
**HOUSE COMMITTEE ON GENERAL INVESTIGATING
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2000**

**A REPORT TO THE
HOUSE OF REPRESENTATIVES
77TH TEXAS LEGISLATURE**

**PETE P. GALLEGO
CHAIRMAN**

**COMMITTEE CLERK
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Committee On
General Investigating

November 8, 2000

Pete P. Gallego
Chairman

P.O. Box 2910
Austin, Texas 78768-2910

The Honorable James E. "Pete" Laney
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol, Rm. 2W.13
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

The House Committee On General Investigating of the Seventy-Sixth Legislature hereby submits its interim report including recommendations for consideration by the Seventy-Seventh Legislature. Draft legislation resulting from the recommendations contained in the interim report has been requested from the Texas Legislative Council and will be submitted accordingly.

Respectfully submitted,

Pete P. Gallego, Chairman

D.R. "Tom" Uher

Joe Crabb

Craig Eiland

Terry Keel

D.R. "Tom" Uher
Vice-Chairman

Members: Joe Crabb, Craig Eiland, Terry Keel

Forward

At the beginning of the 76th Legislature, the Honorable James E. “Pete” Laney, Speaker of the Texas House of Representatives, appointed five members to the House Committee on General Investigating. The committee membership included the following members: Pete P. Gallego, Chairman; D.R. “Tom” Uher, Vice-Chairman; and members: Joe Crabb, Craig Eiland, and Terry Keel.

During the interim, the Committee was assigned four charges by the Speaker:

1. Investigate allegations of excessive use of crowns and other aggressive dental procedures by certain providers in the Medicaid program.
2. Investigate recent actions of the State Board of Education relating to its management of the Permanent School Fund.
3. Review the security resources available to protect state employees and state buildings.
4. Review the program and processes by which disabled workers are afforded priority in certain state procurements, including the roles of the General Services Commission, the Council for Purchasing from People with Disabilities, and the Texas Industries for the Blind and Handicapped.

The Committee has completed its hearings and investigations and issues the report that follows. The members of the Committee have adopted and approved all of the recommendations with the noted exception.

Finally, the Committee wishes to express appreciation to all who contributed their time and effort for the betterment of the state of Texas. Particular thanks are due to Roger Ferris and Martha McCabe of the State Auditor’s Office for their work on the Committee’s behalf.

TABLE OF CONTENTS

Part 1: Excessive Use of Certain Dental Procedures in the Medicaid Program

Introduction	1.1
Roles and Responsibilities	1.1
Scope	1.2
Stainless Steel Crowns	1.3
Documentation and Record Keeping	1.5
Hospitalization, General Anesthesia and the 15-point System	1.5
Behavior Management	1.6
Nutritional Consultation	1.7
Investigation and Enforcement	1.7
Agency Relationships	1.9
Reimbursement Rates	1.9
Summary of Recommendations	1.9
Endnotes	1.11
Appendix I	1.12

Part 2: Investigate Recent Actions of the State Board of Education Relating to the Management of the Permanent School Fund

Executive Summary	2.1
Introduction	2.2
Managing the Permanent School Fund	2.3
State Support of Public Education	2.3
The State Board of Education	2.3
The Committee on School Finance/Permanent School Fund	2.3
Permanent School Fund Staff	2.4
External Consultants and Money Managers	2.4
Downstream Broker-dealers and Others	2.5
Evidence	2.5
Exposing the PSF to Conflicts of Interest	2.6
Conclusions and Recommendations	2.13
Endnotes	2.18

Part 3: Review the Security Resources Available to Protect State Employees and State Buildings

Background	3.1
Risk Management in State Agencies	3.1
State Office of Risk Management	3.1
General Services Commission	3.3
Texas Department of Public Safety - Capitol Police District	3.4
State Preservation Board	3.4
Gauging the Threat of Workplace Violence	3.4

Dealing with Workplace Violence	3.8
At State Agencies	3.8
At the Capitol Complex	3.9
Conclusions & Recommendations	3.12
Endnotes	3.14
Appendix I	3.17
Appendix II	3.18

Part 4: The State Use Program

Background	4.1
State Use Program: Then and Now	4.2
The Dispute	4.5
Conclusions & Recommendations	4.7
Endnotes	4.12
Appendix I	4.16

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Excessive Use of Certain Dental Procedures in the Medicaid Program

INTRODUCTION

The House Committee on General Investigating conducted an interim investigation on excessive use of stainless steel crowns and other aggressive dental procedures by certain providers in the Medicaid program. During this investigation, the Committee did find some evidence of fraud in the Texas Health Steps (THSteps) Dental Services Program. Various procedures and certain billing codes offer providers the chance to defraud the dental program without fear of punishment or repercussion. While the Texas Department of Health (TDH), the Health and Human Services Commission (HHSC), and the National Heritage Insurance Company (NHIC) all have controls in place to detect potential provider abuses in the THSteps program, there is a reluctance to adequately investigate, prosecute and punish abusive providers.

The Texas Health Steps Dental Services Program is extremely important to the children of Texas. One of the biggest criticisms of Medicaid and a hurdle in increasing funding for social programs like Medicaid is the existence of fraud in any form. While abusive providers are a minority of the providers in the dental Medicaid system, any amount of fraud is unacceptable. It is imperative that HHSC and TDH do a better job of minimizing the opportunity for providers to abuse the system.

The ideas and recommendations set forth herein are intended to eliminate opportunities for providers to abuse the system. The Committee's goal is to improve the Medicaid program, ensure appropriate and quality care for children in the Medicaid program, make the program attractive to new providers so that more children can ultimately be treated, and ensure citizens that their tax dollars are not being spent on unnecessary, fraudulent, or frivolous claims. To that end, the agencies responsible for the implementation of the Medicaid program should immediately adopt the policy recommendations contained herein.

The Committee would like to express its gratitude to the Texas Department of Health, the Health and Human Services Commission, and the National Heritage Insurance Company for their courtesy and cooperation throughout this investigation.

ROLES AND RESPONSIBILITIES

Three entities are responsible for the management, implementation, and oversight of the dental Medicaid system in Texas: the Health and Human Services Commission (HHSC), the Texas Department of Health (TDH), and the National Heritage Insurance Company (NHIC).

The Health and Human Services Commission is designated the single state agency responsible for the Medicaid program. Within HHSC, the State Medicaid Director administers the Medicaid program.

HHSC is the primary point of contact with the federal government. It establishes policy directions for the Medicaid program and has final approval of all Medicaid policies, rules, reimbursement rates, and operations of other state agencies contracted to operate the Medicaid program.¹

Within HHSC, the Office of Investigations and Enforcement (OIE) is responsible for the detection, investigation, and prevention of fraud, abuse, or waste in health and human services programs. If fraud or abuse is identified, OIE may recoup funds paid to providers, assess civil monetary penalties, exclude a provider from the Medicaid program and/or cancel the provider's contract. OIE also refers cases to the Office of the Attorney General for criminal and civil action.²

The Texas Department of Health (TDH) operates the Texas Health Steps Dental Services Program according to applicable state and federal laws, Medicaid policies and procedures, standards established by the Texas State Board of Dental Examiners (SBDE), and guidelines set forth by the American Dental Association and the American Academy of Pediatric Dentistry. TDH also manages and administers the contract with the Medicaid claims processor, the National Heritage Insurance Company (NHIC).³

The National Heritage Insurance Company (NHIC) is the State's agent for operating portions of the State's Medicaid program within the purview of the Texas Department of Health. While NHIC participates in some policy discussions, TDH ultimately determines policies and directs NHIC on how to implement those policies at the operational level. The areas of operation delegated by TDH to NHIC are set forth in the claims administrator contract between NHIC and TDH. NHIC processes and adjudicates most claims for Texas Medicaid programs including the THSteps program. In addition to its processing duties, NHIC works with Medicaid providers through seminars and publications. NHIC also conducts institutional cost audits, utilization review activities and manages payment recoveries from third parties. NHIC also maintains a federally certified Medicaid management information system ("MMIS").⁴

SCOPE

The Texas Health Steps Dental Services Program is approximately a \$135 Million program that serves approximately 600,000 children through approximately 3,000 dental providers. Exact figures regarding total expenditures and participation rates are given below.

State Fiscal Year	Dollars Available for the THSteps Program	Total Expenditures for the THSteps Program
1997	\$128,998,171.00	\$125,158,915.26
1998	\$129,980,602.00	\$129,971,233.00
1999	\$137,861,839.00	\$133,884,961.00

Total expenditures for the Texas Health Steps Dental Services Program in state fiscal years 1997, 1998 and 1999⁵

State Fiscal Year	Children Age 1-20	Children Eligible for the THSteps Program	Children Receiving at Least 1 Dental Service	Participation Rate
1997	5,987,796	1,687,968	642,027	38%
1998	6,083,134	1,616,564	620,468	38%
1999	6,173,479	1,583,039	596,141	38%

Participation Rates in the Texas Health Steps Dental Program by Children Age 1-20 for State Fiscal Years 1997, 1998 and 1999⁶

State Fiscal Year	Licensed Dentists in Texas	Dentists Participating in the THSteps Program	Participation Rate
1997	8,509	2,794	33%
1998	9,314	2,919	31%
1999	8,901	3,032	34%

Participation Rate by Texas Dentists in the Texas Health Steps Dental Program for State Fiscal Years 1997, 1998 and 1999⁷

STAINLESS STEEL CROWNS

When treating a tooth with signs of decay, most pediatric dentists agree that treatment options include application of a resin or amalgam filling, or the application of a stainless steel crown. Medicaid reimburses between \$25.00 and \$50.00 per filling, and \$68.75 per stainless steel crown. Some members of the dental community argue that stainless steel crowns are more cost-effective than amalgam fillings. The argument is that amalgam fillings frequently have to be replaced before the primary (baby) tooth falls out, whereas stainless steel crowns almost always stay in place for the life of the tooth. Rather than pay between \$25.00 and \$50.00 two or three times, some dentists argue that it makes more economic sense to pay \$68.75 only once.

Reimbursement for stainless steel crowns represents a significant portion of the entire budget for the THSteps Program. The exact figures for total expenditures on stainless steel crowns are given below.

State Fiscal Year	Total Expenditures for Stainless Steel Crowns	Number of Times the Stainless Steel Crown Billing Code Was Paid
1997	\$17,250,820.25	250,719
1998	\$16,616,358.67	241,582
1999	\$15,017,100.45	218,142

Total Expenditures for Stainless Steel Crowns in State Fiscal Years 1997, 1998 and 1999⁸

The following chart illustrates how providers in Texas place stainless steel crowns with much greater frequency than providers in other comparable states.

State	% Stainless Steel Crowns
California	19.84 %
Florida	16.64 %
Michigan	11.01 %
Pennsylvania	25.94 %
Texas	56.49 %

Percent of Stainless Steel Crowns Related to Amalgam Fillings Placed on Primary Teeth Based on Data from the Fourth Quarter of Fiscal Year 1998⁹

The Committee takes no position on whether stainless steel crowns or amalgam filings represent a *better* or *worse* restorative treatment. However, it is disturbing that the use of these crowns would lag so far behind in other states. The Committee is unable to find an adequate explanation for this variation in different states' use of stainless steel crowns, particularly if they represent a superior restorative treatment.

Some witnesses suggested that Texas placed so many more stainless steel crowns than other states because providers in Texas were using crowns as a preventive treatment. However, this is inconsistent with Medicaid rules. Medicaid rules allow reimbursement to providers only for procedures that are medically necessary. The Texas Department of Health and the Health and Human Services Commission must comply with federal laws and regulations. In accordance with Medicaid regulations, stainless steel crowns should only be used when medically necessary.

Even more disturbing than the statistics above were the anecdotal examples of excessive stainless steel crowns placed on children where the crowns were not justified. Witnesses testified that in certain instances certain providers would unnecessarily place multiple crowns in one sitting. In some instances these crowns were placed on children without either parental knowledge or consent. One witness recounted a story of a child going to a dentist only to return home with a mouth full of stainless steel crowns. The child was subjected to taunts of "metal mouth" at school and could not eat hot or cold foods.

