IN THE WORKERS' COMPENSATION COURT OF THE STATE OF MONTANA

1995 MTWCC 48

WCC No. 9309-6893

MONTANA SCHOOLS GROUP WORKERS COMPENSATION RISK RETENTION PROGRAM

Petitioner

vs.

DEPARTMENT OF LABOR AND INDUSTRY EMPLOYMENT RELATIONS DIVISION

Respondent.

ORDER ON APPEAL

Summary: School district self-insurance association (a Plan 1 insurer) challenged the assessments and fees levied against it by the Department of Labor and Industry, pursuant to section 39-71-201, MCA (1991), to fund state government costs of administering the Workers' Compensation and Occupational Disease Acts. The Plan 1 insurer argued (1) the Department's method of assessment violated equal protection principles by failing to distribute costs proportionately among Plan 1 insurers in accordance with governmental costs attributable to the individual employers; and (2) the Department's method of assessing costs constituted a de facto agency rule promulgated without following statutorily mandated rulemaking procedures (Montana Administrative Procedures Act), that is, without considering the input of impacted persons and entities.

Held: The assessments and fees levied against Plan 1 insurers do not violate equal protection principles. Distribution of the assessment among self-insurers in accordance with their gross payrolls may not be the most precise measure of governmental costs attributable to each individual employer, but equal protection does not require mathematical precision and perfect equality, only a rational measure, which is provided by gross payroll. However, the assessment criteria used by the Department amount to a de facto agency rule where section 39-71-201, MCA (1991) has left significant regulatory details to agency discretion and that discretion could be exercised in different manners, each impacting segments of the public differently. The assessment methodology for implementing section 39-71-201, MCA (1991) must be adopted by rule. Once a rule is adopted, the petitioner is entitled to have its 1992 assessment recomputed and to receive either a refund or credit if appropriate.

Topics:

Constitutions, Statutes, Regulations and Rules: Montana Code Annotated: section 39-71-201, MCA. The assessments and fees levied against school district group self-insurance association to fund state government costs of administering the Workers' Compensation and Occupational Disease Acts pursuant to section 39-71-201, MCA, do not violate equal protection principles. Distribution of the assessment among self-insurers in accordance with their gross payrolls may not be the most precise measure of governmental costs attributable to each individual employer, but equal protection does not require mathematical precision and perfect equality, only a rational measure, which is provided by gross payroll.

Constitutions, Statutes, Regulations and Rules: Montana Code Annotated: section 39-71-201, MCA. The assessment methodology used by the Department of Labor and Industry in 1992 and 1993 under section 39-71-201, MCA, amounted to a de facto rule which, pursuant to section 2-4-102(11)(a), MCA, is deemed void for the Department's failure to follow rulemaking procedures.

Constitutions, Statutes, Regulations and Rules: Montana Code Annotated: section 2-4-102(11)(a), MCA. The assessment methodology used by the Department of Labor and Industry in 1992 and 1993 under section 39-71-201, MCA, amounted to a de facto rule which, pursuant to section 2-4-102(11)(a), MCA, is deemed void for the Department's failure to follow rulemaking procedures.

Constitutional Law: Equal Protection. The assessments and fees levied against school district group self-insurance association to fund state government costs of administering the Workers' Compensation and Occupational Disease Acts pursuant to section 39-71-201, MCA, do not violate equal protection principles. Distribution of the assessment among self-insurers in accordance with their gross payrolls may not be the most precise measure of governmental costs attributable to each individual employer, but equal protection does not require mathematical precision and perfect equality, only a rational measure, which is provided by gross payroll.

Administrative Agencies: Rules: Rulemaking. The method used by the Department of Labor and Industry to assess fees against insurers and self-insurers to fund government costs of administering the Workers' Compensation and Occupational Disease Acts amounts to a de facto agency rule. Where section 39-71-201, MCA (1991) has left significant regulatory details to agency discretion and that discretion could be exercised in different manners, each impacting segments of the public differently, the assessment methodology must be adopted by rule following statutory rulemaking requirements (Montana Administrative Procedures Act). Once a rule is adopted, school district self-insurance association is entitled

to have its 1992 assessment recomputed and to receive either a refund or credit if appropriate.

Insurers: Assessments for WC Regulation. The method used by the Department of Labor and Industry to assess fees against insurers and self-insurers to fund government costs of administering the Workers' Compensation and Occupational Disease Acts amounts to a de facto agency rule. Where section 39-71-201, MCA (1991) has left significant regulatory details to agency discretion and that discretion could be exercised in different manners, each impacting segments of the public differently, the assessment methodology must be adopted by rule following statutory rulemaking requirements (Montana Administrative Procedures Act). Once a rule is adopted, school district self-insurance association is entitled to have its 1992 assessment recomputed and to receive either a refund or credit if appropriate.

This case was initiated by the Montana Schools Group Workers' Compensation Risk Retention Program (MSG) to contest the amount it was assessed under section 39-71-201, MCA, for the 1992 fiscal year. It paid the full amount of the assessment -- $162,477.61 -- under protest and requested a contested case hearing before the Department of Labor and Industry (Department). A hearing was held. MSG's challenge was rejected and this appeal followed.

Montana Schools Group Workers' Compensation Risk Retention Program

Insurance coverage for workers' compensation injuries is provided through three different statutory plans. Plan 1, which is found in Title 39, part 71, chapter 21, permits employers to self-insure provided certain conditions are met. Self-insured employers are referred to *as Plan 1 employers.* § 39-71-2101, MCA. Alternatively, they may be referred to as *self-insurers* or *self-insured employers.* Plan 2, found in Title 39, part 71, chapter 22, regulates commercial insurance companies writing workers' compensation insurance. Those companies are referred to *as Plan 2 insurers.* § 39-71-2201, MCA. Plan 3, found in Title 39, part 71, chapter 23, establishes and regulates a State Compensation Insurance Fund (State Fund), which is a "nonprofit, independent public corporation" established solely for the purpose of writing workers' compensation insurance. § 39-71-2313, MCA.

MSG was organized on November 15, 1989. (Tr. at 65.) It is an association of 230 school districts which collectively self-insure under the MSG umbrella. (Tr. at 65; Finding 1.[1]) MSG is authorized by the Department to operate under Plan 1. (*Id.*)

[1]Reference to "Finding" is to the numbered finding of fact in the hearing examiner's FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER.

The Assessment Statute

Section 39-71-201, MCA, provides a method of funding state government costs of administering the Workers' Compensation Act (WCA) and the Occupational Disease Act (ODA). It provides that those costs be paid from (a) fees and penalties assessed and collected pursuant to sections 39-71-205 and 39-71-304, MCA; (b) fees levied in connection with inspection of boilers and the issuance of licenses to operating engineers; and (c) fees assessed workers' compensation insurers and self-insured employers. At the time of the 1992 assessment, the section provided:

> **Administration fund.** (1) A workers' compensation administration fund is established out of which all costs of administering the Workers' Compensation and Occupational Disease Acts and the various occupational safety acts the department must administer are to be paid upon lawful appropriation. The following money collected by the department must be deposited in the state treasury to the credit of the workers' compensation administrative fund and must be used for the administrative expenses of the department:
>
> (a) all fees and penalties provided in 39-71-205 and 39-71-304;
>
> (b) all fees paid for inspection of boilers and issuance of licenses to operating engineers as required by law;
>
> (c) all fees paid from an assessment on each plan No. 1 employer, plan No. 2 insurer, and plan No. 3, the state fund. The assessments must be levied against the preceding calendar year's gross annual payroll of the plan No. 1 employers and the gross annual direct premiums collected in Montana on the policies of the plan No. 2 insurers, insuring employers covered under the chapter, during the preceding calendar year. However, no assessment of the plan No. 1 employer or plan No. 2 insurer may be less than $200. The assessments must be sufficient to fund the direct costs identified to the three plans and an equitable portion of the indirect costs based on the ratio of the preceding fiscal year's indirect costs distributed to the plans, using proper accounting and cost allocation procedures. Plan No. 3 must be assessed an amount sufficient to fund the direct costs and an equitable portion of the indirect costs of regulating plan No. 3. Other sources of revenue, including unexpended funds from the preceding fiscal year, must be used to reduce the costs before levying the assessments.
>
> (2) The administration fund must be debited with expenses incurred by the department in the general administration of the provisions of this chapter, including the salaries of its members, officers, and employees and the travel expenses of the members, officers, and employees, as provided for in 2-18-501 through 2-18-503, as amended, incurred while on the business of the department either within or without the state.
>
> (3) Disbursements from the administration money must be made after being approved by the department upon claim therefor.

