whose positions are covered under a public retirement system. The state of Texas Section 218 Agreement has been modified over 1,400 times to add coverage groups.

A governmental entity whose employees are covered by a public retirement system may be covered under a Section 218 Agreement only after a referendum is held. All states are authorized to use the majority vote referendum process. If a majority of all the eligible employees in the governmental entity vote in favor of coverage, all current and future employees in positions at the governmental entity will be covered.

In addition to the majority vote referendum procedure, certain states (including Texas) and all interstate instrumentalities are authorized to divide a retirement system based on whether the employees in positions under the retirement system want coverage. Under the divided vote referendum, only those employees who vote "yes" and all future employment positions will be covered (although excluding any as mandated by federal law). Members who vote "no" are not covered as long as they maintain continuous employment in a position with that employer. Although the referendum itself is a state matter, Section 218 of the Act requires that certain conditions be met.

### Charter Schools

Texas Education Code Chapter 12 provides the statutory basis for charter schools in Texas. There are four basic types of charter schools authorized by Chapter 12. The classes of charter include: (1) a home-rule school district charter (Subchapter B); (2) a campus or campus program charter

(Subchapter C); (3) an open-enrollment charter (Subchapter D) and (4) a college or university charter school run by a public senior college or university (Subchapter E). For purposes of this request, we will focus on open enrollment charter schools. The State Board of Education is authorized to grant charters to open enrollment charter schools. Texas Education Code § 12.101 states:

§ 12.101. AUTHORIZATION. (a) In accordance with this subchapter, the State Board of Education may grant a charter on the application of an eligible entity for an open-enrollment charter school to operate in a facility of a commercial or nonprofit entity, an eligible entity, or a school district, including a home-rule school district. In this subsection, "eligible entity" means:

- (1) an institution of higher education as defined under Section 61.003;
- (2) a private or independent institution of higher education as defined under Section 61.003;
- (3) an organization that is exempt from taxation under Section 501(c)(3), Internal Revenue Code of 1986 (26 U.S.C. Section 501(c)(3)); or
- (4) a governmental entity.

Open enrollment charter schools have many characteristics similar to that of public schools. In fact, Texas Education Code § 12.105 states:

§ 12.105. STATUS. An open-enrollment charter school is part of the public school system of this state.

The charter schools have immunity from liability for matters related to their operation. Texas Education Code § 12.1056 states:

§ 12.1056. IMMUNITY FROM LIABILITY. In matters related to operation of an open-enrollment charter school, an open-enrollment charter school is immune from liability to the same extent as a school district, and its employees and volunteers are immune from liability to the same extent as school district employees and volunteers. A member of the governing body of an open-enrollment charter school or of a charter holder is immune from liability to the same extent as a school district trustee.

The open enrollment charter schools are subject to state nepotism laws (§ 12.1055); their board and officers are considered to be local public officials for purposes of Chapter 171 of the Local Government Code (§ 12.1054); they are considered to be a governmental entity for purposes of Subchapter D, Chapter 2252, Government Code and Subchapter B, Chapter 271, Local Government Code; and they are considered a political subdivision for purposes of Subchapter A, Chapter 2254, Government Code (§ 12.1053). With regard to governmental records, an open-enrollment charter school is considered to be a local governmental entity for purposes of Subtitle C, Title 6, Local Government Code, and Subchapter J, Chapter 441, Government Code (§ 12.1052). Public information laws and open meetings laws apply to open enrollment charter schools to the same extent as any governmental body for purposes of Chapters 551 and 552, Government Code (§ 12.1051). The open enrollment charter schools receive state funding pursuant to §12.106.

It is also very significant, for purposes of the SSA, that the employees of open enrollment charter schools operating under a charter granted by the State Board of Education qualify for membership in

the Teacher Retirement System of Texas ("TRS"). They are covered under TRS to the same extent that a qualified employee of a school district is covered. TRS is considered a governmental retirement plan. In addition, as described more fully below, at least one charter school withholds Federal Insurance Contributions Act ("FICA") and Medicare taxes from the wages of its employees in the same manner as private sector and some governmental employers do.