Particularly troubling was the testimony from one witness regarding different standards of record keeping and documentation by providers for Medicaid and privately insured children. Children should receive a uniform standard of care regardless of their pay status. This standard should not vary based on whether Medicaid or private insurance is paying for dental services. Requiring providers to document the need for any stainless steel crown will minimize the excessive use of unnecessarily placed stainless steel crowns. The documentation should be in the form of x-rays or any other method which clearly shows the need for the placement of stainless steel crowns. The Texas Department of Health and the Health and

Human Services Commission should immediately institute a policy that requires providers to document the need for any stainless steel crown before that crown is placed.

DOCUMENTATION AND RECORD KEEPING

Documentation and record keeping with regard to dental charts and x-rays has been a recurring theme throughout this investigation. The Committee heard repeated testimony from former investigators who suggested that it is easy to perpetrate fraud in the Medicaid system (especially in the use of stainless steel crowns) by keeping bad records or no records at all.

The Committee heard testimony from former investigators who suggested that some providers have a double standard with regard to record keeping: one standard for private pay children, and a second standard for children using Medicaid. According to one former investigator, the dental files for private pay kids of some providers contained pristine sets of all-inclusive records while the Medicaid records of those same providers contained substantially less documentation. All children should be afforded a basic, minimum standard of care that includes comparable documentation and record keeping.

The adoption of a minimum standard of documentation and record keeping would significantly aid investigators investigating potential abusers. The Texas Department of Health and the Health and Human Services Commission should work with and enlist the assistance of the Board of Dental Examiners to adopt a minimum standard of documentation and record keeping that applies equally to all patients, regardless of their pay status.

HOSPITALIZATION, GENERAL ANESTHESIA, AND THE 15-POINT SYSTEM

Dental providers may claim a \$75.00 fee if a patient requires hospitalization for dental services. The \$75.00 hospitalization fee provides a financial incentive for unscrupulous providers to provide a potentially unnecessary service. Though hospitalization may be required in extreme cases, Texas children are being hospitalized at too high a rate. Too many children are being exposed to unnecessary risk through hospitalization for dental procedures.

TDH spends more than \$1 Million each fiscal year reimbursing providers for hospital calls. The exact figures for expenditures on hospital calls are given below.

State Fiscal Year	Total Expenditures for Hospital Calls	Number of Times the Hospital Call Code was Paid
1997	\$1,296,397.00	17,323
1998	\$1,297,859.59	17,320
1999	\$1,164,941.44	15,512

Total Expenditures for Hospital Calls for State Fiscal Years 1997, 1998 and 1999¹⁰

Texas is hospitalizing children at a much greater frequency than other states. For example, only 332 children in the entire state of Illinois were approved for hospitalization for dental treatment in 1998.¹¹ That same year, the hospital call billing code was paid 17,320 times in Texas, as the chart above indicates.

The Texas Department of Health and the Health and Human Services Commission should reduce the \$75.00 fee for hospitalization and redistribute the funds into the other most commonly billed procedures.

One of the most significant problems in the dental Medicaid program is the 15-point system. The 15-point system is the criteria used by providers for determining whether general anesthesia is appropriate for certain dental procedures. If the patient reaches the 15-point threshold, the provider is authorized to use general anesthesia in providing the patient with dental services. Different points are given based on the age of the patient, the treatment requirements, behavior, and additional factors.¹²

The lack of objectivity in the 15-point system renders the system meaningless. If a provider determines that a patient exhibits “definitely negative” behavior and has “limited access to dental care,” the provider may justifiably hospitalize the patient and perform the dental procedures. There is no uniform definition applicable to either of these terms. Thus, the 15-point scale is extremely subjective and is inconsistently applied throughout the state. Furthermore, whether a child has “limited access to dental care” seems wholly unrelated to the issue of whether hospitalization and general anesthesia are warranted. Hospitalization and general anesthesia should be used only for serious cases requiring such treatment.

The Texas Department of Health and the Health and Human Services Commission should immediately replace the 15-point system with a more objective, comprehensive and realistic system for determining the medical necessity for hospitalization and general anesthesia.

BEHAVIOR MANAGEMENT

As the Committee investigated the excessive use of stainless steel crowns, other issues surfaced regarding questionable costs in the Medicaid system. One of these questionable costs is the behavior management fee. Dental providers can claim a \$50.00 fee for “behavior management.” Again, there is no uniform definition of behavior management. The total expenditures for behavior management are given below.

State Fiscal Year	Total Expenditures for Behavior Management
1997	\$2,307,732.31
1998	\$3,273,088.72
1999	\$3,839,681.51

Total Expenditures for Behavior Management for State Fiscal Years 1997, 1998 and 1999¹³

Most private insurers do not reimburse providers for this service, and medical doctors do not have the option of claiming this fee either. However, in both state fiscal year 1998 and 1999, the top billing dentist for the behavior management fee billed this code approximately 1,890 times each year and was paid approximately \$95,000 each year just for managing behavior.¹⁴

No adequate explanation regarding any kind of oversight or accountability for this fee was ever given by the Texas Department of Health or the Health and Human Services Commission. It is common sense that some children will require a little more time and attention than others. Some patients will be more difficult, while others will be relatively simple to treat. This is inherent not only in dentistry, but in all health care professions. Providers should not have the ability to arbitrarily claim a \$50.00 fee for a completely subjective determination, particularly when there is no accountability. This fee is an open opportunity for some dental practitioners to pad their dental claims without fear of repercussion. To minimize the risk that some providers will take advantage of the system, an objective criteria for behavior management must be developed if the fee continues in existence.

In the event that no objective criteria are established, the Texas Department of Health and the Health and Human Services Commission should immediately eliminate the \$50.00 behavior management fee and redistribute the funds into other commonly billed procedures for which there is documentation, oversight, accountability, and an objective set of criteria.

NUTRITIONAL CONSULTATION

Providers may now claim a \$15.00 fee for providing “nutritional consultation.” A nutritional consultation consists of a provider giving advice that is above and beyond the basic dental hygiene advice given to most patients. The accountability and oversight for this fee is dubious. The total expenditures for nutritional consultation are given below.

State Fiscal Year	Total Expenditures for Nutritional Consultation
1997	\$96,591.55
1998	\$169,378.25
1999	\$151,272.75

Total Expenditures for Nutritional Consultation for State Fiscal Years 1997, 1998 and 1999¹⁵

TDH and HHSC have no way of knowing whether these services are legitimate, justified, or even being performed. Again, this fee represents an open opportunity for some dental practitioners to pad their dental claims without fear of repercussion.

The Texas Department of Health and the Health and Human Services Commission should

immediately eliminate the \$15.00 nutritional consultation fee and redistribute the funds into other more commonly billed procedures for which there is documentation, oversight, accountability, and an objective set of criteria.

INVESTIGATION AND ENFORCEMENT

Over the past few years, HHSC has taken a much more lax stance with regard to investigating and prosecuting cases of fraud and recouping errant payments. In the past six years there have been only 19 cases of fraud requiring prosecution in a \$135 Million program where 3,000 providers serve 600,000 children each year. The chart below indicates that over the past six years HHSC has referred only 19 cases to the Attorney General's Office for prosecution.

State Fiscal Year	Number of cases referred to the AG by HHSC's OIE
1994	1
1995	3
1996	8
1997	2
1998	1
1999	4

Number of Dental Cases Referred to the Attorney General's Office by the Health and Human Service Commission's Office of Investigations and Enforcement (OIE)¹⁶

As the chart above indicates, HHSC averages just over three cases referred to the AG's office per year. However, investigators formerly employed by the Attorney General's Office and the National Heritage Insurance Company testified that there should be no trouble making one good case a month.

The Health and Human Service Commission's Office of Investigations and Enforcement (OIE) recouped only \$439,704 in errant payments in state fiscal year 1999. That same office had an individual case in the early 1990's that yielded a single recoupment of \$518,906. This single case yielded more money than the total dollars recouped in all of 1999.¹⁷

Given the technology and information available to the HHSC's Office of Investigations and Enforcement, both the number of cases referred for prosecution and the total dollars recouped by HHSC should be significantly higher. The HHSC implemented the Medicaid Fraud and Abuse Detection System (MFADS) in December 1997 to analyze Medicaid claims data for suspected cases of fraud and abuse. MFADS is a system that uses sophisticated neural network technology to identify abuses in the Medicaid program. This information is available to the OIE for further investigation.

The Health and Human Services Commission must walk a very fine line. On one hand, the

Commission must make the Medicaid program more attractive to providers so more children will ultimately be served. This is especially true given the recent decision in *Frew v. Gilbert*, 109 F. Supp. 2d 579 (E.D. Tex. 2000). On the other hand, the Commission must also ensure that no provider abuses the system. It must vigorously and diligently flush out fraud, identify fraudulent providers, remove them from the program, and recoup any and all payments made in error.

The MFADS utilized by the Health and Human Services Commission gives the Commission all the information necessary to efficiently and effectively identify and prosecute potential abusers in the provider community. However, the Health and Human services Commission must refocus efforts to eliminate fraud from the dental Medicaid program. The Commission should adopt a zero tolerance policy toward fraud and aggressively investigate and prosecute any provider who abuses the system. The Health and Human Services Commission should resume the practice of randomly auditing providers, especially those providers whose Medicaid billing activities are excessive or fall outside the reasonable billing expectations with the respective peer groups.

AGENCY RELATIONSHIPS

A problematic aspect of the dental Medicaid system is the intertwining responsibilities of the Texas Department of Health, the Health and Human Services Commission, and the National Heritage Insurance Company. These entities must do a better job of coordinating among themselves to more effectively and efficiently administer the dental Medicaid program. Due to overlapping responsibilities, each entity needs to improve its cooperative working relationship with the other agencies involved in implementing the Medicaid program.

For example, the State Auditor released a July 2000 audit which criticized the Texas Department of Health for not holding National Heritage Insurance Company accountable for processing Medicaid claims accurately, for enrolling providers properly, or for completing a new Medicaid Management Information System on time. Better working relationships among these entities could have potentially prevented some of these findings. The Texas Department of Health, the Health and Human Services Commission, and the National Heritage Insurance Company must do a better job of communicating and coordinating their administration and implementation of the dental Medicaid program.

REIMBURSEMENT RATES

While the issue of Medicaid reimbursements rates do not fall within the parameters of this investigation, the Committee recommends that the 77th Legislature closely examine the reimbursement rates paid by Medicaid to dental providers, especially for the most commonly billed dental procedures.

SUMMARY OF RECOMMENDATIONS

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- The Texas Department of Health and the Health and Human Services Commission should immediately comply with federal laws and regulations. In accordance with Medicaid regulations, stainless steel crowns should only be used when medically necessary.
 - The Texas Department of Health and the Health and Human Services Commission should immediately institute a policy requiring providers to document the need for any stainless steel crown before that crown is placed.
 - The Texas Department of Health and the Health and Human Services Commission should work with and enlist the assistance of the Board of Dental Examiners to adopt a minimum standard of documentation and record keeping that applies equally to all patients, regardless of their pay status.
 - The Texas Department of Health and the Health and Human Services Commission should reduce the \$75.00 fee for hospitalization and redistribute the funds into the other most commonly billed procedures.
 - The Texas Department of Health and the Health and Human Services Commission should immediately replace the 15-point system with a more objective, comprehensive, and realistic system for determining the medical necessity for hospitalization and general anesthesia.
 - The Texas Department of Health and the Health and Human Services Commission should immediately eliminate the \$50.00 behavior management fee and redistribute the funds into other commonly billed procedures for which there is documentation, oversight, accountability, and an objective set of criteria.
 - The Texas Department of Health and the Health and Human Services Commission should immediately eliminate the \$15.00 nutritional consultation fee and redistribute the funds into other more commonly billed procedures for which there is documentation, oversight, accountability, and an objective set of criteria.
 - The Health and Human Services Commission needs to refocus its efforts to eliminate fraud from the dental Medicaid program. The Commission should adopt a zero tolerance policy toward fraud and aggressively investigate and prosecute any provider who abuses the system. The Health and Human Services Commission should resume the practice of randomly auditing providers, especially those providers whose Medicaid billing activities are excessive or fall outside their respective peer groups.
 - The Texas Department of Health, the Health and Human Services Commission, and the National Heritage Insurance Company must do a better job of communicating and coordinating their administration and implementation of the dental Medicaid program.
 - The 77th Legislature should closely examine the reimbursement rates paid by Medicaid to dental

providers, especially for the most commonly billed dental procedures.