§ 39-71-201, MCA (1991). The section was amended in 1993 (1993 Mont. Laws, ch. 555, § 2) but the amendments were technical in nature and do not change the basic assessment scheme.

State Government Regulation of WCA and ODA

With the exception of the Workers' Compensation Court and certain rehabilitation services provided by the Department of Social and Rehabilitation Services (SRS), state government operations under the WCA and ODA are located in the Department of Labor and Industry. The Workers' Compensation Court is attached to the Department for administrative purposes, § 2-15-1707 (1), MCA, but is otherwise autonomous. Section 39-71-2902, MCA, provides that the expenses of the Workers' Compensation Court are payable out of the workers' compensation administration fund.

Workers' compensation operations are separated into functions that are administered by administrative units within the Department's divisions and bureaus. Hearings are conducted by the Hearings Unit, which is part of the Department's Legal Services Division. See Organizational Chart in ARM 24.1.101. In 1992 the following units within the Dispute Resolution Bureau of the Department's Employment Relations Division (ERD) were involved in WCA and ODA matters: Claims Management Unit, Files Management Unit, Accident Cataloging Unit, Rehabilitation Unit and Mediation Unit. (Ex. 16.) The Medical Regulations Unit and Policy Compliance Unit were under the Standards Bureau of ERD. (*Id.)* Mining Inspection, Boiler/Crane Inspection and Loss Control were under the Safety Bureau of ERD. (*Id.*) In addition, administrative and clerical support were provided for all ERD functions by the Division Administrative Support Unit. (Ex. 16.) Therefore, a portion of Administrative Support Unit's work was included in workers' compensation costs assessed to the three plans. (*Id*. and Tr. at 44-45.) The allocation of functions to the units described herein was for 1992 and may not reflect current ERD organization.

1992 Assessment

For fiscal year 1992, the Department determined that the net amount needed to fund governmental operations related to workers' compensation and occupational disease was $2,588,500.63. That amount was determined by adding together the amounts required in 1992 to fund each cost center and subtracting unspent fees from the previous fiscal year. Those amounts were as follows:

Agency, Unit or Function	**Budget**
1. Workers' Compensation Court[2]	374,422.00

[2]While the Court is funded through the assessment, it has no direct or indirect interest in the manner in which the assessment is computed or allocated. Its budget is fixed by the legislature.

2. Hearings Unit	258,191.00
3. Administration/Clerical Support	484,140.00
4. Claims Management	215,541.00
5. Files Management	282,588.00
6. Accident Cataloging	62,855.00
7. Rehabilitation DLI	134,088.00
8. Rehabilitation Panels SRS	68,303.00
9. Medical Regulation	64,378.00
10. Policy Compliance	180,072.00
11. Mediation	139,301.00
12. Subsequent Injury Fund Admin.	25,548.00
13. Administration (Safety Functions)	27,495.00
14. Occupational Safety Statistics	59,026.00
15. Supplemental Data System	31,000.00
16. Loss Control	251,815.00
17. Mining Inspection	240,337.00
18. Boiler Inspection	214,147.00
(Less Estimated Fees)	(32,000.00)
TOTAL NEEDED ASSESSMENT	$3,081,247.00
Unspent carry over from 1991	492,746.37
NET AMOUNT NEEDED	$2,588,500.63

(Ex. 19.) Two areas, Administration/Clerical Support and Administration for safety functions (Items 3 and 13), were part of overall administrative services provided by the Department. The amounts allocated to the WCA/ODA assessment for these two areas were therefore "based on the relative percentages that those functions [WCA and ODA] were utilized." (Tr. at 45.)

As can be seen from the estimated offset of fees for boiler inspection, the amounts generated by the first two sources of fees, section 39-71-201(1)(a) & (b), MCA, are minimal. Thus, government regulation of workers' compensation is substantially funded by the assessments levied against the three plans.

Methodology for Allocating Fees to the Three Plans

Brian McCullough (McCullough), administrator of the Budget and Planning Unit of the Department, testified regarding allocation of the assessment among the three plans. The basic methodology has been used for a number of years. It has never been formalized by rule and no rulemaking proceeding has ever taken place.

For each cost center, the Department determines what percentage of work is performed by the cost center with respect to each plan. The budget for the cost center is then multiplied by the resulting percentages, yielding the amount due from each plan in order to fund the cost center.

The percentages for the Workers' Compensation Court, the Hearings Unit, Claims Management, Files Management, Accident Cataloging, the three Rehabilitation areas, Mediation, and Supplemental Data System are based on the raw numbers of filings, cases processed, reports, and files reviewed. For example, costs of the Workers' Compensation Court are allocated by determining how many petitions were filed with respect to each plan. For fiscal year 1991, 323 petitions were filed, forty-six (46) for Plan 1 employers (14.24%), 109 for Plan 2 insurers (33.75%), and 168 for the State Fund (52.01%). The percentages are then multiplied by the total budget of the Court to arrive at the amount due from each plan to fund the Court.

The percentages for other cost centers are determined by different methods. The percentages for Policy Compliance are based on the number of carriers; Occupational Safety Statistics on the actual number of employers insured by the plan; and Loss Control, Mining Inspection, and Boiler/Crane Inspection on employee hours attributable to inspections for each plan. How the percentages for Administration/Clerical Support, Medical Regulation, and Administration are determined is unclear from the record below.

For 1992, the following chart summarizes the manner in which percentages were determined, the actual percentages allocated to each plan, and the actual amounts allocated for each cost center:

SCHEDULE OF FISCAL YEAR 1992 ESTIMATED BUDGETS PER OPERATIONAL PLAN

ALLOCATED TO PLANS I, II AND III

FUNCTION	TOTAL BUDGET	PLAN I	PLAN II	PLAN III
LEGAL FUNCTIONS:				
1. WORKERS' COMPENSATION COURT Allocation	100.00% $374,422.00	14.24% $53,317.69	33.75% $126,367.43	52.01% $194,736.88
2. HEARINGS Allocation	100.00% $258,191.00	12.65% $32,661.16	20.48% $52,877.52	66.87% $172,652.32
INSURANCE COMPLIANCE:				
3. ADMIN/CLERICAL SUPPORT Allocation	100.00% $484,140.00	21.12% $102,250.37	39.44% $190,944.82	39.44% $190,944.82

4. CLAIMS MANAGEMENT Allocation	100.00% $215,541.00	11.03% $23,774.17	24.94% $53,755.93	64.03% $138,010.90
5. FILES MANAGEMENT Allocation	100.00% $282,588.00	39.47% $111,537.48	60.53% $171,050.52	0.00% $0.00
6. ACCIDENT CATALOGING Allocation	100.00% $62,855.00	50.52% $31,754.35	49.48% $31,100.65	0.00% $0.00
7. REHABILITATION DLI Allocation	100.00% $134,088.00	7.16% $9,600.70	12.41% $16,640.32	80.43% $107,846.98
8. REHABILITATION PANELS SRS Allocation	100.00% $68,303.00	7.16% $4,890.49	12.41% $8,476.40	80.43% $54,936.10
9. MEDICAL REGULATION Allocation	100.00% $64,378.00	11.03% $7,100.89	24.94% $16,055.87	64.03% $41,221.23
10. POLICY COMPLIANCE Allocation	100.00% $180,072.00	16.55% $29,801.92	83.45% $150,270.08	0.00% $0.00
11. MEDIATION Allocation	100.00% $139,301.00	12.09% $16,841.49	20.35% $28,347.75	67.56% $94,111.76
12. SUBSEQUENT INJURY FUND ADMIN. Allocation	100.00% $25,548.00	9.11% $2,327.42	27.45% $7,012.93	63.44% $16,207.65
SAFETY FUNCTIONS:				
13. ADMINISTRATION Allocation	100.00% $27,495.00	27.00% $7,423.65	11.00% $3,024.45	62.00% $17,046.90
14. OCCUPATIONAL SAFETY STATISTICS Allocation	100.00% $59,026.00	0.15% $88.54	14.27% $8,423.01	85.58% $50,514.45

