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NO.
STATE OF NEBRASKA
OFFICIAL
JUN 6 1994
DEPT. OF JUSTICE

DATE: May 24, 1994

SUBJECT: Constitutional Prohibitions and Legislative Authority for Government Subdivisions to Join Risk Retention Groups

REQUESTED BY: Senator Chris Beutler
Legislative District 28

WRITTEN BY: Don Stenberg, Attorney General
Fredrick F. Neid, Assistant Attorney General

This is in response to the series of legal questions you have asked on behalf of the Lincoln Electric System ("LES") related to the "authority under the Constitution and laws of the State of Nebraska" for governmental subdivisions to participate in risk retention groups. Generally, it is our conclusion that LES may not lawfully enter into the Electric Public Power Insurance Consortium, Risk Retention Group ("Consortium") due to lack of clear and definitive statutory authority and due to constitutional constraints.

At the outset, we point out that this Office does not represent LES nor local political subdivisions and this Office has declined to respond to opinion requests on behalf of constituents for that reason. We address the questions you raise only because you have indicated that remedial legislation is contemplated. The constitutional issues you raise are complex and further complicated due to the mixed public and private nature of the Consortium intended to qualify as a risk retention group under the Federal Liability Risk Retention Act of 1986. Accordingly, LES necessarily should ascertain the nature of the ownership interests it will obtain through membership in the Consortium. The information

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supplied to us does not sufficiently reflect the interests derived from membership. Our analysis assumes that ownership interests in private corporations or associations are a consequence of membership in the Consortium. More specific analysis and conclusions are set forth below.

I. LES AND THE CONSORTIUM

LES is a municipal electric utility administered by the Lincoln Electric System Administrative Board established under the Charter of the City of Lincoln, Nebraska. For purposes of this analysis, LES is viewed as an adjunct of the City of Lincoln in the nature of a utilities department or other subdivision of the City. Under its Charter provisions, the City has "the power to join with other political or governmental subdivisions, agencies, or public corporations, whether federal, state or local, or with any number or combination thereof, . . . as may be permitted by the laws of the State of Nebraska, in the joint ownership, operation, or performance of any property, facility, power or function. . . . " *See* Art. II, Sec. 5, City Charter of Lincoln.

The Electric Public Power Consortium is in its formative stages and is being created as a public power owned and controlled insurance facility to provide long-term excess liability and public official's liability insurance for its insureds. It is intended that the members be various public electric power entities who participate and become members in the Consortium by subscription. (Questions and Answers, Electric Public Power Insurance Consortium, P.1). A stated purpose and objective of the Consortium is set forth in its proposed rules and regulations. Article 1, Section 1.3 of the rules and regulations in part provides that the Consortium's purpose is to insure its members as a reciprocal risk retention group under the provisions of Chapter 431, Article 19, and Chapter 431 K, Hawaii Revised Statutes; and to take any actions necessary to qualify as a risk retention group under the Federal Liability Risk Retention Act of 1986, 15 U.S.C. § 3901 to § 3906.

The Federal Liability Risk Retention Act permits risk retention groups to provide all forms of liability insurance. A risk retention group is essentially a captive insurance company owned by its members with similarities to group self-insurance programs. Under the Federal Act, membership is limited to those engaged in business activities having similar or related liability exposure. The capitalization requirements are to be met by member contributions and the members must also pay premiums for the insurance coverages provided by the risk retention group.

The Consortium, as a reciprocal insurance exchange, is planned to be an unincorporated entity. The day to day operations of the Consortium will be managed by an Attorney-in-Fact, Risk Cap Management Group, Inc. The corporate Attorney-in-Fact is a joint venture of Risk Management Group, Inc. of Charlotte, North Carolina, and Risk Cap, Inc. of Denver Colorado. The Board of Governors of the Consortium shall consist of officials of public power companies that are charter members of the Consortium. Initial capitalization of the Consortium will be raised through issuance of $75 million of debt instruments through sale of taxable commercial paper by a separate corporate entity, the Electric Public Power Insurance Consortium Financing Corporation, supported by members of the Consortium. This corporate entity is to be a non-profit corporation organized under the laws of the State of California. Questions and Answers, Electric Public Power Insurance Consortium, PP. 3-10.