ENDNOTES

1. Description of roles and responsibilities provided by the Texas Health and Human Services Commission
2. Description of roles and responsibilities provided by the Texas Health and Human Services Commission
3. Description of roles and responsibilities provided by the Texas Department of Health
4. Description of roles and responsibilities provided by the National Heritage Insurance Company
5. Statistics for total expenditures provided by the Texas Department of Health
6. Statistics for participation rates by children provided by the Texas Department of Health
7. Statistics for participation rates by dentists provided by the Texas Department of Health
8. Statistics for total expenditures on stainless steel crowns provided by the Texas Department of Health
9. Chart based on data from HCFA, December 17, 1999
10. Statistics for total expenditures on hospital calls provided by the Texas Department of Health
11. Statistics cited in "Pediatric dentists in Texas want higher Medicaid fee," The Houston Chronicle, September 19, 1999, by Mark Smith
12. Texas Department of Health - see appendix for 15-point system
13. Statistics for total expenditures on behavior management provided by the Texas Department of Health
14. Statistics on behavior management provided by the Texas Department of Health
15. Statistics for total expenditures on nutritional consultation provided by the Texas Department of Health
16. Statistics for cases referred to the Attorney General's Office provided by the Health and Human Service Commission's Office of Investigation and Enforcement
17. Statistics for dollars recouped provided by the Health and Human Service Commission's Office

of Investigation and Enforcement

APPENDIX I

**DOCUMENT ON FILE WITH
HOUSE COMMITTEE ON GENERAL INVESTIGATING**

Investigate Recent Actions of the State Board of Education Relating to the Management of the Permanent School Fund

EXECUTIVE SUMMARY

The assets of the Permanent School Fund (PSF), now worth approximately \$22 billion, have grown impressively in recent years. Nonetheless, the House Committee on General Investigating has found evidence suggesting, at a minimum, that the appearance of a conflict of interest affects the State Board of Education's (SBOE) decisions on consultant and money manager selection, asset allocation, and broker-dealer eligibility requirements. The fact that financial relationships involving informal advisors to the Chair, the Vice Chair and another member of the SBOE's standing Committee on School Finance/Permanent School Fund (School Finance/PSF Committee) have been undisclosed has limited the full SBOE's ability to safeguard its decisions from influence by self-interest. These relationships and decisions call into question the SBOE's ability to manage the PSF with the ordinary prudence required by the Texas Constitution. This is eroding public trust in one of the major investing entities of the State of Texas.

Managing this large investing entity is a complex task. Moreover, securities trades often occur many steps removed from public view. Tracing previously-undisclosed financial transactions has been challenging. This Report tries to explain events clearly. At times, however, the very complexity of the public investment arena has camouflaged potential self-dealing. Explaining complex transactions in simple terms has been a great challenge.

Despite the challenges presented by the complexity of securities trading and the fact that several individuals disclosed details of their financial relationships only pursuant to subpoena, the House Committee on General Investigating has been able to identify what can appear to be private rewards for public influence. These suggest that some fund management decisions have been affected by private parties with interests in conflict with those of the PSF:

- Perhaps starting as early as 1998, an important PSF consultant has transferred at least \$60,000 to the informal advisor (the Austin advisor) of the Chair and Vice Chair of the School Finance/PSF Committee and the Austin advisor's business partner.
- According to an Internal Revenue Service (IRS) Form 1099, a business controlled by the President of the broker-dealer receiving the largest share of commissions under the SBOE's Historically Underutilized Business policy (the San Antonio HUB) paid \$28,000 to the informal advisor (the San Antonio advisor) of a School Finance/PSF Committee member in 1999.
- In 1999 and 2000, a broker-dealer (the Subsidiary), of which the Austin advisor is a 49 percent owner, received about \$183,000 as the result of a fee-splitting arrangement with the San Antonio HUB. The Subsidiary performed no financial services, yet continues to receive 60 percent of all fees and commissions that two-thirds of the PSF's nine external managers trading in equities are paying to another broker-dealer securing PSF securities execution services.

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- The SBOE's *Ethics Policy*, amended effective April 2, 2000, appears to apply to some, if not all, of these transactions. None of the transactions described here, however, were made public until the House Committee on General Investigating began work on the Interim Charge.

The House Committee found that, despite a clear Legislative mandate to protect the PSF against conflicts of interest¹, a majority of the members of the SBOE are failing to safeguard one of the State's major investing entities against the influence of self-interested outside parties. As a consequence, the House Committee found instances in which the SBOE has failed, and continues to fail, to manage the PSF with the ordinary prudence that the Texas Constitution requires.

INTRODUCTION

The SBOE and its members have drawn the attention of Members of the Legislature and the statewide press, raising questions about how the SBOE is managing the PSF. As a result, the House Committee on General Investigating was asked to review recent SBOE actions relating to its management of the PSF.

The House Committee on General Investigating heard testimony from 15 invited and subpoenaed witnesses.² It received voluminous documents produced voluntarily and under subpoena. It heard testimony from four members of the SBOE's Committee on School Finance/PSF that makes recommendations on asset management decisions to the full SBOE.

Additionally, the House Committee heard from the Austin advisor to the Chair and Vice Chair of the School Finance/PSF Committee, from the Austin advisor's business partner, from the President of the San Antonio HUB, and from the PSF's Evaluation Consultant. At the House Committee's request, the State Auditor's Office (the SAO) interviewed another School Finance/PSF Committee member, as well as his informal advisor, referred to as the San Antonio advisor. Taken together, the information reveals that some SBOE members, especially a majority of members of its School Finance/PSF Committee, continue to allow factors other than the efficient and prudent management of the PSF to influence their decisions.³

This Report describes the roles of SBOE members and standing committees, informal advisors, PSF staff and the PSF's consultants, money managers and "downstream" broker-dealers and other entities in managing the PSF. It reviews the evidence presented in testimony and documents. Finally, it recommends actions to address weaknesses in the SBOE's management of the PSF.

MANAGING THE PERMANENT SCHOOL FUND

STATE SUPPORT OF PUBLIC EDUCATION

Since 1840, Texas has supported public education with public resources.⁴ The SBOE is one of several institutions the Legislature and the voters have used over the years to manage those resources and set education policy.⁵ Financing Texas public education depends in part on efficiently increasing the principal value of the PSF.⁶ Income generated by PSF assets contributes over five percent of state public education funding.⁷

PSF management is a constitutional as well as a statutory function of the SBOE.⁸ In 1995, the Legislature curtailed the education policy-making powers of the SBOE.⁹ The SBOE continues, however, to have sole constitutional authority to manage the PSF.¹⁰ Operational responsibility for managing PSF investments is divided among the SBOE and one of its three standing committees, the staff of the PSF, and external consultants and money managers.

THE STATE BOARD OF EDUCATION

The Legislature and the voters have changed the SBOE from an elected entity to an appointed one and back to an elected body since 1984. It has 15 members.¹¹ The SBOE's five-member standing School Finance/PSF Committee oversees management of the PSF.¹² Based on the public record, the testimony of four PSF Committee members and a statement from the fifth member, it appears that, in recent years, the full SBOE has frequently adopted School Finance/PSF Committee recommendations, at times despite concerns and alternatives offered by other SBOE members. School Finance/PSF Committee recommendations, therefore, have been effectively directing the SBOE's management of the PSF. Many of the weaknesses this Report identifies originate in actions of the School Finance/PSF Committee.

THE COMMITTEE ON SCHOOL FINANCE/PERMANENT SCHOOL FUND

The School Finance/PSF Committee operates under the authority of a resolution the full SBOE passed in January, 1999.¹³ To carry out the duties delegated to it, the School Finance/PSF Committee interacts with consultants, money managers, and PSF staff. In general terms, the PSF consists mainly of domestic and foreign equities and domestic bonds. The School Finance/PSF Committee proposes funds management decisions, forwarding recommendations to the full SBOE for final action.

For example, the School Finance/PSF Committee recommended, and the SBOE adopted, a policy re-allocating PSF investments among several classes of assets, adopted benchmarks to measure the performance of both internal and external funds managers, and established brokers fees within limits set by the General Appropriations Act¹⁴. The School Finance/PSF Committee also recommended, and the full SBOE adopted in July 1999, a goal that Texas-domiciled HUBs will receive 20 percent of all commissions from PSF securities trading. Effective April 2, 2000, the SBOE amended its brokerage guidelines to help implement this policy by removing barriers to market entry.¹⁵

The Texas Constitution mandates that the SBOE make investments such as “persons of ordinary

prudence, discretion, and intelligence, exercising the judgment and care under the circumstances then prevailing,” would make. It further provides that investments must be made as the “prudent person” would, “not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.”¹⁶

In practice, the House Committee on General Investigating has found a number of actions and practices that appear to fall short of the standard of ordinary prudence. These actions and practices, often originating with the School Finance/PSF Committee, also involve the full SBOE, PSF staff, external consultants and money managers, and at least one firm whose purpose appears to develop business opportunities for private entities.

PERMANENT SCHOOL FUND STAFF

Twenty full-time equivalent staff positions are allocated to the Permanent School Fund within the organizational framework of the Texas Education Agency (TEA).¹⁷ The PSF’s Executive Administrator is hired by and reports directly to the Commissioner of Education. The Commissioner of Education, appointed by the Governor with Senate confirmation, reports to the SBOE, but can neither be hired nor dismissed by it. Moreover, although the PSF’s Executive Administrator and his staff implement the decisions of and provide information to the School Finance/PSF Committee and the full SBOE, the SBOE can neither select nor dismiss the Executive Administrator. TEA’s Chief Counsel provides legal advice to the Executive Administrator.

As of March 31, 2000, PSF staff members manage approximately two-thirds of the PSF, worth over \$13 billion dollars. Staff also implements the SBOE’s decisions concerning externally-managed funds. For example, staff members monitor contracts with external money managers to ensure they comply with their obligations and are paid according to the terms of their contracts.¹⁸

EXTERNAL CONSULTANTS AND MONEY MANAGERS

Consultants and money managers outside state government play a contractual role in managing the PSF. Consultants are financial services firms offering institutional clients like the PSF investment research and portfolio management advice.

- One consultant (the General Consultant) provides general investment consulting services for the Permanent School Fund, including strategic asset allocation planning, policy and procedure review, fiduciary education, and other services, including searching for new money managers.
- Another consultant (the Evaluation Consultant) evaluates the performance of external money managers by measuring their performance each quarter against accepted benchmarks and reporting to the School Finance/PSF Committee and the full SBOE. PSF performance is also to be measured against the investment objectives in the General Appropriations Act (See Endnote 4).

Each internal and external money manager handles a percentage of PSF assets allocated according

to the SBOE's portfolio management strategy. That strategy originates with the General Consultant and must be acted on by the School Finance/PSF Committee before the full SBOE approves it. In Fiscal Year 1999, money managers received approximately \$19.3 million in fees.¹⁹ The PSF's external money managers select securities for the PSF to invest in, arranging with other financial services providers to make and execute trades. Several broker-dealers and other firms figuring in the House Committee on General Investigating's review belong to a group of private entities "downstream" from PSF money managers.

DOWNSTREAM BROKER-DEALERS AND OTHERS

The SBOE set a goal in July 1999, that 20 percent of all PSF commissions would go to Texas-domiciled HUBs. According to the testimony of the President of the San Antonio HUB, Texas-based HUB brokerages are typically less-well capitalized and more recently established than larger national non-HUB broker-dealers.²⁰ Brokerage selection guidelines amended effective April 2, 2000, exempt HUB broker-dealers from three requirements seen as barriers to entry to securities trading: (1) HUB brokerage firms need not have in-house research capabilities; (2) they need not be members of major financial exchanges; (3) they are exempt from some capitalization requirements.

To comply with the SBOE's HUB brokerage policy, therefore, several money managers recently increased their use of Texas-based HUB broker-dealers to execute securities trades. In 1999, the San Antonio HUB got 34 percent of all HUB business of the PSF. Six of nine external money managers handling equities directed trades to the San Antonio HUB. The San Antonio HUB, in turn, uses a securities execution specialist located in Pennsylvania.²¹ In fact, evidence shows that money managers may completely by-pass the San Antonio HUB, calling the Pennsylvania firm directly. Even farther downstream of the PSF is another broker-dealer, as well as another firm involved in and evidently profiting from School Finance/PSF Committee recommendations that the full SBOE has adopted.