15. SUPPLEMENTAL DATA SYSTEM Allocation	100.00% $31,000.00	40.04% $12,412.40	38.64% $11,978.40	21.32% $6,609.20
16. LOSS CONTROL Allocation	100.00% $251,815.00	49.71% $125,177.24	2.22% $5,590.29	48.07% $121,047.47
17. MINING INSPECTION Allocation	100.00% $240,337.00	18.88% $45,375.63	22.83% $54,868.94	58.29% $140,092.44
18. BOILER INSPECTION Estimated Budget Less Estimated Fees Allocation	100.00% $214,147.00 ($32,000.00) $182,147.00	18.30% $33,332.90	4.65% $8,469.84	77.05% $140,344.26
TOTAL NEEDED ASSESSMENT	$3,081,247.00	$649,668.50	$945,255.14	$1,486,323.37
COLLECTION ADJUSTMENT	$492,746.37	($29,462.13)	$303,809.74	$218,398.77
NET NEEDED ASSESSMENT	$2,588,500.63	$679,130.63	$641,445.40	$1,267,924.60

(Ex. 19.)

Based on the foregoing, the amount of fees assessed for fiscal 1992 to each of the three plans was as follows:

Plan 1	$ 679,130.63
Plan 2	$ 641,445.40
Plan 3	$1,267,924.60

(Ex. 19.)

Allocation of Assessed Fees within Plan 1

After the fees are determined for each plan, they are then distributed among the participants of the plans. The methodology for distribution among plan members differs with each plan. Since it is the sole participant in Plan 3, the State Fund is assessed the entire amount due from Plan 3. § 39-71-201(1)(c), MCA. In the case of Plan 2, the fees are allocated to individual insurers based on gross annual directed premiums collected in

Montana for workers' compensation insurance policies. *Id.* For Plan 1 employers, the assessed fees are distributed on the basis of gross annual payroll. *Id.*

The gross annual payroll for all Plan 1 employers was $977,590,700.42. (Ex. 19.) Thus, to raise the $679,130.63 allocated to Plan 1 for fiscal 1992, an assessment of .0695% of gross payroll was imposed on each Plan 1 employer. ($977,590,700.42 x .000695 = $679,425.50.) (*Id.*) The gross payroll of MSG (calendar year 1990) was $-233,780,734.42, or 23.85% of the gross payroll of all Plan 1 employers. Thus, MSG's share of Plan 1 fees was $162,477.61. ($233,780,734.42 x .000695 = $162,477.61.)

The final assessment for fiscal 1992 is contained in the *ADMINISTRATIVE ASSESSMENT REPORT,* which was introduced as Exhibit 19. That report sets forth the basic information concerning the methodology used by the Department. The chart on the preceding pages is from that report.

Proceedings Below

The first assessment levied against MSG was for fiscal year 1991 (July 1, 1990 to June 30, 1991). It paid that assessment. In early 1992, following receipt of an estimated assessment for fiscal year 1992, MSG requested a meeting with Department officials. (Finding 23.) In a meeting with Department representatives on March 30, 1992, it expressed concern with the method used to distribute costs among the Plan 1 employers. (*Id.*) The Department then organized a task force to look into alternative methods of assessment but that task force ultimately concluded that no changes should be made in the Department's methodology. (Findings 25 and 26; Exs. 12-14.) No rulemaking proceeding was ever commenced.

Upon receiving final notice of the 1992 assessment, MSG initially refused to pay. (Finding 20.) However, when the Department threatened to decertify it as a Plan 1 employer and turn the assessment over to the State Auditor's Office for collection, MSG paid the full amount on June 16, 1992. (Findings 20-22.) It made its payment under protest and requested a contested case hearing regarding the assessment. (Finding 22.)

A hearing was held on January 21 and 22, 1994. The first three issues presented by MSG were as follows:

1) whether the Department of Labor and Industry, Employment Relations Division (hereinafter referred to as DOLI) properly assessed MSG pursuant to § 39-71-201, Montana Code Annotated (MCA);

2) whether the assessment against MSG is void in that the procedures used to determine and assess the amount are in fact rules, within the meaning of the Administrative Procedures Act; and

3) whether the assessment is invalid and void in that the administrative costs are not allocated based on actual use using proper accounting and cost allocation procedures.

(FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER at 2.)

Citing *Jarussi v. Board of Trustees,* 204 Mont. 131, 664 P.2d 316 (1983), the hearing examiner ruled that two other issues were constitutional challenges outside the jurisdiction of the Department. (FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER at 2.) Thus, MSG's constitu-tional challenges were deferred for consideration by this Court.

The hearing examiner considered MSG's contention that the methodology used by the Department amounted to a rule and was void because it had been promulgated without a rulemaking proceeding. (*Id.* at 13-17.) He found the Montana Supreme Court decisions cited by MSG to be inapposite. (*Id.* at 15.) He concluded that the assessment methodology utilized by the Department merely "interpret[ed]" the assessment statute and construed section 2-4-102(11), MCA, as permitting but not requiring "interpretive" rulemaking. (*Id.* at 17.) He concluded that the Department properly implemented the methodology without a formal rule. (*Id.*)

The hearing examiner also rejected MSG's contention that the methodology does not employ proper cost and allocation procedures. He noted MSG's dissatisfaction with the allocation procedure because it fails to identify and allocate costs *within* the various plans. He pointed out that the statute requires only that costs be allocated as between plans. (*Id.* at 20-21.) In reply to MSG's evidence and argument that the Department could utilize more accurate methods of measuring work load, the hearing examiner said, "The consensus among the DOLI's witnesses was that the methodology [actually used] was nonetheless appropriate, practical and accurate." (*Id.* at 20.)

ISSUES RAISED ON APPEAL

In its opening brief on appeal, MSG raises the following issues:

Issue 1: Was DOLI required to comply with the Administrative Procedure Act prior to adopting the Administrative Assessment Report?

Issue 2: Did the DOLI's administrative assessment comply with the controlling statute, Section 39-71-201, MCA?

Issue 3: Whether the DOLI administrative assessment violates the Schools Groups' [sic] right to equal protection and due process.

(APPELLANT'S BRIEF AT 3, 15 and 20.)

Initially, the appeal was submitted without a transcript of the testimony taken by the hearing examiner. Neither party attacked the hearing examiner's findings of fact. MSG disputed only his conclusions of law. However, the parties' briefs referred to testimony and the Court determined that a transcript would benefit its review. Therefore, it directed that a transcript be prepared and submitted to the Court.

After receiving the transcript, and further considering the parties' arguments, the Court determined that it would benefit from additional argument concerning the rulemaking issue and possible relief. It requested, and the parties provided, supplemental briefs. The case was deemed finally submitted on February 16, 1995.

DISCUSSION

I. Equal Protection and Due Process

We address the constitutional challenges first. It is the general rule that constitutional challenges should be avoided whenever possible. *Wolfe v. St. Dept. of Labor and Industry,* 255 Mont. 336, 339, 843 P.2d 338 (1993). The challenges in this case involves the assessment statute itself. Consideration of the constitutional issues is unavoidable since the resolution of the other issues does not render the constitutional issues moot.

MSG challenges the constitutionality of its assessment because the assessment methodology does not take into consideration the amount of government resources expended with respect to *individual* Plan 1 employers. It relies on Finding of Fact 15 as demonstrating that it is dis-proportionately taxed in comparison to other Plan 1 employers:

> 15. Actual utilization of the various DOLI workers' compensation functions is not proportionately distributed among the Plan One member insurers. MSG, whose insureds are made up of predominately professional personnel such as teachers and administrators, utilizes a much smaller proportion of the services provided through many of the assessment functions than would a construction, manufacturing, mining or timber industry employer. To illustrate: between November 15, 1989 and October 22, 1992, no petitions had been filed with the Workers' Compensation Court, five (5) mediation conferences had been scheduled or held, and three (3) rehabilitation panel reviews processed relative to claims attributable to MSG. Also, no member schools are involved in the operation of mines or cranes and MSG maintains its own safety loss control program. In contrast, there were 46 petitions filed with the Workers' Compensation Court, 63 mediation cases processed, 88 rehabilitation panel reviews, 675 mining and 421 boiler/crane inspection hours, and 1,507 loss control activity hours attributable to Plan One member insurers during FY 1991 alone. (Testimony of Bailey; Exhs. 1, 5, 12, 19--pp. 5-6, and 20--pp. 1-2.)