II. CONSTITUTIONAL ISSUES

A. Article XIII, Section 3 of the Nebraska Constitution.

The first specific question you ask is whether the participation of LES in the Consortium would violate Article XIII, Section 3 of the Constitution of the State of Nebraska. This constitutional provision prohibits the giving or lending of the credit of the State "in aid of any individual, association, or corporation, ..." We believe that participation of LES in the Consortium would constitute the extension of credit and would likely violate this constitutional prohibition.

The purpose of the constitutional prohibition is to prevent the state, or any of its governmental subdivisions, from extending the state's credit to private enterprise. ***Chase v. County of Douglas***, 195 Neb. 838, 241 N.W.2d 334 (1976); ***Cosentino v. City of Omaha***, 186 Neb. 407, 183 N.W.2d 475 (1971). From the information furnished, it appears that participation of LES in the Consortium would require the lending of credit to the Consortium since capitalization for its operation will be obtained from issuance of bonds or other debt instruments supported by members of the Consortium. Membership necessarily requires the lending of credit by members through securing the repayment of obligations and debt instruments issued by the private corporation, the Electric Public Power Insurance Consortium Financing Corporation. The capitalization will serve to finance day to day operations and surplus reserves of the Consortium to be managed by a private corporation, Risk Cap Management Group, Inc.

The fact that bonds or debt instruments are issued by a private corporation is not solely determinative of whether the constitutional prohibition is violated. The determinative questions are whether a public purpose is served and whether the credit of the state is loaned or given in aid of any individual, association, or corporation. The prohibition is not offended if the actions serve a public purpose and the state's credit is not extended to private enterprise. ***See United Community Services v. The Omaha Nat. Bank***, 162 Neb. 786, 77 N.W.2d 576 (1956). What constitutes a public purpose is in the first instance for the Legislature to determine and no hard and fast rule can be laid down for determining whether a proposed expenditure of public funds is valid as devoted to a public use or purpose. ***Lenstrom v. Thorne***, 209 Neb. 783, 311 N.W.2d 884 (1981); ***State ex rel. Douglas v. Nebraska Mortgage Finance Fund***, 204 Neb. 445, 283 N.W.2d 12 (1979). Accordingly, the fact that private entities are part of the Consortium does not in and of itself offend the constitutional prohibition regarding the extension of credit for the benefit of private enterprise.

It may be contended that the participation of LES in the Consortium would serve some public purpose in the sense that lower insurance costs of the public utility would benefit and serve the public interest. The fact that a public purpose may be served, however, is not dispositive of this issue. The Nebraska Supreme Court observed that whether or not a public purpose is served is not determinative of whether Article XIII, Section 3 is offended. In ***Haman v. Marsh***, 237 Neb. 699, 467 N.W.2d 836 (1991), the Nebraska Supreme Court concluded that the purpose of the constitutional provision is to prevent the state, or any of its governmental subdivisions, from extending the state's credit to private enterprise by acting as a surety or guarantor of the debt of another. The Court held that the state is not empowered to become a surety or guarantor of another's debts.

The same rationale was applied in the earlier case of ***State ex rel. Beck v. City of York***, 164 Neb. 223, 82 N.W.2d 269 (1957). In this case, the City of York, Nebraska, sought to purchase certain industrial buildings through issuance of revenue bonds by the City for economic development purposes. The Nebraska Supreme Court acknowledged that the facilities would be of material benefit to the growth and prosperity of the municipality but, that our organic law prohibits the expenditure of public money for the purpose of acquiring property for the benefit of a private concern.

While some public purpose may be accomplished through membership of LES in the Consortium, it cannot be overlooked that

the Consortium is dominated by private interests. That is, the Consortium includes private corporations, the Attorney-in-fact is a private management company and the financing entity is a private corporation. We believe these private entities will substantially benefit from financing arrangements that will be supported by extension of the state's credit. Essentially, the Consortium is a captive insurance company to be operated by private companies and individuals. Capitalization and income in the form of premiums will be derived from public monies resulting in significant benefit to private interests. In applying the rationale of ***Haman v. Marsh*** and ***State ex rel. Beck*** cases to known facts, we believe a strong legal argument exists that membership in the Consortium would be violative of the constitutional prohibition regarding the lending of the state's credit to private enterprise.

B. Article XI, Section 1 of the Nebraska Constitution.

You next inquire whether the participation of LES in the Consortium would violate the constitutional provision prohibiting investment in private corporations and associations. Article XI, Section 1 of the Nebraska Constitution provides, "No city, county, town, precinct, municipality, or other sub-division of the state, shall ever become a subscriber to the capital stock, or owner of such stock, or any portion or interest therein of any railroad, or private corporation, or association." (Emphasis supplied.) It is our opinion that membership in the Consortium by a governmental subdivision would offend this constitutional provision.