The San Antonio HUB broker-dealer directs to another brokerage firm (the Subsidiary), of which the Austin advisor is a 49 percent owner, 60 percent of the commissions it derives from securing the execution of PSF securities trades. That second broker-dealer, also a HUB, is in turn wholly owned by a firm that is not a broker-dealer. The second firm was apparently organized in 1998 to increase HUB business at the PSF and other public investing entities in Texas by lobbying and other marketing activities.

EVIDENCE

The House Committee on General Investigating found evidence suggesting that the SBOE is, at a minimum, failing to safeguard one of the State's major investing entities from the appearance that its deliberations and decisions are influenced by self-interested outside parties. The Committee found instances, apparently resulting from conflicts of interest, when the School Finance/PSF Committee's management of the PSF failed to meet the standard of ordinary prudence set by the Texas Constitution.

EXPOSING THE PSF TO CONFLICTS OF INTEREST

The 76th Legislature expressly required that SBOE members and persons “who provide[s] services to the board relating to the management or investment of the permanent school fund” must disclose conflicts between the interests of the PSF and their private financial undertakings.²² The new requirements, applicable in certain circumstances to “informal advisors” as well as to SBOE members, consultants and money managers, became effective September 1, 1999.

On April 2, 2000, the SBOE’s amended *Code of Ethics* containing a new conflicts of interest disclosure rule became effective.²³ Neither the legislation nor the new rule, however, has kept self-interested outside parties from profiting from PSF business, while perhaps influencing business and policy decisions of the School Finance/PSF Committee and the full SBOE. The new disclosure requirements have not served to compel disclosure of these conflicts of interest, much less to prevent them.

Initially, the House Committee on General Investigating heard testimony that the Chair and Vice Chair of the School Finance/PSF Committee were using, or had in the past used, “unpaid advisors” who are neither PSF staff nor contracted PSF service providers to assist with such PSF Committee functions as evaluating investment data and interviewing a bidder on a PSF contract. To the extent that the officers or members of the School Finance/PSF Committee lacked investment expertise, they found experts in the private sector, as officeholders often do.

When the House Committee began work on the Interim Charge, therefore, one concern appeared to be a possible lack of judgment on the part of some SBOE members who were sharing confidential information with someone owing no fiduciary duty to the PSF. Another concern arose because the Chair and Vice Chair of the School Finance/PSF Committee seem to have tacitly presented the Austin advisor, a private citizen, as an official representative of a major state investing entity for purposes of interviewing a bidder. Additionally, letters from the Chair of the School Finance/PSF Committee suggest that the Austin advisor was acting as the Chair’s agent.²⁴

Then, as a result of the subpoenas for witnesses and documents the House Committee unanimously voted to issue on May 19, 2000, information came to light indicating the appearance of conflicts of financial interest between the Austin advisor’s private businesses and the PSF. Furthermore, information shows that the San Antonio advisor is closely associated with a third School Finance/PSF Committee member. The San Antonio advisor’s long-standing business relationship with the San Antonio HUB and his payment by a firm owned by the President of the San Antonio HUB creates, at a minimum, the appearance of a conflict interest with the PSF. At no time before the House Committee hearings began in March, 2000, were any of these financial connections publicly disclosed.

Documents, public testimony, and interviews conducted by House Committee Staff and the SAO show that:

- The Evaluation Consultant’s present three-year contract, for an amount not to exceed \$300,000, became effective January 3, 2000.
- The *General Provisions* of the Evaluation Consultant’s January 2000 contract specify that the

Consultant is subject to all TEA rules, including those governing conflicts of interest and disclosure by PSF service providers, which were under consideration by the SBOE, although not finally adopted, when the agency approved the Evaluation Consultant's present contract.

- Pursuant to changes in the 76th Legislature, the SBOE amended its Conflict of Interest rules, effective April 2, 2000.
- The SBOE amended its Conflict of Interest rules to apply to a category defined as "PSF service providers."²⁵ The General Consultant, the Evaluation Consultant, and PSF money managers clearly fall within this definition.
- To the extent the Austin advisor provides "services to the board that relate to the management or investment of the permanent school fund" and has access to non-public PSF information or has met with outside parties on behalf of the PSF, the term "PSF service provider" also includes the Austin advisor.
- At a meeting of the School Finance/PSF Committee in November, 1999, the Vice Chair publicly stated that the Austin advisor was his "financial advisor" and would be for every meeting at least as long as [Committee member] served on the SBOE. As of the date of this report, the committee member is still serving on the SBOE.
- It is unclear whether the San Antonio advisor has, or has had, the same access as the Austin advisor to non-public information. Thus, under current rule language, he may not be required to disclose any financial transactions that PSF staff refer to as "cross-pollination" with other PSF providers.
- Among other things, SBOE rules also provide that "Permanent School Fund Service Providers shall avoid personal...or business relationships that create conflicts of interest." The rules further state that a "conflict of interest exists whenever Permanent School Fund service providers have personal or private commercial or business relationships that could reasonably be expected to diminish their independence of judgment."²⁶
- At the June 30, 2000, House Committee hearing, witnesses testified that, by April 2, 2000, when the SBOE's new ethics rules became effective, the Evaluation Consultant had transferred nearly \$60,000 to the Austin advisor, and to the Austin advisor's business partner. The Evaluation Consultant characterized these as gifts probably taking place over a period of more than one year. The Austin advisor and his business partner testified they regarded these payments as loans. They both testified that, as of June 30, neither man had repaid the Evaluation Consultant.
- In an interview with the SAO, the Austin advisor's business partner said he and the Austin advisor needed \$5,000 as a down payment to acquire a broker-dealer that was to become the Subsidiary. The business partner told the SAO that the two men had to borrow the money for the down payment. The SAO interviewer asked "from whom?" The business partner named the Evaluation Consultant as the source of the down payment.

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- At the June 30 hearing, the Evaluation Consultant testified that he felt no legal obligation to disclose to the SBOE his financial relationships with the Austin advisor or the Austin advisor's business partner.
 - The Austin advisor, when asked at the same hearing whether he would, based on what he had learned, disclose his financial relationships with his business partner and the Evaluation Consultant, said that he would disclose them. As of October 20, 2000, however, the Austin advisor has not made written disclosure to the SBOE of this financial relationship.
 - The Austin advisor and his business partner share interests in two firms, one being the parent (the Parent) of the other (the Subsidiary). The Austin advisor owns 49 percent of the Parent, his partner 51 percent. The partner is a member of a minority class making the Parent eligible for HUB status. The Parent is not a broker-dealer, but it is registered with the Texas General Services Commission as a HUB. Under the rules of the U. S. Securities and Exchange Commission and the National Association of Securities Dealers that govern securities trading, the Subsidiary is eligible to split commissions with other broker-dealers.
 - The Austin advisor's business partner admitted that the partner had misrepresented himself to the School Finance/PSF Committee in 1999 as a member of the San Antonio HUB. He never disclosed to the SBOE his business affiliation with the Austin advisor through the men's joint ownership of the Parent and the Subsidiary.
 - In June, 2000, the Austin advisor's business partner testified before the House Committee that he lobbied the School Finance/PSF Committee to adopt a Texas-domiciled HUB brokerage policy. The SBOE adopted such a policy in July, 1999.
 - On July 9, 1999, and effective immediately, the SBOE amended its *PSF Investment Procedures Manual* to require HUBs to be domiciled in Texas to be eligible for PSF business, and to set the goal that Texas-domiciled HUBs should receive 20 percent of securities commissions.
 - On July 11, 1999, the Evaluation Consultant hosted a meeting at his Houston home at which the Austin advisor and his business partner discussed the Parent's recent success in lobbying for HUB policy changes favorable to them. They discussed plans for acquiring the broker-dealer that became the Subsidiary.
 - Texas Ethics Commission records show that the Austin advisor registered as a lobbyist for the Parent company in January, 2000. The Austin advisor was not a registered lobbyist in 1999. There are no records reflecting that the Austin advisor's business partner has ever registered with the Texas Ethics Commission as a lobbyist.
 - At no time since the April 2, 2000, effective date of the SBOE's amended Code of Ethics has the Evaluation Consultant disclosed to the SBOE any of the gifts or loans to the Austin advisor and his

business partner.

- At the June 30, 2000, hearing of this Committee, the Committee Clerk furnished to the Evaluation Consultant a copy of the PSF Conflict of Interest provisions of the Education Code which the SBOE's *Code of Ethics* was intended to implement.
- As of October 20, 2000, the Evaluation Consultant has still not reported the gifts or loans to the Austin advisor and his business partner.²⁷ The Evaluation Consultant's statement before the House Committee that he had filed the required disclosure appears accurate as to his filing, on August 31, 2000, the day of the hearing, under a different part of the SBOE's rules, not its so-called "cross-pollination" provisions. He disclosed payments from another PSF provider, a small cap money manager.
- The San Antonio HUB is a San Antonio broker-dealer and investment banking firm founded in 1982. It started doing PSF business in July 1999. By December 31, 1999, approximately six out of nine external equities managers were using the San Antonio HUB to execute trades.
- The San Antonio HUB contracts with a Pennsylvania firm to execute the trades that PSF money managers send to the Pennsylvania firm for credit to the San Antonio HUB.
- In July, 2000, the President of the San Antonio HUB told the SAO that the firm was negotiating a formal written contract with the Subsidiary.
- Under subpoena, the President of the San Antonio HUB gave the House Committee on General Investigating a copy of an unexecuted draft contract between the San Antonio HUB and the Subsidiary. The cover page dated August 30, 1999, apparently transmitted via facsimile from the San Antonio HUB's corporate counsel to the San Antonio HUB's President a document styled *Independent Marketing Consulting Agreement*. The draft *Marketing Agreement* states that the San Antonio HUB and the Subsidiary "desire jointly to further develop their business of trading and clearing stocks, bonds and other securities for the Permanent School Fund of Texas, *presently a client of each party hereto*" (emphasis added).
- Thus, at least as of August 1999, the San Antonio HUB's corporate counsel described the HUB as a vendor of financial services to the PSF. The draft contract also referred to the parties' mutual interest in receiving placement fees as a result of the PSF's external money manager selection process.
- Subpoenaed documents show that, between July 1999 and May 31, 2000, the Subsidiary earned approximately \$183,000 in fees from the San Antonio HUB's share of commissions from PSF money managers.
- The San Antonio HUB's President told the SAO that the San Antonio advisor has been a consultant to the San Antonio HUB since 1990. The President also stated that, starting in March 1999, the San Antonio advisor's role has been attending meetings, including meetings of the SBOE

and the School Finance/PSF Committee, to get contracts for the San Antonio HUB.

- The San Antonio advisor is a long-time personal friend of an SBOE member appointed to the School Finance/PSF Committee in January, 1999. The San Antonio advisor told the SAO that he makes himself available to accompany this SBOE member on drives to Austin in connection with meetings of the School Finance/PSF Committee and the full SBOE.
- The San Antonio HUB President gave the House Committee a copy of an IRS Form 1099 reporting that another entity, of which the HUB President is the majority owner, paid the San Antonio advisor \$28,129.91 in 1999.
- The San Antonio advisor told the SAO in a follow-up telephone conversation on August 10, 2000, that “90 percent to 95 percent” of this sum came in relation to his work for the benefit of the San Antonio HUB in connection with the PSF.
- On July 19, 2000, the San Antonio HUB’s President told the SAO that he does not consider himself subject to the SBOE’s *Conflict of Interest* disclosure rules.
- The San Antonio advisor also told the SAO that he was not subject to the SBOE’s *Conflict of Interest* disclosure rules. He then said that he had not read the rules.
- As of August 15, 2000, the TEA reported that no statements had been filed with the agency disclosing the \$60,000 paid by the Evaluation Consultant to the Austin advisor and his business partner as gifts or loans, the payment of \$28,129.91 to the San Antonio advisor by the other entity owned by the President of the San Antonio HUB, or the \$183,000 in commission splits the San Antonio HUB paid to the Subsidiary owned by the Austin advisor and his business partner.
- In October, the House Committee on General Investigating requested and received additional documents from the PSF and the TEA. The existence of these documents came to the House Committee’s attention after the final hearing on the Interim Charge. The documents relate (1) to an incident about which allegations of violation of the Texas Open Meeting Act on August 30, 2000, have been made, and (2) to even more recent information relating to a meeting of the School Finance/ PSF Committee on September 14, 2000.
 1. Two employees of the PSF gave written statements, one initialed, one not, both dated August 31, 2000, to the Chief Counsel of the TEA. Both statements described alleged actions of the Chair and Vice Chair of the School Finance/PSF Committee and another member of the School Finance/School Finance/PSF Committee. The employees allege that these actions occurred August 30, 2000.