MSG argues that "the effect of the assessment method adopted by DOLI is that the Schools Group subsidizes the workers compensation system usage of the remaining Plan 1 insurers (and probably the usage of other Plans as well.)" (APPELLANT'S BRIEF at 21.) It goes on to "attribute . . . this result in substantial part to DOLI's failure to comply with its rulemaking obligations and its failure to fashion an assessment methodology that complies with the cost allocation directives of the statute." (*Id.*) It then says, "There is every reason to believe that if DOLI allocated the assessment based upon an identification of direct costs as the statute requires, then the entire Plan 1 assessment and the Schools Group's share of it would decrease." *(Id.*) Finally, it concludes that the situation in the present case is analogous to that in *Montana Department of Revenue v. Barron,* 245 Mont. 100, 799 P.2d 533 (1990), where the Supreme Court held that the method used by the Department of Revenue to assess real property resulted in disproportionate assessments and disproportionate taxes in violation of the Equal Protection and Due Process Clauses.

A careful reading of MSG's argument shows that it is attacking the assessment as disproportionate in comparison to other Plan 1 employers and that it is further attacking the assessment as disproportionate as among the plans. These are two different matters. The first involves a challenge to the face of the assessment statute, the second is a challenge to the implementation of the statute.

Section 39-71-201(1)(c), MCA, initially provides that assessments be based on the costs attributable to each of the three plans, determined in the following manner:

> The assessments must be sufficient to fund the direct costs identified to the three plans and an equitable portion of the indirect costs based on the ratio of the preceding fiscal year's indirect costs distributed to the plans, using proper accounting and cost allocation procedures.

It does not require individualized assessments within plans or consideration of work load attributable to individual Plan 1 employers and Plan 2 insurers. To the contrary, once overall costs attributable to each plan are determined, the section provides that assessments for individual plan members "must be levied against the preceding calendar year's gross annual payroll of the Plan No. 1 employers and the gross annual direct premiums collected in Montana on the policies of the plan No. 2 insurers . . . ." Thus, the total amount assessed with respect to Plan 1 must be allocated among Plan 1 employers based on gross payroll, and in fact it was.

MSG's reliance on *Barron* is misplaced. *Barron* involved valuation of real property for purposes of a property tax. The Supreme Court held that an adjustment factor derived from a sales-assessment ratio study violated the plaintiff property owners' rights to equal protection, due process and uniformity because it exacerbated already existing disparities in property valuations. Prior to the application of the factor, which adjusted valuations upwards by thirty (30%) percent, forty (40) of two hundred and forty-three (243) properties

analyzed were over-appraised and two hundred and three (203) were under appraised.[3] After applying the adjustment factor, one hundred and two (102) properties were over appraised. One property was appraised at almost two times the price at which it had recently sold, while at the other end of the spectrum another property was appraised at only fifty (50%) percent of its selling price. The net result was that some property owners were grossly over-taxed while others were grossly under-taxed.

Barron is one in a line of cases holding that property values must be equalized so that property owners throughout the state pay only their fair share of real property taxes. *See e.g., Larson v. Department of Revenue,* 166 Mont. 449, 534 P.2d 854 (1975). Obviously, taxing one parcel of property at fifty (50%) percent of its market value and another parcel at one hundred and fifty (150%) percent of its market value results in an effective tax rate that is three times greater for the over-assessed property than for the under-assessed one. If a parcel with a fair market value of $100,000 is assessed at $50,00, or fifty (50%) percent of its value, and another parcel with the same value is assessed at $150,000 or one hundred and fifty (150%) percent of its value, the over-assessed property will be assessed at three (3) times the value of the under-assessed one and be saddled with three (3) times as much tax. That sort of discriminatory disparity is blatant and arbitrary, and the Supreme Court did not hesitate to strike it down.

The assessment at issue in this case, however, is **not** a property tax. It is not based on the value of property and it does not involve any appraisal. It must be analyzed according to traditional equal protection and due process principles.

Although due process is mentioned as one of the grounds for MSG's challenge, neither MSG nor *Barron* distinguish due process analysis from equal protection analysis. Therefore, I will not separately address the due process contention.

The guaranty of equal protection of the laws is found in both the Fourteenth Amendment to the United States Constitution and Article II, section 4 of the 1972 Montana Constitution. "The equal protection provisions of the federal and state constitutions are similar and provide generally equivalent but independent protections." *In re C.H.,* 210 Mont. 184, 198, 683 P.2d 931, 938 (1984).

As a general matter, the Equal Protection Clauses guaranty that persons are not subject to arbitrary and discriminatory action. *McKamey v. State,* 855 P.2d 515, 521, 51 St. Rep. 1218 (Mont. 1994). However, it ". . . forbids only those legislative classifications which represent some form of invidious discrimination. [Citations omitted.] Generally, a classification will not be held to be invidious if some rational basis can be found to support it. [Citations omitted.]" *State v. Sanders,* 208 Mont. 283, 289, 676 P.2d 1312, 1315 (1984).

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[3]Simple arithmetic will show that *none* of the properties were accurately appraised.

The first step in any equal protection analysis is to determine the applicable level of scrutiny.

> Courts examine the right to equal protection under three levels of scrutiny--strict scrutiny for classifications which infringe fundamental rights or involve suspect classifications, such as race or national origin; middle tier analysis in specific limited situations requiring a somewhat heightened scrutiny; and rational basis analysis, for all other classifications. *Meech v. Hillhaven West, Inc. (1989), 238 Mont. 21, 44-45, 776 P.2d 488, 502.*

McKamey v. State, 885 P.2d 515, 521, 51 St.Rep. 1218 (Mont. 1994). Where taxation is concerned, the proper test is ordinarily the rational basis test. *See GBN, Inc. v. Montana Department of Revenue,* 249 Mont. 261, 266, 815 P.2d 595, 597 (1991). While this case involves a "fee", that fee is in effect a tax. A tax is a "pecuniary burden laid upon individuals or property to support the government, and is a payment exacted by legislative authority." BLACK'S LAW DICTIONARY (FIFTH ED.).

Under the rational basis test, the classification must be examined to determine whether it is rationally related to a proper governmental purpose. In *McClanathan v. Smith,* 186 Mont. 56, 66, 606 P.2d 507, 512 (1980), the Supreme Court summarized the test as follows:

> The test in equal protection challenges is whether the classification is supported by a rational basis. *Richardson v. Belcher* (1971), 404 U.S. 78, 92 S.Ct. 254, 30 L.Ed.2d 231; *Dandridge v. Williams* (1970), 397 U.S. 471, 90 S.Ct. 1153, 25 L.Ed.2d 491. In *State v. Jack* (1975), 167 Mont. 456, 461, 539 P.2d 726, 729, this Court stated:
>
> "Where the challenge extends only to the more general legislative classifications, the judicial inquiry must be limited to determining whether the distinction is justified by a rational basis. Stated another way, we can determine only whether the law has a sufficiently reasonable relation to a proper legislative purpose so as not to be deemed arbitrary. [Citations omitted.] In connection with this standard, a classification having some reasonable basis does not deny equal protection merely because it is not made with precise mathematical nicety or results in some inequality."