The primary question to be resolved is whether a government subdivision which assumes the obligations and interests of a subscriber would own an interest in the Consortium that is violative of Article XI, Section 1. This issue is somewhat obscured by the fact that the type of ownership or equity interest obtained by a subscriber cannot be readily ascertained. While the Consortium is not itself a corporation, each subscriber shall participate in the collective profits and also assume additional contingent liability for assessments to meet unexpected obligations and to maintain surplus reserves. Consequently, it appears that subscribers have an ownership interest to the extent of their participation in the Consortium as well as interests in other private corporate entities owned and controlled by the Consortium. The constitutional prohibition applies to ownership of any interest in private associations.

In ***Nebraska League of S & L Assn's. v. Mathes***, 201 Neb. 122, 266 N.W.2d 720 (1978), the issue regarding whether a deposit of

public funds in mutual savings and loan associations would violate the prohibition of Article XI, Section 1, was addressed. In determining that deposit of funds by government subdivisions was constitutionally prohibited, the Nebraska Supreme Court found no distinction between ownership represented by a stock certificate or by some other form of ownership. The Court commented that, "The constitutionally prohibited acquisition of any interest applies to any interest in private associations, which ordinarily issue no capital stock, to the same extent as it does to corporations which issue capital stock." *Id.* at 130, 266 N.W.2d at 724. ***Also see Nebraska League of Savings & Loan Assn's. v. Johnson***, 215 Neb. 19, 337 N.W.2d 114 (1983).[1] Thus, the fact that the corporate entities owned and controlled by the Consortium do not issue stock or other indicia of ownership is not controlling. The significant factor is whether the members would acquire an ownership interest in some form to the private corporate entities as a result of membership in the Consortium.

In a case having similar facts to the LES membership question, ***Omaha Pub. Power Dist. v. Nuclear Elec. Ins. Ltd.***, 229 Neb. 740, 428 N.W.2d 895 (1988), the Nebraska Supreme Court dismissed a declaratory judgment action for lack of appropriate parties. The declaratory ruling was sought to determine constitutionality of the Omaha Public Power District's membership in a mutual insurance company. The Power District desired membership to comply with requirements of a federal Nuclear Regulatory Commission amendment to increase their nuclear liability insurance. The constitutional issue was not addressed in the Supreme Court proceedings but the issue was addressed by the District Court of Lancaster County. The District Court concluded that membership in the mutual insurance concern, Nuclear Electric Insurance Limited, constituted an ownership interest since non-voting members acquired certain indicia of ownership including financing rights and other interests in the company. The District Court applied the precedent of the ***Mathes*** and ***Johnson*** cases and held that Article XI, Section I, precluded the power districts, as political subdivisions, from

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[1]In ***Nebraska League of Savings & Loan Assn's.***, Nebraska savings and loan associations attempted to avoid constitutional prohibition by waiver of any voting and other membership rights by depositor political subdivisions. The Nebraska Supreme Court concluded that the waiver was ineffectual and beyond the powers conferred upon mutual savings and loan associations and beyond the powers granted by the legislature to political subdivisions of this state.

obtaining the insurance coverage through membership in Nuclear Electric Insurance Limited.

It appears that members of the Consortium would acquire ownership interests including voting rights similar to that of a mutual insurance company by membership. The second issue is whether the Consortium is a public or private association or corporation. The Consortium has elements of both. The insurance operations are to be conducted by an Attorney-in-Fact, and financing efforts will be conducted by a subsidiary. These entities are private corporations owned and controlled by the Consortium. Membership in the risk Retention Group would be constitutionally prohibited if LES would obtain ownership interests, including governance and voting rights, sharing of profits and losses, and any other interests as a result of ownership and control of private corporations by the Consortium.

III. LEGISLATIVE ENACTMENTS

A. Intergovernmental Risk Management Act.

The third question you ask is whether the Intergovernmental Risk Management Act, Neb. Rev. Stat. §§ 44-4301 to 44-4339 (1988, Cum. Supp. 1992, and Supp. 1993), authorizes LES to participate in the Consortium. For reasons that follow, we do not believe the Intergovernmental Risk Management Act ("Act") provides sufficient authority for LES to become a member of the Consortium.