### **Government Pension Offset**

The Government Pension Offset ("GPO") is a provision in Social Security law that can reduce or eliminate the Social Security benefit for spouses, divorced spouses, and surviving spouses who also receive a pension based on their own work for federal, state or local government that was not covered by Social Security. The GPO initially became law in 1983. Under Social Security law, an individual may receive Social Security benefits by working the required number of years to be eligible to receive a *worker* benefit based on his/her own work record, or one may be eligible for Social Security benefits by being married to a *worker*, thus becoming entitled to a *spousal* benefit that is 50 percent of the *worker's* benefit amount. When an individual is eligible for benefits *both as a worker and as a spouse*, he or she receives the highest benefit amount to which he or she is entitled. Under the GPO, the amount of a spouse's, divorced spouse's, or widow/widower's Social Security benefit is reduced by two-thirds of the amount that individual earns from his or her own government pension.

Before the passage of the Social Security Protection Act of 2004, the GPO focused on whether or not the governmental employee was working in a position covered by Social Security and looked to the last employment that the person had in government. This apparently led to a practice in connection with the GPO known as the "last day covered employment exemption." Governmental employees could work a long career in positions exempt from Social Security coverage and then transfer to or obtain a job at a governmental employer covered by Social Security, even if only for a day or so, but immediately before retiring. This would then allow them to avoid the GPO entirely. Such a practice apparently became so commonplace that many school districts and other governmental employers who were covered by Social Security began "selling" short-term jobs to governmental employees for a fee. Eventually, there was an investigation of this practice by the SSA and other designated federal officials. Although they generally concluded the practice may be legal in most instances, recommendations were made that the "last day covered employment exemption" be eliminated by law. See, for example the report by the General Accounting Office to the Chairman of the Subcommittee on Social Security, Committee on Ways and Means, U.S. House of Representatives, which said the exemption raised "fairness and equity" concerns. See, also, a similar report for Congress by the Congressional Research Service, dated July 6, 2004. A copy of each report is attached hereto as Exhibit No. 5. As a result, Congress passed H.R. 743, the "Social Security Protection Act of 2004," on February 11, 2004, and it was signed into law by the President on March 2, 2004 (P.L. 108-203). The new GPO provision became effective for Social Security spousal benefit applications filed after March 31, 2004. The law contains a provision that eliminates the "last day covered employment exemption" to the GPO. Now, the law requires that the last 60 months of a person's government employment before retirement must be covered by Social Security and the pension system in order to avoid reduction under the GPO.

### **John H. Woods, Jr. Charter School**

The John H. Woods, Jr. Charter School ("JHW Charter School") is an open enrollment charter school under Subchapter D of Chapter 12 of the Texas Education Code. The school made application for a charter to the Texas State Board of Education and received a charter. Its employees participate in TRS. Copies of relevant documents from the State Board of Education are attached as Exhibit No. 6,

including the application, charter, and governing documents for the school. Also attached as Exhibit No. 7 is a letter from the Commissioner of Education expressing an opinion on this subject.

Based on information that ERS has received in connection with this matter, it appears that during the period of time before March 31, 2004, before the "last day covered employment exemption" was eliminated, the JHW Charter School may have employed many teachers and other school district employees for a single day, charging them a fee. Wages were apparently paid and FICA and Medicare taxes were withheld and remitted to the SSA.

The JHW Charter School is not currently covered by the state of Texas Section 218 Agreement with the SSA. If the JHW Charter School is a governmental entity, it may be possible to hold a referendum and submit a modification of the state of Texas Section 218 Agreement to the SSA so that the JHW Charter School would be so covered. As it is understood that FICA and Medicare taxes have been paid on behalf of the employees for that time period, it may be possible to retroactively cover many of the affected employees, if the JHW Charter School is a governmental entity. If the JHW Charter School is not a governmental entity, FICA and Medicare taxes would have been due in the same manner that is required from any other non-governmental employer. But only if the FICA and Medicare taxes are paid by a governmental entity pursuant to a Section 218 Agreement is it useful for the "last day covered employment exemption" under prior law. Therefore, it is not a question of whether FICA and Medicare taxes have or should have been paid; rather, it matters whether the FICA and Medicare taxes were paid as a private entity or as a governmental entity.

The JHW Charter School submitted a Private Letter Ruling Request ("PLRR") to the Internal Revenue Service ("IRS") in connection with this matter. A memorandum regarding this issue prepared by Padgett, Stratemann, & Co. L.L.P., the Certified Public Accountants for the JHW Charter School, is attached hereto as Exhibit No. 8, and it is useful to understand many of the reasons that the school sets forth as reasons it should be considered a governmental entity. The exhibits attached have also been highlighted to show you other relevant information that you may find useful in rendering an opinion in this matter.