In *State v. Sanders,* 208 Mont. 283, 288, 676 P.2d 1312, 1315 (1984), the Supreme Court adopted the analysis of *Lindsley v. Natural Carbonic Gas Co.,* 200 U.S. 61, 78 (1911):

> ". . . 1. The equal-protection clause of the 14th Amendment does not take from the state the power to classify in the adoption of police laws, but admits of the exercise of a wide scope of discretion in that regard, and avoids what is done only when it is without any reasonable basis, and therefore is purely arbitrary. 2. A classification having some reasonable basis does not

> offend against that clause merely because it is not made with mathematical nicety, or because in practice it results in some inequality. 3. When the classification in such a law is called in question, if any state of facts reasonably can be conceived that would sustain it, the existence of that state of facts at the time the law was enacted must be assumed. 4. One who assails the classification in such a law must carry the burden of showing that it does not rest upon any reasonable basis, but is essentially arbitrary."

In a final analysis, "[t]he legislative classification must be sustained unless it is patently arbitrary and bears no rational relationship to a legitimate governmental interest." *State v. Turk,* 197 Mont. 311, 316, 643 P.2d 224, 227 (1982).

MSG does not challenge the purpose served by the assessment statute. That purpose is readily apparent: To require workers' compensation insurers and self-insurers to pay for the governmental costs of regulating their activities.

Under the assessment statute, Plan 1 employers constitute a separate classification for purposes of allocating the amount assessed to Plan 1. That allocation is based on gross payroll. Providing the payroll method of allocation for Plan 1 employers rather than the gross premiums used for Plan 2 insurers is rational and reasonable. Insurers charge premiums; self-insured employers generally do not. Therefore, different measures are required.

Within Plan 1, the assessment is distributed equally among employers based on their gross payrolls. While MSG calls for a different measure which would more accurately reflect government costs attributable to regulating each individual employer, equal protection does not require such a precise measure. Mathematical precision and perfect equality is not required. *McClanathan*, 186 Mont. at 68, 606 P.2d at 507. All that is required is that the measure be rational. While gross payroll may not be the best or wisest measure, "in the absence of an affirmative showing that there was no valid reason behind the classification, we are powerless to disturb it." *Id.*, 186 Mont. at 66, 606 P.2d at 507 (quoting from *State ex rel. Hammond v. Hager,* 160 Mont, 391, 399, 503 P.2d 43, 56 (1972)). Gross payroll provides at least a rough measure of the anticipated contribution of a Plan 1 employer to the cost of government regulation and is rationally related to the purpose of the statute.

The equal protection clauses do not require that MSG receive benefits directly in proportion to its assessed fees. Taxes levied to fund schools do not benefit every member of the community equally but have been upheld on the ground that the community as a whole benefits. *State ex rel. Woodahl v. Straub,* 164 Mont. 141, 150-51, 520 P.2d 776, 781 (1974). In this case, the tax extracted by the assessment statute is more precisely aimed at those who benefit from government regulation than is any school tax. The governmental activities which are funded by the assessment benefit all insurers and Plan 1 employers.

In conclusion, the method is rationally related to a proper governmental purpose even though it may not perfectly reflect the amount of benefits received by any individual Plan 1 employer, or, for that matter, any individual insurer. It does not violate the Equal Protection Clauses.

No different analysis is required with respect to MSG's assertion that the methodology used by the Department to determine the amounts assessable to the three plans is unconstitutional. Putting aside the question of whether the Department's methodology is consistent with the statute and should have been adopted through rulemaking, the methodology provides a rough measure of government activity associated with the three plans. While more precise methods of measuring activity may be possible, the work load factors adopted by the Department are not patently arbitrary or unreasonable. They do not violate the Equal Protection Clauses.

II. Rulemaking

Since the assessment survives constitutional scrutiny, I turn next to MSG's argument that the fees assessed are invalid because the Department did not follow rulemaking procedures.

From the record below it is unclear when the work load methodology used by the Department was first adopted.[4] From McCullough's testimony, it appears that it was used by the old Division of Workers' Compensation, which was abolished in 1989, and has been used for at least ten years. (Tr. at 136, 142.) The methodology is not contained in any formal rule and no rulemaking proceeding has ever been conducted. (Tr. at 143.)

The Department's hearing examiner found that the work load factors adopted by the Department were "interpretive" of the assessment statute. He concluded that the Department was not **required** to promulgate its methodology by rule, citing section 2-4-102(11), MCA, which states that an agency **may** adopt interpretive rules.

In this appeal, the Department makes no attempt to defend the hearing examiner's reasoning. Rather, it advances several different reasons as supporting his ultimate conclusion that rulemaking was not required. First, it argues that the methodology is an implementation of the statewide budgeting and accounting system (SBAS). (RESPONDENT'S BRIEF at 21.) Second, it contends that the methodology does not constitute a rule, citing 35 Atty. Gen. Op. 2 (1973) in support of its contention. (*Id.* at 18.) Third, citing *Ramage v. Department of Revenue,* 236 Mont. 69, 768 P.2d 864 (1989), it says that the methodology is exempt from rulemaking because it is best developed through ad hoc litigation. (*Id.* at 22.) Fourth, it characterizes the Montana cases cited by MSG as inapposite and distinguishable. Fifth, citing section 2-4-102(10)(a), MCA, it says that

[4]The assessment statute was originally enacted in 1973. 1973 Montana Laws, ch. 253, § 1. Subsection (1)(c) was added in 1975, 1975 Mont. Laws, ch. 318, § 1, and has remained substantially unchanged since that time.

rulemaking was unnecessary because the methodology constitutes a statement "concerning only the internal management of an agency and not affecting private rights or procedures available to the public." Finally, it cites two out-of-state cases which it characterizes as supporting its position that rulemaking was not required.

Rulemaking is governed by the Montana Administrative Procedure Act (MAPA), which defines a rule as follows:

> (10) "Rule" means each agency regulation, standard, or statement of general applicability that implements, interprets, or prescribes law or policy or describes the organization, procedures, or practice requirements of an agency. The term includes the amendment or repeal of a prior rule but does not include:
>
> (a) statements concerning only the internal management of an agency and not affecting private rights or procedures available to the public;
>
> (b) formal opinions of the attorney general and declaratory rulings issued pursuant to 2-4-501;
>
> (c) rules relating to the use of public works, facilities, streets, and highways when the substance of the rules is indicated to the public by means of signs or signals;
>
> (d) seasonal rules adopted annually or biennially relating to hunting, fishing, and trapping when there is a statutory requirement for the publication of the rules and rules adopted annually or biennially relating to the seasonal recreational use of lands and waters owned or controlled by the state when the substance of the rules is indicated to the public by means of signs or signals;
>
> (e) rules implementing the state personnel classification plan, the state wage and salary plan, or the statewide budgeting and accounting system;
>
> (f) uniform rules adopted pursuant to interstate compact, except that the rules must be filed in accordance with 2-4-306 and must be published in the Administrative Rules of Montana.

§ 2-4-102(10), MCA (emphasis added). MAPA goes on to define substantive rules:

> (11) "Substantive rules" are either:
>
> (a) legislative rules, which if adopted in accordance with this chapter and under expressly delegated authority to promulgate rules to implement a statute have the force of law and when not so adopted are invalid; or
>
> (b) adjective or interpretive rules, which may be adopted in accordance with this chapter and under express or implied authority to codify an interpretation of a statute. The interpretation lacks the force of law.

§ 2-4-102(11), MCA (emphasis added).

A. Interpretive rule analysis.

As stated earlier, the Department does not defend the hearing examiner's rationale concerning the rulemaking issue. Nonetheless, the Court has considered that rationale but finds it flawed.

The methodology adopted by the Department does not merely "interpret" the assessment statute. The statutory directive concerning assessments against the three plans is:

> The assessments must be sufficient to fund the direct costs identified to the three plans and an equitable portion of the indirect costs based on the ratio of the preceding fiscal year's indirect costs distributed to the plans, using proper accounting and cost allocation procedures.

§ 39-71-205(1)(c), MCA. The statute does not define direct costs or state how those costs are to be identified. It does not state how indirect costs are determined. It does not define "proper accounting and cost allocation procedures."