In summary, the Act authorizes public agencies to enter into agreements for joint and cooperative action and become members of, or operate a risk management pool to provide members management services and insurance coverages described in Neb. Rev. Stat. § 44-4304 (1988). Other provisions of the Act provide that all bonds of a risk management pool are declared to be issued for an essential, public and governmental purpose; and that the State of Nebraska pledges and agrees with the holders of any bonds and with contracting parties that the state will not alter, impair or limit vested rights. *See* Neb. Rev. Stat. §§ 44-4337 and 44-4338 (1988).

Although LES is a public agency as that term is defined in the Act, public electric power companies of other states are not. By definition, the Act limits formation of risk management pools to

political subdivisions of this state.[2] Consequently, the Act does not serve as authorization for a government subdivision of this state to join with public power companies of other states to form risk retention groups having private corporate interests. Further, the Act requires that a risk management pool not provide any insurance coverage to members until specific requirements are complied with. Neb. Rev. Stat. § 44-4307 (Supp. 1993) states:

> 44-4307. **Certificate of authority; issuance; fee.** (1) A risk management pool shall not provide any form of group self-insurance to its members until it has received a certificate of authority to do so from the Department of Insurance. Such certificate shall expire on the last day of April in each year and shall be renewed annually thereafter if the risk management pool has continued to comply with the Intergovernmental Risk Management Act and the rules and regulations of the Department of Insurance adopted and promulgated thereunder.
> (2) The Department of Insurance shall issue a certificate of authority to a risk management pool if the Director of Insurance determines:
> (a) That the pool's financial plan and plan of management and any amendments thereto satisfy the requirements of section 44-4306;
> (b) That the pool has adequate surplus and reserves and will receive adequate financial contributions from its members in order to operate in a manner which is not hazardous to the public; and
> (c) That any individual, corporation, partnership, limited liability company, or other entity engaged by the pool to provide services in connection with its management or operation is capable of running the affairs of the pool, is of good character and known business ability, and has a practical knowledge of the executive duties of conducting a risk management pool.
> (3) The filing fee for a certificate of authority issued pursuant to the Intergovernmental Risk Management Act shall be one thousand dollars.

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[2]The term "public agency" is defined in Neb. Rev. Stat. § 44-4303 (1988) to mean "... any public power district, rural fire district, or other political subdivision of this State, the State of Nebraska, the University of Nebraska, and any corporation whose primary function is to act as an instrumentality or agency of the State of Nebraska." (Emphasis supplied).

It is not known whether the Consortium would have any intention of meeting the statutory requirements of Section 44-4307 and thereby obtain a certificate of authority from the Nebraska Department of Insurance. If the Act is intended to serve as authority for participation in the Consortium, then all provisions and requirements of the Act including obtaining a certificate of authority would need to be complied with.

B. Interlocal Cooperation Act.

You further inquire whether the Interlocal Cooperation Act, Neb. Rev. Stat. §§ 13-801 to 13-827 (1991) authorizes membership in the Consortium. We do not think this Act authorizes LES to participate in the Consortium.

The Act in general terms authorizes public agencies to jointly act with other public agencies of this state, other states, and of the United States in exercise of their mutual powers. Section 13-808 of the Act authorizes a joint entity to issue bonds for the specific purpose or purposes for which the joint entity was created. While the Act authorizes joint ventures and agreements for exercise of powers of public agencies, it cannot serve to add to or increase existing powers. As the Nebraska Supreme Court has often observed, political subdivisions are purely entities of legislative creation. Government subdivisions do not exist independent of some action of the legislative department of government bringing them into being. ***Nebraska League of S & L Assn's v. Johnson***, 215 Neb. 19; ***Garver v. City of Humboldt***, 120 Neb. 132, 231 N.W. 699 (1930). Traditionally, Nebraska has strictly construed authority granted to political subdivisions. ***See Metropolitan Utilities Dist. v. City of Omaha***, 171 Neb. 609, 107 N.W.2d 397 (1961). Unlike natural persons, they can exercise no power except as has been expressly delegated to them, or such as may be inferred from some express delegation of power essential to give effect to that power.

In any event, the Act necessarily must be construed consistent with constitutional requirement by what the law authorizes to be done; and, it is assumed that the legislature intended a valid result rather than one in conflict with the Constitution. ***Wilson v. Marsh***, 162 Neb. 237, 75 N.W.2d 723 (1956). Accordingly, we conclude that the Act does not provide LES with the power to enter into an insurance consortium providing ownership rights and interests in private associations.