The IRS considered the PLRR for a period of time and declined to answer it on the basis that it believed the SSA had jurisdiction. The JHW Charter School then asked the SSA to make a determination of its status as a governmental entity. The SSA considered the issue for some time, but told the JHW Charter School that it believed the issue turned on state law (see letter from Ms. Ramona J. Schuenemeyer, Regional Commissioner, Social Security Administration, to the school, attached hereto as Exhibit No. 9). Thereafter, the JHW Charter School approached ERS regarding the issue. I understand that this is the first time the SSA has requested an opinion of state law from ERS in connection with ERS' administration of the state Social Security program. ERS asked the SSA directly whether it desired the state to make a determination or not as to the governmental entity status of the JHW Charter School, and ERS was told that it was a state of Texas decision to determine, under Texas law, whether the JHW Charter School was a political subdivision or instrumentality of Texas (see letter from ERS to the SSA, dated April 18, 2007, attached hereto as Exhibit No. 10; see also the following correspondence between ERS and the SSA: letter from the SSA to ERS, dated May 2, 2007, attached hereto as Exhibit No. 11; letter from ERS to the SSA, dated August 24, 2007, asking for a clarification, attached hereto as Exhibit No. 12; requested clarification thereof from the SSA to ERS, dated September 14, 2007, attached hereto as Exhibit No. 13). ERS determined that neither it nor Carolyn Fry, under her appointment by Governor Perry, had statutory authority to make such a determination on behalf of the state.

The Attorney General is authorized to make legal determinations regarding state law, and ERS now asks for this legal opinion on the question presented with regard to the law of the state of Texas. The SSA has informally indicated that it has previously accepted the determinations of other state

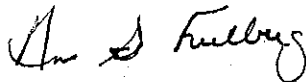
Attorneys General when presented with questions or issues about state law. See for example, the Memorandum from Mary E. Smith, Director of the Tennessee OASI Agency, attached hereto as Exhibit No. 14. The following questions of state law are important because if the JHW Charter School is a governmental entity under the laws of the state of Texas, such as a political subdivision or an instrumentality of the state, then it is possible for the school and other similarly situated charter schools to submit to a referendum process, and assuming the referendum passes, the state of Texas can propose a modification to the SSA to cover eligible employees and former employees at the school. If the JHW Charter School is not a governmental entity under the laws of the state of Texas, then it is not eligible to be covered under a Section 218 Agreement.

### Questions Presented

- (1) Is an open enrollment charter school created under Subchapter D of Chapter 12 of the Texas Education Code, like the John H. Woods, Jr. Charter School, considered to be an eligible entity under Chapter 606 of the Texas Government Code for the state to enter into agreements with the Social Security Administration to obtain social security coverage for the entity's employees?
- (2) Is an open enrollment charter school created under Subchapter D of Chapter 12 of the Texas Education Code, like the John H. Woods, Jr. Charter School, considered under Texas law to be a governmental entity (i.e., political subdivision or other instrumentality of the state of Texas or of another political subdivision)?
- (3) For each of the above questions that are answered affirmatively, what is the effective date of John H. Woods, Jr. Charter School's attaining that status?

Please let me know if you would like me to provide any additional information.

Sincerely,



ANN S. FUELBERG  
Executive Director

Enclosures

cc (without enclosures):

- Ms. Paula A. Jones, General Counsel, Employees Retirement System of Texas
- Ms. Carolyn Fry, State Social Security Administrator
- Mr. David Cabrales, General Counsel, Office of the Governor of Texas
- Ms. Conni Brennan, General Counsel, Teacher Retirement System of Texas,  
1000 Red River, Austin, Texas 78701
- Mr. David A. Anderson, General Counsel, Texas Education Agency,  
1701 North Congress Ave., Austin, Texas 78701
- Mr. Thomas Crawley, General Counsel, Social Security Administration,  
6401 Security Boulevard, Altmeyer Building, Suite 600, Baltimore, Maryland 21235
- Ms. Ramona J. Schuenemeyer, Regional Commissioner, Social Security  
Administration, 1301 Young Street, Dallas Texas 75202
- Mr. Robert Wilson, Deputy Commissioner for Legislation and Congressional  
Affairs, Social Security Administration, 500 E. SW, Suite 800, Washington, D.C. 20254
- Mr. David A. Rusk, Acting Deputy Commissioner, Social Security  
Administration, 6401 Security Boulevard, Baltimore, Maryland 21235

The Honorable Greg Abbott

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