As the testimony at the hearing demonstrates, these are significant matters. They are matters which are susceptible to different approaches and a great deal of discretion. The provision is not self-executing, and neither a court nor an agency can apply usual rules of statutory interpretation to come up with the methodology used by the Department. I reviewed the Montana Code Annotated for some definition of "direct costs" but could find none. I did locate a definition of "indirect costs" in Title 17, chapter 3, part 1, which deals with state acceptance and expenditure of federal funds. Section 17-3-102(4), MCA, defines indirect costs as follows:

> (4) "Indirect costs" means costs which benefit more than one agency or program and are **not readily assignable** to the agency or program specifically benefitting. [Emphasis added.]

By implication, direct costs are costs which **are readily assignable** to a particular agency or program. This definition is consistent with the one provided at the hearing by McCullough, a certified public accountant, who has extensive experience in state government accounting practices. McCullough testified, "Direct costs are costs that are **practical** to attribute directly to an activity or function. Indirect costs are costs that are not practical to allocate to a, to a function." (Tr. at 32; emphasis added.) MSG's expert accountant, Kathy Johnson (Johnson), provided a similar although not identical definition, testifying, "A direct cost is a cost that can be **readily** identified to those benefiting [sic] from that cost." (Tr. at 102.)

"Practical " and "readily identifiable" are virtually synonymous. "Readily" means "without much difficulty: EASILY." WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY (1991

ED.) (capitalization in original). "Practical" means "capable of being put to use or account: USEFUL." *Id.* (capitalization in original).

On cross-examination, McCullough provided hypothetical examples of direct cost accounting. One example related to hearings held by the Department. Direct costs for the hearing examiner's time could be determined by accounting for the number of hours spent hearing cases for each plan, multiplied by the hearing examiner's hourly salary. (Tr. at 52.) Another example concerned photocopies of documents. Copies could be directly expensed to each plan by using a photocopy counter. (Tr. at 52-53.) But McCullough emphasized that the definition of direct costs includes the term "practical." (Tr. at 54.) He pointed out that it may be possible to directly account for costs but it may be impractical because the collection of the additional information may be burdensome and create additional costs to an agency. (*Id*.)

Johnson, who practices with a private accounting firm, provided actual examples of direct cost accounting in her firm. Her clients are billed on a hourly basis for the actual time she spends on their work. Photocopies are directly billed to her clients. (Tr. at 102-103.) On the other hand the cost of support staff, such as a receptionist, constitute an indirect cost since the receptionist's time is not separately accounted for by the client. (Tr. at 103.)

In its brief on appeal, the Department argues that the work load factors utilized for all but two cost centers amount to direct cost accounting. (RESPONDENT'S BRIEF at 12.) MSG argues that no direct costs are used in the Department's methodology. (APPELLANT'S BRIEF at 16.) The Department is clearly wrong; MSG is correct. The work load measures are only rough measures of costs. For example, the raw number of hearings held by the hearings unit may not accurately reflect actual hearings unit costs attributable to a plan. The number of actual hours spent by hearing examiners hearing cases would be a far more reliable measure of actual costs, at least with respect to the hearing examiners' salaries. The methodology used by the Department is more in the nature of an allocation of indirect costs.

It should be clear from this discussion that section 39-71-201(1)(c), MCA, does not specify some single, correct methodology for assessing fees. Different methodologies are possible and the adoption of a particular methodology requires consideration of cost and reasonableness. For example, McCullough's testimony on behalf of the Department indicates that it would be possible to require hearing examiners to account for their time and allocate their salaries based on the time they spend with respect to each plan. There is nothing in his testimony to indicate that such an accounting measure would be inconsistent with "proper accounting and cost allocation procedures." Adoption of such measure may, however, be impractical and increase agency costs, which would then be charged to the three plans.

By referring to direct costs in section 39-71-201(1)(c), MCA, the legislature contemplated some effort to determine what costs can be directly accounted for. At a minimum, the section requires the Department to determine what direct costs can be

reasonably tracked. Similarly, the allocation of indirect costs is not self-executing; it requires selection of some measure which fairly estimates the costs attributable to each plan. Selection of the measure requires consideration of possible alternatives.

Since there are different methods of accounting for ways agency costs are attributable to the three plans, methodology adopted by the Department is the equivalent of a "legislative rule." § 2-4-102(11)(a), MCA. The methodology does not amount to an interpretive rule.

B. SBAS analysis.

Relying on section 2-4-102(10)(e), MCA, the Department argues that its methodology is exempt from rulemaking requirements. The cited section specifically excludes from rulemaking those "rules implementing . . . the statewide budgeting and accounting system." The Department's contention is frivolous. While the methodology used by the Department may utilize information *derived* from SBAS, it is not a rule *implementing* SBAS.

C. 35 Atty. Gen. Op. 2 (1973).

The Department's reliance on 35 Atty. Gen. Op. 2 (1973), is similarly frivolous. The Attorney General opinion addressed whether MAPA rulemaking requirements applied to management memos issued by the Department of Administration. Attorney General Woodahl held that they did not because the Department of Administration was not authorized to hear contested cases and therefore did not meet MAPA's definition of an agency. The Department of Labor is authorized to hear contested cases, has express rulemaking authority (§ 39-71-203, MCA), and is clearly an agency within the meaning of MAPA.

D. Internal management.

Section 2-4-102(10)(a), MCA, excludes "statements concerning only the internal management of an agency and not affecting private rights or procedures available to the public" from rulemaking requirements. The assessment methodology at issue in this case is not merely an internal management matter, it is a method of assessing taxes against third parties.

E. Ad hoc adjudication.

In this case, the Department of Labor cites *Ramage v. Department of Revenue,* 236 Mont. 69, 768 P.2d 864 (1989), as authority for avoiding rulemaking requirements. It suggests that ad hoc adjudication, such as the present proceeding, is an acceptable alternative to rulemaking. (RESPONDENT'S BRIEF at 22-23.) It is not.

Ramage concerned the issuance of liquor licenses. One of the prerequisites for a license was a finding that "the issuance of such license is justified by public convenience and necessity." DOR considered that criteria on a case-by-case basis in connection with individual license applications. The appellants, who were denied licenses, argued on appeal that "DOR's use of the adjudicative process to determine whether applications for liquor licenses are warranted by public convenience and necessity" amounted to "an invalid exercise of rulemaking authority." 236 Mont. at 73-74. The Supreme Court rejected the argument, holding that the statute did not define "public convenience and necessity" and that the DOR was free to define the term through either a rulemaking proceeding or through case by case adjudication of license applications. 236 Mont. at 73.

The Supreme Court's decision in *Ramage* turned on twin factors. First, there were inherent difficulties in precisely defining "public convenience and necessity." *Id.* Second, "whether an application is justified by public convenience and necessity involves . . . a **fact-intensive** inquiry." *Id.* (emphasis added.)

With the adoption of the assessment methodology, the Department eliminated any vagueness concerning the manner in which fees are allocated. Fee determinations are mathematical: no fact intensive inquiry is necessary. The assessment methodology adopted by the Department is fixed and has general application. *Ramage* is inapposite and does not support the Department's position.

F. Case law.

In its initial brief MSG cited two Montana cases as supporting its contention that the assessment methodology is invalid because the Department failed to adopt it in a formal rulemaking proceeding. It cited *Montana Health Care Assoc. v. Board of Directors of State Compensation Mutual Ins. Fund,* 256 Mont. 146, 845 P.2d 113 (1993) and *Northwest Airlines v. State Tax Appeal Board,* 221 Mont. 441, 720 P.2d 676 (1986). Both cases are factually distinguishable and do not directly address the issue in this case.

Northwest Airlines concerned Montana's corporation license tax. The legislature adopted a statutory formula for determining the tax. That formula was based on the proportion of the company's Montana property, payroll, and sales to its total property, payroll and sales. However, the statute further empowered the DOR to alter the method of apportionment where the statutory formula did "'not fairly represent the extent of the taxpayer's business activity *in this state* . . . . '" *Northwest Airlines*, 221 Mont. at 443. The DOR adopted a rule, aimed at the transportation industry, which required that the apportionment be based on "percentage of miles traveled within Montana to total miles traveled everywhere." Then, "[b]y **fiat** of its auditor, DOR included miles attributed to nonstop flyovers, i.e. to airplanes which fly over Montana but which do not land or take off from Montana airports, as miles traveled within Montana in computing the tax owed by Northwest." 221 Mont. at 444 (emphasis added.) The Court held that non-stop overflights

over Montana do not constitute "miles traveled *within* Montana"; hence, the auditor's determination represented an expansion of the rule. *Id.* (italics in original).