On September 8, another PSF employee gave a written statement, neither signed nor initialed, to TEA’s Chief Counsel on the same subject. The three PSF employees, (collectively referred to as Employees) stated that they had seen the Chair and Vice Chair of the SBOE’s School Finance/PSF Committee and another member of that Committee,

along with the Evaluation Consultant, the Austin advisor, and the San Antonio advisor, at an Austin restaurant on August 30, 2000. Each of the Employees' statements contains slightly differing details. In general, however, the Employees allege:

- Around 12 noon or 12:15 p.m. on Wednesday, August 30, 2000, the Employees arrived at a downtown Austin restaurant.
 - When the Employees arrived, the Chair of the School Finance/PSF Committee was seated at a two-person table with the Evaluation Consultant.
 - The Vice Chair of the School Finance/PSF Committee and another member of the Committee were seated at a nearby table²⁸ with the Austin advisor and the San Antonio advisor. The Austin advisor left the restaurant before the others.
 - Employees stated that they saw on both tables documents prepared by the General Consultant to aid the School Finance/PSF Committee and the full SBOE in hiring external money managers. The Employees stated that the General Consultant's reports were recognizable by their covers.
 - One of the Employees alleged "[t]here was much movement between the two tables, and that "[t]he Board members were reviewing reports from [the General Consultant]. The others in the group aided in the review of the [General Consultant's] material."
 - About 10 minutes after the Employees arrived, the Chair left the restaurant. The Evaluation Consultant moved to the table with the Vice Chair, the other member and the two advisors. Shortly after that, the Austin advisor and the San Antonio advisor left.
 - The Vice Chair and the other member remained in conversation with the Evaluation Consultant for "about another hour," one Employee alleged, while another stated that the Vice Chair, the Evaluation Consultant and the other Committee member remained at the table as the Employees were leaving the restaurant.
- External money manager selection was on the agenda of the School Finance/School Finance/PSF Committee the same afternoon.²⁹ The Committee voted to recommend several finalists for each category of large cap managers. A representative of the General Consultant addressed the School Finance/School Finance/PSF Committee. Among other matters, he drew the members' attention to the "presentation booklets" prepared by the General Consultant, which recommended finalists.
 - The Employees gave these statements to the TEA's Chief Counsel. The SBOE Chair referred the matter to the Attorney General. The Chair's referral letter, dated September 12, 2000, stated in part:

Commissioner of Education Jim Nelson has forwarded to me the enclosed statements by members of the Texas Education Agency staff to the effect that a violation of the state open meetings law may have occurred on 30 August when three of my colleagues (all members of the five-member Permanent School Fund Committee of the SBOE) had lunch in the same location in Austin prior to a Committee meeting at which action was taken.”³⁰

- On September 19, 2000, the Attorney General replied by letter to Chairman Untermeyer. Attorney General John Cornyn stated that his office is:

not specifically authorized by the Open Meetings Act to enforce the Act’s provisions, . . . and is not able to resolve questions of fact in the opinion process. Thus, we could not determine whether this particular incident constituted a violation of the Act.³¹

He further states that,

because certain violations of the Act are punishable as misdemeanors, they are within the jurisdiction of a district or county attorney to investigate and prosecute if he or she chooses to do so. The Office of the Attorney General may assist in such an investigation or prosecution, but only if requested to do so by the prosecuting attorney.³²

- A fourth PSF employee directed a document dated September 15, 2000, and styled “Memorandum” to the Executive Administrator of the PSF. The Memorandum states that on Thursday, September 14, 2000, the employee found a packet of information remaining on the table after the meeting of the SBOE’s School Finance/PSF Committee, adjourned. The employee attached the packet to the Memorandum. The copy reviewed by the House Committee on General Investigating contains 33 unnumbered letter-sized pages relating generally to the selection of external PSF money managers.
- Summarizing the entire document exceeds the scope of this Report. Excerpts provide a sense of its contents. The first line of the first page contains the typed first name and last initial corresponding to those of one of the members of the School Finance/PSF Committee. The next three lines of text state:

1) Let [Committee member]—Democrat—spokesman lead the defense.
Joe Chase Bob
Will David”

- The next two and one-half pages of text set out points alleging, among other things, that the PSF’s Executive Administrator has impeded implementation of the SBOE’s Texas-based HUB brokerage policy. The final text line in this section of the packet reads “19. Nelson has not been confirmed as Commissioner of Education.”

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- Other pages in the packet contain arguments in favor of the hiring or retention of certain external money managers and in opposition to the hiring or retention of others.
 - It is unclear who prepared the packet. Page 12 of the packet contains a diagram very similar to one in a document given to staff of the House Committee on General Investigating and the SAO in June, 2000, by the Evaluation Consultant.³³ It is, of course, not possible for the House Committee to conclude that a source of one or two pages, even if it were shown to be the Evaluation Consultant, was also the author or a source of the entire packet. The General Consultant, rather than the Evaluation Consultant, is contractually responsible to advise the SBOE on manager selection.

The House Committee on General Investigating can conclude neither that three SBOE members violated the Open Meetings Act, nor that the Evaluation Consultant gave one or more members of the School Finance/PSF Committee what appears to be a sort of “play book” for the September 14-15, 2000, meetings of the School Finance/PSF Committee and the full SBOE. Taken together, these circumstances do, however, suggest that since sometime in 1999, a voting majority of the School Finance/PSF Committee, whose recommendations on investment decisions and policies the SBOE has often adopted in recent years, has been advised by individuals with previously undisclosed financial interests in PSF business.

Other SBOE members, therefore, may have lacked information needed to evaluate whether and to what extent School Finance/PSF Committee recommendations have been influenced, perhaps even determined, by personal financial motivations of these outside individuals. This appears to have denied other SBOE members information they needed to make PSF investment decisions in accordance with the Constitutional standard of “ordinary prudence.”

CONCLUSIONS AND RECOMMENDATIONS

In spite of the PSF’s impressive record of capital accumulation in recent years, some SBOE members, especially a majority of the School Finance/PSF Committee, have exposed their votes on PSF policy, asset allocation and money manager selection to questions about whether those votes have been cast with ordinary prudence. Despite amending its *Code of Ethics* in light of statutory changes, the SBOE has failed to implement effective rules on conflicts of interest and ethics. Previously undisclosed financial relationships apparently exist among the Evaluation Consultant, the Austin advisor, his business partner, the San Antonio HUB and the San Antonio advisor.

Furthermore, the actions of several SBOE members, the Evaluation Consultant and the two advisors have eroded public trust in this major state investing entity. By sharing confidential information with the Austin advisor and allowing him to participate in interviewing bidders, SBOE members improperly gave a person with no fiduciary relationship to the PSF the apparent authority to speak and act on the PSF’s behalf.

By disregarding PSF staff’s information, technical advice and recommendations while relying on

the advice of their informal advisors, SBOE members have caused the relationship between the SBOE and PSF staff to become unusually rancorous. It is true that officeholders often turn to private sources for technical advice. In an executive branch agency, however, whose staff exists to carry out the agency's specialized investment mission, the SBOE members' hostility to and refusal to accept agency staff assistance does not serve the public interest.

The SBOE majority has likewise proved itself unreceptive to the concerns about prudent decision-making voiced by fellow SBOE members. For example, several members expressed concerns about the prudence of contracting with the Evaluation Consultant in light of his enforcement history with the United States Securities and Exchange Commission. Some SBOE members continue to disregard prudent suggestions by their fellow members and to publicly express hostility toward staff. As a result, the entire PSF operation, SBOE and staff alike, is being held up to what appears to the House Committee on General Investigating to be well-merited public criticism.

Finally, although the House Committee on General Investigating supports executive agencies' implementing the Texas-based HUB goals called for by the 76th Legislature, the influence of undisclosed private financial relationships downstream of the PSF appears to be distorting the way the SBOE implements the legislation. The continuing influence exerted by undisclosed financial relationships, for example, seems to be responsible for the fact that the San Antonio HUB is by far the largest beneficiary of the PSF's Texas-domiciled HUB policy.

Even further, the San Antonio broker-dealer appears to serve as a cross-roads for the network of undisclosed financial relationships the House Committee has reviewed. In 1998, the Evaluation Consultant provided money to the Austin advisor and his business partner with which the two men bought what became the Subsidiary broker-dealer. This made them partners in an entity eligible to earn or split brokerage fees.

In 1999, the Austin advisor's business partner and the San Antonio advisor successfully lobbied the SBOE to adopt its Texas-based HUB brokerage policy. In 1999, the San Antonio HUB began earning fees for executing trades for the PSF's external equities managers. For the calendar year 1999, the President of the San Antonio HUB reported paying the San Antonio advisor over \$28,000 for the advisor's services in increasing the San Antonio HUB's share of PSF business.

Starting in 1999, and continuing to the present, the San Antonio HUB pays 60 percent of its commissions deriving from PSF trades to the Subsidiary owned by the Austin advisor and his business partner. At least partially in light of the financial relationships existing among the Evaluation Consultant, the companies owned by the Austin advisor and his business partner, and the San Antonio HUB, PSF staff no longer use the San Antonio HUB to execute internal trades.

Staff's actions in this regard may be one cause of the Evaluation Consultant's recommendation, made at the September 14-15 meetings of the School Finance/PSF Committee and the full SBOE, to send to external managers the large volume of trades required to re-balance PSF assets, rather than have PSF staff perform that function. If staff did this work, neither the San Antonio HUB nor the brokerage owned by the Austin advisor and his partner would earn or split commissions on trades staff has estimated at nearly

\$429,000.

The San Antonio HUB does not appear on any lists of “PSF Service Providers.” Nor does the Parent or the Subsidiary owned by the Austin advisor and his business partner, or the separate entity through which the President of the San Antonio HUB paid the San Antonio advisor. Thus, but for the subpoenas of the House Committee and the work of the SAO, the financial connections among these entities would have remained unknown except perhaps to the SBOE members most closely associated with the two advisors.

Alternatively, it is possible that even the SBOE members most closely associated with the Austin and San Antonio advisors may have been unaware of the extent to which those men have benefitted and continue to benefit financially from SBOE decisions. It appears from the evidence, however, that the Evaluation Consultant has either helped facilitate the connections among the others, or at least been aware since 1998 of the relationships existing and coming into existence in 1998-1999 among the SBOE members, the advisors and the San Antonio HUB.

At a minimum, other SBOE members’ ignorance of the details and scope of these financial relationships has significantly limited those members’ ability to safeguard PSF management decisions from influence by self-interested persons. This means that the SBOE’s ability to manage the PSF with the ordinary prudence required by the Texas Constitution has been compromised. Without question, the actions of some members of the SBOE, their advisors, a key PSF consultant and others downstream of the PSF have eroded the public trust in the SBOE’s management of the Permanent School Fund.

The following recommendations are made to restore prudence and public trust in the management of the PSF. It is equally important to ensure that conflicts of interest now affecting this major state investing entity are detected and sanctioned now, and prevented in the future.

- The Legislature should retain a consultant to perform a comprehensive review of PSF management practices, with periodic follow-up reviews.³⁴
- The Constitution should be amended to create an appointed Permanent School Fund Investment Board, separate from the State Board of Education. The jurisdiction of the State Board of Education would be limited to education policy.
- If the Constitution is not amended, and the current State Board of Education structure is retained, then an effective Investment Advisory Committee should be established. The Investment Advisory Committee should be appointed by the Governor, Lieutenant Governor and Speaker of the House.
- The Education Code should specify the minimum investment management qualifications for membership on the Investment Advisory Committee.
- The Education Code should require that members of the Investment Advisory Committee be governed by the same rules regarding disclosure of conflicts of interest as are members

of the State Board of Education.