C. Joint Public Power Authority Act.

The Joint Public Power Authority Act, Neb. Rev. Stat. §§ 70-1401 to 70-1423 (1990) authorizes public power districts organized under the Public Power and Irrigation Act, Neb. Rev. Stat. §§ 70-601 to 70-681 (1990, Cum. Supp. 1992, and Supp. 1993) to jointly finance, develop, own, and operate electric generation and transmission facilities and ethanol production and distribution facilities. You inquire whether the Joint Public Power Act authorizes LES to participate in the insurance consortium. After review, we conclude that the ACT has no application to LES and does not authorize a municipal elective utility to participate in a risk retention group.

The Act authorizes public power districts organized under the Public Power and Irrigation Act to engage in certain described joint projects. LES, in the first instance, is not a public power district organized under the Public Power and Irrigation Act. Rather, the municipal utility is established under the Charter of the City of Lincoln. Even if LES were such a public power district, the Act does not authorize engaging in projects with public utilities of other states. Membership in the joint projects is restricted to public power districts of this state. Neb. Rev. Stat. § 70-1404 (1990) in part states:

> (1) A public power district may plan, finance, develop, acquire, purchase, construct, reconstruct, improve, enlarge, own, operate, and maintain an undivided interest as a tenant in common in a project situated within or without the state jointly with one or more public power districts in this state owning electric distribution facilities or ethanol production or distribution facilities or with any political subdivision or agency of this state or any other state and may make such plans and enter into such contracts not inconsistent with the Joint Public Power Authority Act as are necessary or appropriate, except that membership in a joint authority shall consist only of public power districts located within this state. ...

(Emphasis supplied).

It would further seem that the projects contemplated by the Act do not include participation in insurance consortiums. For these reasons, we conclude that the Joint Public Power Authority Act has little or no application to LES and cannot serve as any independent authority for LES to join the Consortium.

D. The Federal Risk Retention Act.

It is further asked whether the Federal Risk Retention Act of 1986, or other state statutory provision, "provides Lincoln Electric System independent authority to participate in EPPIC" (Consortium). It is our view that the Federal Risk Retention Act does not provide separate and independent authority for LES to become a member of the Consortium and we are not aware of other state legislative enactment which expressly or impliedly authorizes LES"s participation.

The Federal Risk Retention Act in general fashion authorizes the formation of risk retention groups to provide for insurance coverage for common or related liability exposure. Its purpose is to allow the establishment of risk financing entities, called risk retention groups. It is not a comprehensive act to establish new, additional or increased powers for various state and local government subdivisions. As we have previously noted, political subdivisions of this state are purely entities of state legislative creation and have only those powers expressly delegated to them by the state legislature.

IV. CONSTITUTIONALITY OF LEGISLATIVE PROVISIONS

It is last inquired whether any of the legislative provisions,if applicable, are unconstitutional. It is inappropriate that an opinion regarding constitutionality of existing statutes be requested of the Attorney General by legislators. Initially, we point out that the statutes you have inquired about constitute existing law and have a presumption of constitutionality. In Atty. Gen. Op. No. 157, December 20, 1985, we advised members of the Legislature that this office is required by law to defend existing statutes and opinion requests regarding constitutionality of existing statutes would be declined for this reason.

For the purposes of this opinion, the question need not be addressed since we have generally concluded that the legislative enactments do not sufficiently provide authority for LES to join the Consortium.

V. SUMMARY

We have concluded that membership in the Consortium would offend constitutional prohibitions because LES would be acting as a surety or guarantor of the debts of another; and because LES would acquire ownership interests in private entities. The

conclusions set forth in this opinion are necessarily qualified since important facts are not known or ascertained. That is, the materials and information furnished to this office do not reflect with necessary certainty the ownerships interests that would be obtained through participation in the Consortium. The Consortium is in the early stages of formation and its relationship to private corporations engaged in operations of the Consortium are not clearly described. Obviously, any conclusions regarding constitutionality are based on the extent and nature of the ownership interests that would be obtained by LES through membership. Verification of facts related to the nature of ownership interests resulting from membership in the Consortium is essential to determine whether membership would comport with Nebraska Law.

The Legislative Acts reviewed permit joint and cooperative actions by government subdivisions. However, all provisions of the Acts must be complied with and the Acts are construed consistent with constitutional requirements.

Sincerely yours,

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APPROVED BY:

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