The Court held the airline formula invalid for two reasons. First, it determined that there was "no statutory authority to include nonstop flyover miles in the numerator of the apportionment formula."[5] 221 Mont. at 445. Thus, whether or not adopted by rule, the statute did not authorize the use of the formula. Second, the Court held that the formula constituted a rule and was therefore invalid because the DOR had not complied with MAPA's rulemaking requirements. Discussion of the rulemaking requirement was cursory and brief: "

> The inclusion of overflight mileage in the statutory apportionment formula `implements, interprets or prescribes law or policy' and thus qualifies as a rule by statutory definition. Section 2-4-102(10), MCA. A rule to be valid must be adopted after notice and hearing in conformity with Section 2-4-302, MCA." 221 Mont. at 441.

As previously discussed in this decision, the Department has argued that the assessment methodology used in this case is "interpretive" and that rulemaking is optional when an agency is merely interpreting the law. *Northwest* does not discuss that distinction. Moreover, it is clear from the statute at issue in *Northwest* that the formula adopted by the DOR went beyond mere interpretation of a statute. Indeed, the formula represented an express *deviation* from the statutory formula. In this case, there is no explicit statutory method fixed by the statute for allocating direct and indirect costs among the three plans, and the Department argues that it is merely applying the assessment statute, not deviating from it.

Montana Health Care Association involved five different rulemaking issues. First, the Supreme Court held that changes in classifications and premium rates need not be made by rulemaking, although the process, procedure, formulas and factors for doing so must be promulgated by rule. 256 Mont. at 153. That holding, however, was pursuant to an express statutory provision, section 39-71-2316(6), MCA (1991). *Id.*

The second rule concerned changes in the classification section of the State Fund's Underwriting Manual. The Court held that since the section had been adopted by rule it can only be changed by rule. This holding is inapposite to the present case since no rule has ever been adopted.

The third issue concerned the State Fund's failure to adopt the "General Rules" section of its underwriting manual as a formal rule. The State Fund resisted such adoption,

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[5]The Court went on to point out that nothing in their opinion should be construed as barring the use of nonstop flyover miles in **both** the numerator and denominator. Thus, the statutory defect was the failure of the formula to fairly compare Montana overflights with total overflights of other states.

arguing that the section "merely states some of the contract terms and does not implement, interpret, or prescribe law or policy." 256 Mont. at 154. The district court held that the issue was "not critical to this lawsuit, and that in any case State Fund is nor required to adopt this section . . . as a formal rule." *Id.* The Supreme Court, without any discussion, merely determined that the district court was correct and affirmed the ruling. *Id.*

The fourth issue concerned contractual agreements the State Fund had with various trade associations for safety inspectors. The Court held that the agreements were uniquely tailored to the "circumstances of each trade association and class of employers" and that rulemaking was not required. 256 Mont. at 155.

The fifth and final issue concerned a change in the due date of premiums. The Court held that premiums are due when coverage is provided and that "the timing of billing for that coverage is not a matter that requires a rule." *Id.*

The Court's discussion of the five issues is not particularly helpful in the present context. The case does confirm that certain matters need not be established by the rulemaking process, for example matters which are best left to individual contracts.

The parties have provided citation to and discussion of a number of out-of-state cases. Those cases are helpful and support the result I reach in this case. However, the touchstone of my ultimate analysis is rooted in a common-sense approach to rulemaking requirements.

One of the fundamental reasons for requiring formal rulemaking is to require the governmental agency to consider and make a reasoned choice among alternative proposals for agency regulation. *Cf. Patterson v. Montana Dept. of Revenue,* 171 Mont. 168, 179-80, 557 P.2d 798, 804-05 (1976). Where a statute on its face sets forth a complete scheme of regulation, or where a complete scheme can be derived using ordinary principles of statutory interpretation, rulemaking is unnecessary. It may also be impossible to draft a rule which would cover all situations and circumstances.

However, rulemaking is appropriate and is required where the statute leaves significant regulatory details to agency discretion and those details can be formulated in a manner that generally applies to persons and entities subject to regulation. Rulemaking contemplates choices among competing alternatives. Thus, rulemaking procedures require an opportunity for the public to object to agency proposals and offer alternative proposals. *Patterson,* 171 Mont. at 179, 557 P.2d at 804; § 2-4-302, MCA. The agency must pay more than lip-service to public comment and must fully consider public objections and alternatives to a proposed rule. *Id.,* 171 Mont. 180, 557 P.2d at 805. It must even "issue a concise statement of the principal reasons for and against its [the rule's] adoption, incorporating therein its reasons for overruling the considerations urged against its adoption." § 2-4-305(1), MCA.

In this case, the assessment statute is not self-executing and cannot be made self-executing by resort to customary principles of statutory interpretation. To determine what constitutes a direct cost requires a consideration of what is practical and reasonable. Reasonable persons may disagree as to what is practical and reasonable. The work load measures adopted by the Department to allocate indirect costs are not the only possible measures. Other measures are available, for example time-keeping by hearing examiners. While the Department puts much emphasis on the words "using proper accounting and cost allocation procedures", § 39-71-201(1)(c), MCA, (1991), the testimony at the hearing indicates that there may be alternative measures which satisfy that definition, just as LIFO and FIFO methods of valuing inventory may both be acceptable accounting practices.[6]

In a rulemaking proceeding, the Department would have been required to consider and respond to objections to the methodology it has adopted. It would have been required to consider alternatives offered by the public, including MSG. The informal, ad hoc committee formed in the Spring of 1992 went part way to respond to criticisms of the Department's methodology but not far enough. I hold that the methodology adopted by the Department is subject to rulemaking requirements.

The decisions cited by the parties in their supplementary briefs *tend* to support my conclusion, although some individual decisions could be construed as supporting a different view.

Swenson v. Department of Revenue, 553 P.2d 351 (Or. 1976), cited by the Department, involved the valuation of timber for purposes of a property tax. The taxpayer argued that the method adopted by the Department of Revenue constituted a rule and was invalid because it had not been formally adopted. The Court rejected the challenge, pointing out that valuation of timber, as with other property, involved standard methods of appraisal and that emphasis on the appraisal factors varied depending on the individual characteristics of the property. The ultimate goal of appraisal was to determine retail market value and the Court concluded that a formal rulemaking proceeding was not required where standard, commonly understood methods of appraisal are used. In this case there is no evidence that the assessment methodology is a common one or commonly understood. Moreover, the controversy is over the methodology itself rather than its application to a specific instance.

Island Count Committee on Assessment Rations v. Department of Revenue, 500 P.2d 756 (Wash. 1972), also cited by the Department, is a perplexing decision which could be read as supporting the Department's position. In that case, the Washington Department of Revenue was required to equalize property values for the purposes of determining the taxing capacity of each school district and distributing state school monies. The ratios were similar to the sales-assessment ratios used in *Barron.* Initially, they were based on

[6]LIFO (last in, first out) and FIFO (first in, first out) were at least acceptable a generation ago when this writer studied basic accounting!

warranty deed sales but the Department then expanded the ratios to include contract for deeds. An association of taxpayers contended that the ratio studies were subject to rulemaking requirements but the Washington Supreme Court disagreed, holding that the ratios were matters concerning the internal operations of the department and as such do not constitute an "order, directive or regulation of general applicability." 500 P.2d at 762. The Department in this case has made a similar "internal operations" argument, which I have already rejected. I am convinced that the logic in *Island Count* is flawed for the same reasons set forth in my discussion of the Department's contention.

Several cases cited by MSG, while factually inapposite, provide illustrations of circumstances where assessments and allocation formulas must be formally adopted by rule. In *Jefferson School District R-1 v. Division of Labor,* 791 P.2d 1217 (Colo. App. 1990), an agency practice permitted premium adjustments for insurers but not to self-insureds for purposes of assessments levied to fund a Colorado Major Medical Insurance Fund. The Colorado Court of Appeals deemed the practice "`agency statement of general applicability and . . . future affect"' subject to rulemaking requirements. 791 P.2d at 1219 (quoting *Home Builder's Ass'n. v. Public Utilities Commission,* 720 P.2d 522 (Colo. 1986).)