- The Education Code should require that the SBOE’s rules governing conflicts of interest should be expanded to cover any person or entity that applies for, or receives, anything of value as a direct or indirect result of PSF investments. These persons and entities should be classified as “interested parties” and brought within the scope of SBOE disclosure rules.
- The Education Code should require that every interested party, as a condition of approval as a consultant or money manager, must sign a standard, non-negotiable contract, agreeing to be bound by all statutes and regulations, and acknowledging the SBOE’s right to cancel any contract or other undertaking in the event the interested party violates Board rules or state law.
- Further, the Education Code should require that every interested party, including “downstream” entities, as a condition of approval as a consultant or money manager or vendor of those entities, must acknowledge that, if one interested party has an undisclosed relationship with another interested party, both or all those interested parties may have their contracts voided and their eligibility to conduct PSF business withdrawn.
- The SBOE should establish a frequently updated web site, on which PSF staff must post names and business addresses of all interested parties who receive, or who are eligible to receive, anything of value, directly or indirectly, as a result of PSF investment management.
- State officers, specifically the Legislative Audit Committee, Commissioner of Education, Comptroller, Attorney General or the Texas Ethics Commission, rather than SBOE members, should make the initial findings that an interested party has violated SBOE rules and refer complaints to the appropriate agency for enforcement.
- Any interested party who violates SBOE rules should be debarred from contracting with both the PSF and any other interested party for PSF business, for a period varying from six months to ten years, depending on whether the infraction is a first or subsequent violation.
- The SBOE should enter into a Memorandum of Understanding under the Interagency Cooperation Act to allow another agency to investigate alleged violations and enforce SBOE rules.
- Hearings on debarment and other sanctions should be held at the State Office of

Administrative Hearings.

- The agency performing SBOE's enforcement function should serve as liaison between the state's major investing agencies and the Securities and Exchange Commission, self-regulatory organizations like the National Association of Securities Dealers and professional organizations like the Association for Investment Management and Research to ensure close cooperation and information-sharing about disciplinary actions taken against consultants and broker-dealers doing business with, or seeking to do business with, the PSF.

The House Committee on General Investigating makes these recommendations to conform the practices of the State Board of Education and particularly of its School Finance/PSF Committee to the rules already intended to govern their actions. Since this rule appears to have been honored at times and by some but certainly not all members of the SBOE, more in the breach than the observance, it is worth concluding this Report by citing the SBOE's rules:

The members of the State Board of Education (SBOE) serve as fiduciaries of the Texas Permanent School Fund (PSF) and are responsible for prudently investing its assets. The SBOE members or anyone acting on their behalf shall comply with the provisions of this section, the Texas Constitution, Texas statutes, and all other applicable provisions governing the responsibilities of a fiduciary.³⁵

ENDNOTES

1. 76th Legislature, H.B. 3739.
2. The House Committee on General Investigating invited all members of the State Board of Education to testify. Five of the SBOE's fifteen members did so, along with the following:

March 20, 2000

- Chase Untermeyer, Chair and School Finance/PSF Committee member
- David Bradley, Vice Chair, School Finance/PSF Committee
- Jim Nelson, Commissioner of Education
- Paul Ballard, Executive Administrator, Permanent School Fund
- Lawrence F. Alwin, CPA, Texas State Auditor
- Carol A. Smith, CPA, Audit Manager, State Auditor's Office
- Roger Ferris, CPA, Senior Supervising Auditor, State Auditor's Office

May 19, 2000

- Robert H. Offutt, D.D.S., Chair, School Finance/PSF Committee
- David Bradley, Vice Chair, School Finance/PSF Committee
- Will D. Davis, School Finance/PSF Committee member
- Martha McCabe, Legal Counsel, State Auditor's Office

June 30, 2000

- Russell Stein, First Union Securities, PSF Evaluation Consultant
- Robert Rodriguez, President, Southwestern Capital Markets, Inc., broker-dealer
- Christian Washington, President, Omni Securities, Inc.
- Brian Borowski, partner, The Collaborative Group
- Don McLeroy, Member, State Board of Education

August 31, 2000

- Paul Ballard, Executive Administrator, Permanent School Fund
- Roger Ferris, CPA, Senior Supervising Auditor, State Auditor's Office
- Martha McCabe, Legal Counsel, State Auditor's Office

3. The SAO's follow-up report on the state's largest investing entities, including the PSF, has not yet been released. Following the SAO's usual procedure of allowing audited entities to review and comment on reports before releasing them to the members of the Legislative Audit Committee and the public, the House Committee on General Investigating has not seen a draft. The release is anticipated in late December, 2000.
4. The first Anglo-American public school law in Texas was enacted in 1840 and provided for surveying and setting aside four leagues (17,712 acres) of land in each county to support public schools. Later, the state constitution of 1845 provided that one-tenth of the annual state tax

revenue be set aside as a perpetual fund to support free public schools. In 1845, a new school law set aside as a permanent school fund \$2 million of the \$10 million in five-percent U.S. Indemnity bonds received in settlement of Texas' boundary claims against the United States.

After the Civil War and Reconstruction, the new state constitution of 1876 set aside 45 million acres of public domain for school support and directed that the income from the new Permanent School Fund be invested in bonds.”

Texas Education Agency, *History of Public Education in Texas*

<http://www.tea.state.tx.us/tea/history.html> (October 5, 2000).

5. The Legislature and the voters have altered the State Board of Education many times:
 - The first SBOE included the governor, the comptroller and the elected superintendent of public instruction. It was disbanded during the Reconstruction era, giving the elected superintendent of public instruction sole authority over public education.
 - In 1876, the new constitution created a new SBOE including the governor, comptroller, and secretary of state.
 - In 1926, voters approved a proposal to let the Legislature set the SBOE’s composition and method of selection. The SBOE grew to nine members appointed by the governor, subject to Senate confirmation, serving staggered six year terms.
 - In 1949, the Legislature changed the SBOE to an elected body with members serving from congressional districts. The SBOE grew from 21 members in 1949 to 27 by 1984.
 - In 1984, HB 72 replaced the elected board with a 15-member appointed board to serve until January 1, 1989. The Legislature reduced the term to 4 years.
 - In 1987, the Legislature proposed a referendum letting voters decide whether the SBOE should remain appointed. Voters supported the decision to return to an elected board.

The current SBOE has 15 members chosen from single-member districts that are subject to reapportionment after each decennial census. Members serve staggered four-year terms. Subject to Senate confirmation, the Governor fills vacancies. The Governor also appoints the SBOE’s chair from among its members; that person may serve up to two consecutive two-year terms as chair. The SBOE may designate a vice chair and secretary and establish its own rules of procedure and internal structure.

House Research Organization, Texas House of Representatives, Focus Report, *State Board of Education: Controversy and Change*, January 3, 2000, p. 2.

6. “[I]ncrease the principal value of the Permanent School Fund...” is a strategy in the Texas Education Agency’s appropriation, 76th Legislature, GENERAL APPROPRIATIONS ACT, Article III, Section I, C.1.2., School Finance System Operations. Texas Education Code §43.004.
7. In FY 1999, the most recent year for which a complete report is available, income from the PSF provided 5.84% of the total of \$11.3 billion in state funding for public education.

Texas Education Agency, Division of Performance Reporting, Office of Policy Planning and Research, e-mail to Oscar Rangel, SAO Administrative Technician, October 9, 2000.

8. Tex. Educ. Code Ann. § 7.102 (31) and TEX. CONST. ANN. ART. VII, § 5 (d).
9. House Research Organization, Texas House of Representatives, Focus Report, *State Board of Education: Controversy and Change*, January 3, 2000, p. 1.
10. Experts say the PSF could produce appreciably more revenue for the Available School Fund without endangering its long-term viability, if the PSF became a so-called "total return" fund similar to many U. S. endowment funds. The House Committee on General Investigating, however, did not review and does not advocate particular investment strategies.
11. TEX. EDUC. CODE ANN. § 7.101 provides:
 - (a) The State Board of Education is composed of 15 members elected from districts. Each district from which a board member is elected is composed as provided by former Sections 11.2101(b)–(t), as enacted by Chapter 2, Acts of the 72nd Legislature, 2nd Called Session, 1991.
 - (b) Members of the board are elected at biennial general elections held in compliance with the Election Code.

Added by Acts 1995, 74th Leg., ch. 260, § 1, eff. May 30, 1995.

12. §1.2. Committees of the Board.

- (a) The standing committees of the board are:
 - (1) Committee on School Finance/Permanent School Fund;
 - (2) Committee on Planning; and
 - (3) Committee on Instruction.

The board may from time to time define by resolution the jurisdiction of each committee as may be necessary.

- (b) The *Committees on School Finance/Permanent School Fund*, Planning, and Instruction shall be composed of five members selected by the officers of the board. Each member will serve on one committee. Each committee shall elect a chair from among its members and the chair may appoint a vice chair. The officers of the board shall receive in writing two committee choices ranked in order of preference and shall in accordance therewith make committee assignments for terms of two years at the organizational meeting

following the qualification of new members as the next order of business following election of board officers and adoption of rules. Vacancies shall be filled in a similar fashion. In addition to preference, the officers of the board shall also consider seniority, ethnicity, and gender balance in making committee assignments.

SBOE *Operating Rules*, (amended May 12, 2000)

<http://www.tea.state.tx.us/sboe/oprules/index.html> (October 4, 2000)(emphasis added).

13. The current SBOE *Operating Rules* provide in pertinent part:

“The Board may from time to time define by resolution the jurisdiction of each committee as may be necessary.”

This resolution specifies the areas of jurisdiction for each board committee currently delineated in the board's operating rules, including:

Committee on School Finance/Permanent School Fund.

...

11. *Permanent School Fund management oversight, including audit responsibility, investment objectives, and investment decisions.*”

SBOE *Operating Rules* (Amended May 12, 2000)

<http://www.tea.state.tx.us/sboe/oprules/index.html> (October 4, 2000) (emphasis added).

14. 76th Legislature, General Appropriations Act, Art. III, Section 1, Rider 40.
15. The amended SBOE brokerage selection guidelines allowing less well-capitalized HUBs to conduct PSF business became effective April 2, 2000, the same day the amended *Code of Ethics* became effective. SBOE's rules summary states in part:

Proposed Amendment to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, §33.40, Trading and Brokerage Policy

... The proposed amendment to §33.40 modifies guidelines for selection of brokerage firms...*The amendment changes language* in the rule to bring the brokerage selection guidelines for historically underutilized business-certified, soft dollar, commission recapture, and electronic communications network brokers into line with the basic business models of those types of brokerage concerns.

<http://www.tea.state.tx.us/sboe/summary/sboesummary/sum0003.html> (October 9, 2000) (emphasis added).

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16. Tex. Const. Ann. Art. VII §5 (d).
 17. Clyde Reynolds, Texas Education Agency Communications Division, telephone conversation with Oscar Rangel, SAO Administrative Technician, October 5, 2000.
 18. The House Committee on General Investigating notes that PSF staff may not have effectively monitored compliance with the SBOE's Conflict of Interest rules. Given the lack of enforcement mechanisms in place to address violations, however, this may be a moot point under present law and regulations.
 19. TEA's Rider 40 provides that PSF income above certain levels can be appropriated to pay internal costs and external management fees for managing PSF assets. These fees are not to exceed 0.5% of the market value of funds placed with external managers. Amounts appropriated for this purpose are available for expenditure on a quarterly basis. 76th Legislature, GENERAL APPROPRIATIONS ACT, Art. III, Section 1, Rider 40. [Note: 0.5% equals 50 basis points.]
 20. PSF money managers tend to be firms like Salomon Brothers Asset Management and Wellington Management Company.
 21. The Pennsylvania firm describes itself:

“[The firm’s] success is dependent entirely on client satisfaction with [the firm’s] trade execution abilities. As an agent-only brokerage firm, [the firm’s] only business product is trade execution. By not entering into principal transactions and filling client trades from inventory, [the firm] has eliminated the inherent conflict of interest of brokers who as act principals—also earning a trading profit. [The firm’s] strategy to achieving client satisfaction is to ensure goal congruence. [The firm’s] goal is to represent their customer’s interest and to maximize their investment performance through best trade execution.”

<http://www.quakersec.com> (October 5, 2000).
 22. Sec. 43.0032. CONFLICTS OF INTEREST.

(a) A member of the State Board of Education, the commissioner, an employee of the agency, or a person who provides services to the board that relate to the management or investment of the permanent school fund who has a business, commercial, or other relationship that could reasonably be expected to diminish the person's independence of judgment in the performance of the person's responsibilities relating to the management or investment of the fund shall disclose the relationship in writing to the board.

76th Legislature, H.B. 3739, TEX. EDUC. CODE ANN. § 43.0032(a).

23. 19 TAC § 33.5(c) states:

2) Persons Providing PSF Investment and Management Services to the SBOE (PSF Service Providers) are the following individuals:

- (A) any person responsible by contract for managing the PSF, investing the PSF, executing brokerage transactions, or acting as a custodian of the PSF;
- (B) a member of the Investment Advisory Committee;
- (C) *any person who provides consultant services for compensation regarding the management and investment of the PSF; or*
- (D) *any person who provides investment and management advice to an SBOE Member, with or without compensation, if an SBOE Member:*
 - (i) *gives the person access to records or information that are not currently available to the public or without otherwise complying with the Public Information Act; or*
 - (ii) *asks the person to interview, meet with, or otherwise confer with current or potential consultants, advisors, money managers, investment custodians, or others who currently provide, or are likely to provide, services to the SBOE relating to the management or investment of the PSF.*

([http://www.tea.state.tx.us/rules/tac/chapter 033/ch03.html#§33.5](http://www.tea.state.tx.us/rules/tac/chapter%20033/ch03.html#%2433.5). (October 20, 2000) (emphasis added).

24. SBOE management of PSF: Hearing on Interim Charges before the House Committee on General Investigating, 76th Legislature (2000)(Statement of Dr. Bob Offutt, Chair of PSF) (May 19, 2000).

25. 19 TAC §§ 33.5(c)(2)

26. 19 TAC §§ 33.5 (e)(3) and (g).

27. TEA Chief Counsel telephone conversation with SAO Legal Counsel Martha McCabe, October ____, 2000.

28. Although the written statement of one Employee describes the two tables occupied by SBOE members as “contiguous,” the Employee later clarified that in conversation with the SAO. He stated that the two tables were “no more than three feet apart,” close enough to allow the people to communicate between the tables. Telephone conversation with Martha McCabe, Legal Counsel, the SAO, October 18, 2000.

29. *Report of the State Board of Education Committee on School Finance/Permanent School*

Fund, August 30, 2000:

“The Committee . . . met at 1:50 p.m. on August 30, 2000. Presiding: Bob Offutt, Chair; David Bradley, Vice-Chair; Joe Bernal, Chase Untermeyer. Absent: Will Davis . . .

ACTION ITEM

1. Section of Finalist Candidates for Domestic Large Cap Core Equity, Large Cap Growth Style, and Large Cap Value Style Assignments . . .”
30. The Honorable Chase Untermeyer, Chairman, State Board of Education, letter to the Honorable John Cornyn, Attorney General of Texas, dated September 12, 2000. Chairman Untermeyer’s letter indicates that copies were sent to all SBOE members and the Commissioner of Education.
31. The Honorable John Cornyn, Attorney General of Texas, letter to the Honorable Chase Untermeyer, Chairman, State Board of Education, dated September 21, 2000, page 1.
32. Cornyn letter, above, Endnote 29, page 1.

33. The first graphic was given to the House Committee staff and the SAO in June, 2000.

What is wrong with this picture?

Large Cap Value
Capital Guardian: 7.48
\$502,086,629
Russell 1000: 4.37
Russell 1000 Value: 0.48

Large Cap Growth: ?
\$0
Russell 1000: 4.37
Russell 1000 Growth: 7.13

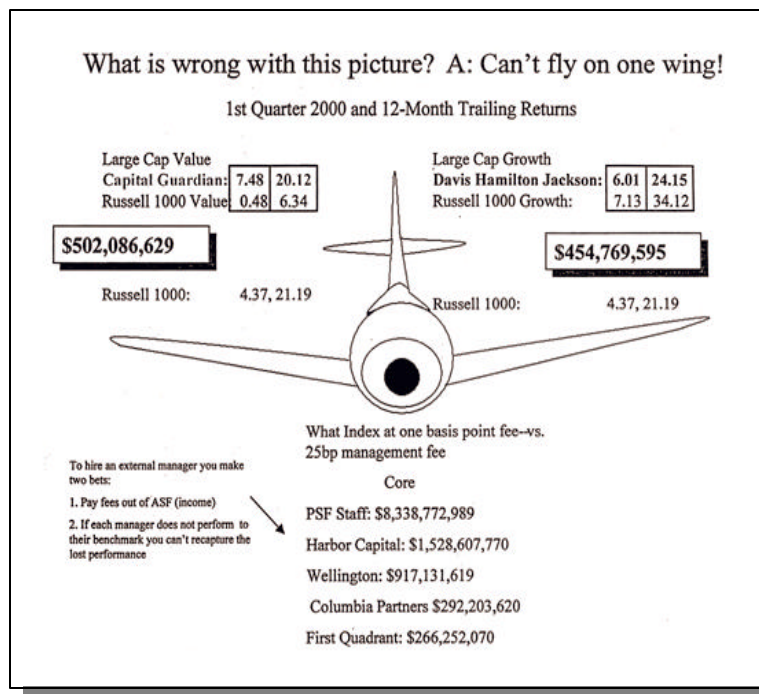
To hire an external manager you make two bets:
1. Pay fees out of ASF (income)
2. If each manager does not perform to their benchmark you can't recapture the lost performance

What Index at one basis point fee?
Core
Columbia Partners \$292,203,620
First Quadrant: \$266,252,070
Harbor Capital: \$1,528,607,770
Wellington: \$917,131,619
PSF Staff: \$8,338,772,989
Davis Hamilton Jackson: \$454,769,595

A: Can't fly on one wing!

The second graphic included in a packet of information a PSF employee says were left on a meeting table after the School Finance/PSF Committee Meeting September 14, 2000.

34. The 74th directed Audit contract independent investment functions Retirement approxima revealed a strengths areas for the SAO's independent review



Legislature the Legislative Committee to for a similar independent review of the management of the Teachers' System. It cost tely \$250,000, number of and identified improvement. In opinion, the independent investment proved

worthwhile and allowed TRS to regain a reputation for being a well-managed and successful investing entity.

35. 19 TAC §33.5(a) State Board of Education, *Code of Ethics* (amended April 2, 2000)
<http://www.tea.state.tx.us/rules/tac/chapter033/ch033.html#§33.5>. (October 10, 2000).

Review the Security Resources Available to Protect State Employees and State Buildings

BACKGROUND

Protecting the state's buildings and employees from workplace violence is a growing concern. The national media has focused primarily on dramatic, but rare, instances of workplace violence. Incidents of violence such as shootings by disgruntled employees in office buildings, bomb threats made against government offices, domestic disputes that enter the workplace, and anti-government sentiment give rise to questions about our own preparedness. As a result, the House Committee on General Investigating was asked to review the security resources available to protect state employees and state buildings.

Because of the nature of state government, a comprehensive *de novo* review of security resources available to protect state employees and state buildings is beyond the capability and resources available to the House Committee on General Investigating. Instead, the Committee reviewed practices and relationships between the State Office of Risk Management (SORM), the General Services Commission(GSC), the Texas Department of Public Safety - Capitol Police District (Capitol Police), and the State Preservation Board (SPB). Each agency plays a role in state building security, management, leasing procurement and protection.

Along with the SORM, each state agency is responsible for maintaining a risk management program to reduce the possibility of accidents and workplace losses.¹ The Committee's review included a survey of selected state agencies to gain an understanding of the level to which these programs address workplace violence issues.²

While limitations prevented a comprehensive review of state buildings, the Committee did review security and emergency plans for the Capitol Building, the Capitol Extension and the William Clements Building. The results of these "spot checks" revealed flaws in the security and emergency preparedness plans. Although security and emergency planning is given serious consideration by the State Preservation Board, Capitol Police, and the Capitol Fire Marshal, implementation flaws may render the plans ineffective.

RISK MANAGEMENT IN STATE AGENCIES

STATE OFFICE OF RISK MANAGEMENT

The State of Texas has hundreds of thousands of employees working in thousands of state-owned and leased buildings throughout the state. Chapter 412 of the Labor Code obligates SORM to review, verify, monitor and approve risk management programs developed by state agencies and to assist agencies that fail to establish effective risk management programs.³ SORM's authority reaches to all state agencies, except for the Texas Department of Transportation, the University of Texas System, Texas A&M System, and Texas Tech University System. By its own definition, SORM's obligation also covers the risk of exposure due to workplace violence.⁴

SORM was created in 1997 and is statutorily required to administer the state employees workers' compensation insurance program and the state risk management program. Prior to SORM's formation, these programs were administered by the Office of the Attorney General (OAG) and the Texas Workers' Compensation Commission (TWCC). As SORM evolved, its efforts have been focused primarily on the state employee workers' compensation insurance program.

To implement the risk management program required by Chapter 412 of the Texas Labor Code, SORM has directed each agency to develop and implement its own risk management program.⁵ SORM has also developed *Risk Management for Texas State Agencies*, a four-volume set of guidelines. These guidelines form the direction and basis for a comprehensive risk management program. The goal of the risk management program is to reduce property, liability, and workers' compensation losses in each state agency.⁶

SORM maintains active relationships with all 136 state agencies and has approved risk management programs for all agencies under its jurisdiction. However, SORM has reported that the Texas Incentive and Productivity Commission, the Texas Funeral Services Commission, and Texas Southern University have failed to fulfill reporting requirements that allow SORM to adequately evaluate the agencies' risk management programs.⁷

In fulfilling its obligation to review, verify, monitor, and approve risk management programs adopted by state agencies, SORM's Risk Assessment and Loss Prevention Section conducts periodic reviews to assist state agencies in establishing employee health and safety programs. This three-level review process provides SORM and the reviewed agency an opportunity to "fine-tune and improve" existing risk management programs at state agencies. SORM's seven Risk Management Specialists (including the department manager) conduct 50 reviews of agency risk management programs per year.

Each agency reviewed by SORM is given an opportunity to respond to the evaluation within 60 days after it receives the evaluation report. This gives SORM and the agency the opportunity to address any outstanding issues. Full evaluations of an agency's risk management program are followed by periodic on-site consultations and health and safety reviews.

SORM's evaluation of agency risk management programs includes a cursory review of what agencies do to prevent or prepare for instances of workplace violence. When a SORM Risk Management Specialist conducts an agency risk management program review, obvious exposures that might present workplace violence risks are identified.

In FY 1999, SORM's review of agency risk management programs included surveying security conditions and aggressive behavior incident reporting systems. During this period, SORM's review yielded major comments and recommendations to agencies in the following areas:

- Written Procedures for Building Security
- Procedures to address access controls to facilities

-
- Procedures establishing parking lot security and escorts
 - Availability, licensing and training of security guards
 - Training program for aggressive behavior

Although SORM does conduct reviews that survey an agency's preparedness for incidents of workplace violence, the broad array of issues involved in risk management forces SORM to rely on a limited number of Risk Management Specialists armed with generalized training. SORM acknowledges that it cannot conduct assessments that include full exploration of workplace violence prevention measures.

In addition to agency risk management reviews, SORM offers periodic training for all state agencies. The risk management training component includes specialized instruction on workplace violence prevention and handling "bomb threats." SORM also has a "train-the-trainer" series aimed at providing agency risk managers with specialized training on workplace violence. SORM's limitations on workplace violence specialists requires them to rely on the Texas Department of Public Safety and the Austin Police Department's bomb squad for expertise.

These training sessions are offered three times per year in Austin. SORM reports that over 90 state employees from 30 different agencies have participated in these training activities during the 1999 fiscal year. It publishes an annual training calendar that is sent to all state agencies as well as agency risk managers. SORM also maintains a web site that lists training opportunities.

In addition to serving 136 state agencies, the Risk Management Specialists have other duties that require varying levels of involvement. The Risk Assessment and Loss Prevention Section provides other risk management services to 26 Mental Health/Mental Retardation facilities, 15 Texas Youth Commission facilities and 122 Texas Department of Criminal Justice facilities. This division of SORM also provides more limited services to over 3,300 state agency field offices throughout the state.