Ocosta School District No. 172, 689 P.2d 1382 (Wash. App. 1984), involved a determination by the Superintendent of Public Instruction to deduct county timber sale proceeds from state school equalization monies. The determination was made pursuant to a statute which authorized the Superintendent to deduct "such other available revenues as . . . [he] may deem appropriate for consideration in computing state equalization support." 689 P.2d at 1383. The deduction for timber sales was nullified because the Superintendent did not follow rulemaking procedures and thereby give school districts a chance to dispute his assumptions for adopting the rule. 689 P.2d at 1385.

Matanuska-Susitna Borough v. Hammond, 726 P.2d 166 (Alaska 1986), concerned Alaska revenue sharing with municipalities, as well as a statute limiting local taxation. One of the factors considered in distributing available revenue sharing funds and limiting taxes was municipal population. One of the difficulties in determining population arose because of the employment of workers in Alaska's North Slope oil fields. Those workers often resided in other municipalities and states during their time off. The Alaska Supreme Court noted that the agency responsible for administering the statutes

> . . . investigated the feasibility of a variety of approaches for estimating population. It considered counting "de facto" populations — that is, the total number of people physically present in each municipality on the date of the census — but rejected this approach because of the absence of benchmark data against which to test the accuracy of the initial de facto counts and the necessity of hiring additional personnel to implement such a program.

726 P.2d at 172. Other available methods of determining population were based on where an individual spent most nights during the week of the census, 726 P.2d at 170, and where the individual resided during a majority of the year -- the so-called "51% percent rule", 726

P.2d at 171. Among other holdings, the Supreme Court of Alaska held that the definition of "population" should have been promulgated by rulemaking. 726 P.2d at 182. While the Court did not specifically say so, it appears that the availability of alternative definitions was crucial to its holding. The availability of alternative direct cost and work load measures is a critical consideration in this case.

Salmon Brook Convalescent Home, Inc. v. Commission on Hospitals and Health Care, 477 A.2d 358 (Conn. 1979), involved state regulation of nursing home rates for patient care. Rates were based on nursing home costs. Salmon Brook's application for a rate increase was denied because certain costs, namely owner's compensation and the salary of the nursing director, exceeded guidelines adopted by the commission. The Connecticut Supreme Court held that application of the guidelines was illegal because rulemaking procedures had not been followed. The Court rejected the commission's "guidelines" label and determined that they were substantive, legislative-type regulations governing the rights and obligations of nursing home owners. While factually different, *Salmon Brook* supports by analogy this Court's finding that the assessment methodology adopted by the Department affects the rights and obligations of self-insured employers and constitute substantive, legislative-type regulation.

Finally, *Metromedia, Inc. v. Director, Division of Taxation*, 478 A.2d 742 (N.J. 1984), strongly supports the result reached in this case. At issue in *Metromedia* was an agency's calculation of a corporate business tax on a radio station. The Director of Taxation of the State of New Jersey determined that business revenue of the station should be allocated based on the in-state audience share of the station. Audience share had not previously been used in allocating business receipts and was adopted by directive rather than through rulemaking. The New Jersey Supreme Court held that the allocation amounted to de facto, but invalid rulemaking.

In reaching its conclusion, the Court observed that "[i]t has been consistently recognized that the widespread, continuing, and prospective effect of an agency pronouncement is the hallmark of an "`administrative rule"'. 478 A.2d at 750. It went on to say:

> An agency determination that is intended to be applied as a general standard and with widespread coverage and continuing effect can also be considered an administrative rule if it is not otherwise expressly authorized by or obviously inferable from the specific language of the enabling statute. *See Crema, supra,* 94 N.J. at 301, 463 A.2d 910; *cf. Airwork v. Director, Div. of Taxation,* 97 N.J. 290, 478 A.2d 729 (1984) (where tax statute is sufficiently specific, determination in the form of a tax assessment does not require antecedent rule); *R.H. Macy & Co., Inc., supra,* 41 N.J. 3, 194 A.2d 457 (when adequate legislative standard exists for administrative guidance, general rule is not required).

Id. The quoted text and citations directly support the approach I have adopted in this case. As I have already found, the assessment statute at issue herein is not self-executing and definite, hence rulemaking is required.

In conclusion, assessment methodology for implementing section 39-71-201, MCA, must be adopted by rule. The fact that the present methodology has been used for years does not alter this conclusion since the purpose of rulemaking is to allow consideration of alternative methods of regulation. Moreover, the affected party in this case is a newcomer. It is not one who by its inaction over a period of years has acquiesced to use of the methodology.

III. Compliance with Statute

Finally, MSG argues that the methodology does not comply with section 39-71-201, MCA, because the statute requires the Department to identify and utilized direct costs where possible and the Department has failed to do so. (APPELLANT'S BRIEF at 15-20.)

MSG's argument in this regard cannot be separated from its argument concerning rulemaking. The statute refers to "direct costs identified to the three plans." The rub, however, is determining what costs are "readily" identifiable. As I have already determined, the statute is not self-executing. In any rulemaking proceeding the Department must determine what direct costs, if any, can be readily traced to the three plans. Any direct costs which are identified must be utilized in the assessment.

RELIEF

This Court requested the parties to address what relief should be granted should it hold that rulemaking requirements have been violated. MSG requests the Court to order the Department to undertake rulemaking. With respect to the amount paid in 1992, it concedes that the statute imposes an obligation upon it and requests that its obligation be recomputed under methodology duly adopted by rule and that the difference be refunded or applied to its obligations in future years.

Section 2-4-102(11)(a), MCA, provides that legislative rules which are not properly adopted are invalid. Thus, the application of the assessment methodology to MSG was invalid. However, since section 39-71-201, MCA, specifically provides that insurers and self-insureds shall pay fees in an amount sufficient to fund government regulation of workers' compensation, the Court agrees with MSG that it is entitled to a refund or credit in the amount of the difference between the 1992 assessment under current methodology and the amount assessed pursuant to a validly adopted rule. Since the Department is responsible for the assessment, it is obligated to initiate a rulemaking proceeding and adopt methodology consistent with its statutory mandate. Once a rule is adopted, the MSG is entitled to have its 1992 assessment recomputed pursuant to the rule and to either a refund or credit in the amount of any difference.

1993 Assessment

MSG's NOTICE OF APPEAL extends to its 1993 assessment. Based on the hearing examiner's FINDINGS OF FACT, CONCLUSION OF LAW AND ORDER with respect to the 1992 assessment, on September 1, 1993, the hearing examiner dismissed the challenge to the 1993 assessment. For the reasons set forth with regard to the 1992 assessment, the dismissal was in error and must be reversed.

JUDGMENT

1. The assessments and fees levied pursuant to section 39-71-201, MCA, do not violate equal protection principles. The constitutional claims of the Montana Schools Group are **dismissed.**

2. The assessment methodology used by the Department of Labor and Industry in 1992 and 1993 under section 39-71-201, MCA, amounted to a de facto rule which, pursuant to section 2-4-102(11)(a), MCA, is deemed void . Since the Department failed to follow rulemaking procedures, use of the methodology in determining the fees due from the Montana Schools Group was void. The hearing examiner's determination to the contrary is **reversed** and this matter is **remanded** for a rulemaking proceeding to properly establish an assessment methodology implementing section 39-71-201, MCA.

3. After properly adopting a rule regarding assessment methodology, the Department shall recompute Montana Schools Group's fees for 1992 and 1993 using the new methodology. If the fees are less than originally assessed, the Department shall either refund the difference or credit that difference to Montana Schools Group's obligations in future years.

4. The Court retains continuing jurisdiction to resolve any disputes which may arise in the carrying out of this judgment.

5. This JUDGMENT is certified as final for purposes of appeal pursuant to ARM 24.5.348.

Dated in Helena, Montana, this 16th day of June, 1995.

(SEAL)

/S/ Mike McCarter
JUDGE

c: Mr. Allen B. Chronister
Mr. Daniel B. McGregor
Ms. Melanie A. Symons