GENERAL SERVICES COMMISSION

The General Services Commission (GSC) serves as the leasing agent and property manager for thousands of buildings throughout the state.⁸ In *Facilities Master Plan 2000*, the GSC reports that it provides working space for over 131,000 state employees in state-owned and leased buildings.⁹ Forty-seven percent of full-time state employees are housed in GSC leased or managed facilities. Others are housed in workplaces built, leased or managed by other state agencies or institutions of higher learning.¹⁰

The scope of GSC's services as property manager and leasing agent does not include workplace safety and violence prevention. GSC's *Facilities Master Plan 2000* report does not take workplace violence issues into account. Instead, GSC assumes individual state agency risk management plans are included in an agency's request for office space.

Because workplace violence prevention is not considered a facility issue by GSC, there is no coordinated effort by GSC and other involved agencies to insure that workplace violence prevention standards are addressed. GSC acknowledges that it has no minimum standards for security or safety in its standard lease contracts. And, unless a client agency requests special consideration for workplace

violence prevention measures, these issues go unaddressed until an agency receives an on-site review by the State Office of Risk Management. With SORM's limited resources, it could take several years before an on-site review of newly acquired facilities is conducted.

TEXAS DEPARTMENT OF PUBLIC SAFETY - CAPITOL POLICE DISTRICT

The Texas Department of Public Safety - Capitol Police District (Capitol Police) has primary responsibility for law enforcement and security services on the Capitol Complex.¹¹ To this end, it provides crime suppression and control, security management and parking administration in the Capitol Complex and at other state office buildings in Austin within a 46-square block area surrounding the Capitol Building.¹² The Capitol Police also provide law enforcement and security services to the William P. Hobby, E.O. Thompson and Brown/Heatly State Office Buildings. Importantly, the Capitol Police do not provide law enforcement or security services to any other state buildings or employees outside of the Capitol Complex.

The Capitol Complex includes 28 state office buildings and 15 private office buildings. The Capitol Police serves a day time population of approximately 40,000 with an additional state employee workforce of approximately 14,000.¹³

The Traffic Law Enforcement Division of the Texas Department of Public Safety is responsible for the overall administration of the Capitol Police. The Capitol Police is divided into three details: the first is responsible for security of the State Capitol Building, Capitol Extension and the Capitol grounds; a second is responsible for police patrols and building security in other areas; and the third detail performs criminal investigations, parking administration, research and training and locksmith services.

The Capitol Police fulfills its role with 257 personnel. One hundred thirty-seven (137) are commissioned personnel and 120 are non-commissioned support personnel. Ninety-six non-commissioned support personnel are assigned to provide varying levels of security-related work. Fifty-percent of commissioned officers are assigned to the State Capitol Building, Capitol Extension and the Capitol Building grounds. Moreover, as required, the Department of Public Safety and the City of Austin have entered into an inter-local agreement for traffic and parking enforcement and general security in the Capitol Complex.¹⁴

STATE PRESERVATION BOARD

The State Preservation Board (SPB) was established in 1983 for the purpose of preserving, maintaining, and restoring the State Capitol and the General Land Office Building, and their contents and grounds. The State Preservation Board is involved in workplace safety in so much as security measures impact its preservation efforts. The SPB's focus is now on preservation maintenance.

GAUGING THE THREAT OF WORKPLACE VIOLENCE

Current crime statistic reporting methods make it impossible to gauge the threat of workplace violence. Statistical data contained in the Uniform Crime Report compiled by the United States Department of Justice from reports filed by all law enforcement agencies contains no separate category for workplace related violence. In Texas, no state agency compiles or maintains any statistical data to gauge

the seriousness of the threat of workplace violence. Moreover, a National Crime Victimization Survey found that 56% of workplace violence victims never reported their particular incident to any law enforcement agency.¹⁵ These factors make gauging the seriousness of the threat of workplace violence impossible.

Government employees disproportionately suffer incidents of workplace violence. The Bureau of Justice Statistics analysis of crime victimization data shows that 61% of workplace violence incidents occurred in private companies, 30% occurred among government employees, and 8% of the victims were self-employed.¹⁶ Since 18% of the workforce in the United States are government employees (federal, state and local), studies have concluded that there is a disproportionate share of attacks against government employees.¹⁷

The National Institute for Occupational Safety and Health (NIOSH) has identified certain factors that appear to increase a worker's risk for workplace assault. These factors include:

- Contact with the public
- Exchange of money
- Delivery of passengers, goods, or services
- Having a mobile workplace such as a police cruiser
- Working with unstable or volatile persons in health care, social service, or criminal justice settings
- Working alone or in small numbers
- Working late at night or during early morning hours
- Working in high-crime areas
- Guarding valuable property or possessions
- Working in community-based settings¹⁸

The nature of state employment involves many of the risk factors identified by NIOSH. This makes state employees more vulnerable to incidents of workplace violence than the overall workforce.

The House Committee on General Investigating conducted a survey of selected state agencies to quantify the seriousness of workplace violence at state agencies. The Committee surveyed the following agencies and component institutions:

- Texas Health and Human Services Commission
 - Texas Department of Human Services
 - Texas Department of Protective and Regulatory Services
 - Texas Department of Mental Health and Mental Retardation
 - Texas Department of Health
 - Texas Commission for the Blind

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- Texas Commission on Alcohol and Drug Abuse

 - Texas Department of Information Resources

 - Texas Natural Resource Conservation Commission

 - Texas Department of Transportation
 - The University of Texas System
 - System Administrative Offices
 - The University of Texas at Arlington
 - The University of Texas at Austin
 - The University of Texas at Brownsville
 - The University of Texas at Dallas
 - The University of Texas at El Paso
 - The University of Texas at Pan American
 - The University of Texas at Permian Basin
 - The University of Texas at San Antonio
 - The University of Texas Houston Health Science Center
 - The University of Texas Health Science Center at San Antonio
 - The University of Texas - M.D. Anderson Cancer Center
 - The University of Texas Medical Branch at Galveston
 - The University of Texas Southwestern Medical Center
 - The University of Texas Health Center at Tyler

 - Texas A&M System
 - System Administrative Offices
 - Tarleton State University
 - Texas A&M at Kingsville
 - Texas A&M at Commerce
 - Texas A&M Health Science Center
 - Texas Transportation Institute
 - Texas A&M Agricultural Programs
 - Texas A&M at Galveston
 - Texas A&M International
 - Texas A&M at Texarkana
 - Texas Engineering Experiment Station
 - Texas Engineering Extension Service
 - Texas A&M University
 - Prairie View A&M University
 - West Texas A&M

The survey questionnaire consists of a series of six questions focusing on (1) an agency's assessment of the problem; and (2) its policies and practices addressing this problem. The survey is included in "Appendix I." Agency responses to the survey are on file with the House Committee on General Investigating.

Along with a survey of state agency policies and practices, the House Committee on General Investigating asked the Capitol Police to identify the seriousness of the threat of workplace violence at the Capitol Complex. The Capitol Police reported workplace violence is not a major problem.¹⁹ However, it did report that "be on the lookout" and "harassment" complaints are increasing, especially where adverse actions are taken against employees or license holders.

The table below shows total reported crimes investigated by the Capitol Police within the Capitol Complex.²⁰ The Capitol Police statistical report shows no discernable pattern of workplace violence or crime in the Capitol Complex. Again, measuring the seriousness of the threat of workplace violence is impossible because of the lack of reporting requirements.

Capitol Police Crime Statistics
1995-1999

Type of Crime	1995	1996	1997	1998	1999
Assault	5	5	6	8	17
Bomb Threat	4	8	4	5	2
Breach of Computer Security	0	0	0	0	4
Burglary of Building	5	13	5	7	1
Burglary of Coin Operated Machine	0	1	3	1	1
Burglary of Vehicle	37	38	34	31	32
Criminal Mischief	104	92	45	53	26
Criminal Trespass	5	15	7	11	13
Disorderly Conduct	6	5	2	4	0
Drug Offenses	30	15	32	68	91
Indecent Exposure	1	0	0	0	2
Family Violence	3	2	1	3	1
Harassment	18	20	20	21	24
Public Lewdness	0	0	0	1	4
Public Intoxication	45	44	45	71	111
Resisting Arrest	1	0	4	3	2
Robbery	1	0	0	2	1

Sexual Assault	0	0	0	0	1
Terroristic Threat	9	8	12	12	14
Theft	190	161	150	147	112
Unlawful Carrying Weapon	0	0	0	6	6
Unlawful Use of Motor Vehicle	7	12	18	9	8
Unlawful Use of Motor Vehicle (attempted)	1	0	3	0	0

The survey of state agency policy and the practices on workplace violence show that instances of workplace violence occur with varying degrees of frequency. For example, the Texas Natural Resource Conservation Commission (TNRCC) reported 12 potential/alleged workplace violence cases in FY 1999 and 22 cases in FY 2000.²¹ Although a dramatic increase was observed, TNRCC points out that the greatest number of incidents occurred prior to the implementation of training associated with a new Workplace Violence Policy. Since the policy's implementation, TNRCC reports only one workplace violence incident.

The survey also revealed that incidents of workplace violence occur in many locations throughout the state. For instance, the Texas Department of Human Services (DHS) reported that it observed 143 incidents of workplace violence during FY 2000. Of those, 73 were from regional offices throughout the state and 60 occurred in the agency's State Office Complex in Austin. DHS noted that this number does not represent a significant increase in occurrence of workplace violence.

The survey also revealed differing levels in severity of incidents of workplace violence. Many responding agencies reported having received bomb and death threats and incidents of vandalism and criminal trespass. However, several agencies reported more serious incidents of workplace violence. For example, the Texas Department of Mental Health and Mental Retardation reported that an "employee held a department head hostage at knife point for several hours."²² And, the General Services Commission reported that two leased parole offices in Houston were the target of arson (a parolee is suspected) resulting in the loss of over 20,000 square feet of office space and approximately \$475,000 to the building's owner.²³

The survey also revealed that workplace violence is not limited to instances between co-workers. In one case reported by Tarleton State University, a student in a class told fellow classmates and the professor of dreaming about "bringing a gun to class and killing everyone."²⁴ Further, the Texas Department of Transportation (TxDOT) reported that its security office receives an average of two calls per week dealing with domestic violence involving TxDOT employees.²⁵

Although the selected examples taken from the survey might be alarming, no data exists and no suggestion is made that these examples and frequency rates are beyond national levels or those in the private sector. The Texas Public Employees Association has not received any complaints about workplace violence and has taken the position that it is not a major issue or problem.²⁶ Even so, the State Office of Risk Management and all agencies surveyed have adopted policies and practices to address this problem.

DEALING WITH WORKPLACE VIOLENCE

AT STATE AGENCIES

Because the nature of state employment places employees at risk of workplace violence, state agencies on their own and through the State Office of Risk Management have adopted policies and modified workplace practices to better provide for the safety and security of agency employees. Moreover, the Capitol Police provides a variety of security-related services to insure the safety of those working in the Capitol Complex.

As mentioned above, the State Office of Risk Management (SORM) is the agency primarily responsible for administering the state's risk management and worker's compensation program. SORM offers training resources to state agencies and employees in various aspects of risk management. SORM's training program on workplace violence prevention is aimed at agency risk managers and supervisors. It includes components on recognizing violent persons and dangerous situations, designing a safe workplace and managing stressful situations.

SORM also provides training on how to handle bomb threats. SORM's training session focuses on profiling the psychology of persons making threats, search techniques, and recognizing explosive devices. SORM's training also stresses the value of an agency "bomb incident" plan. To this end, SORM provides a detailed "bomb threat procedures" guide to assist employees and agencies dealing with bomb threat incidents. SORM relies heavily on expertise provided by the Texas Department of Public Safety and the Austin Police Department for the "bomb threat" training.

SORM also reviews and monitors agency risk management plans. Its periodic review includes monitoring of an agency's implementation plan on workplace violence. However, SORM's limited resources and its inability to enforce risk management rules or regulations limits its effectiveness in obtaining agency compliance with recommended improvements.

Each state agency is required to adopt safe workplace policies and practices.²⁷ State agencies reviewed by SORM have all adopted risk management programs. Those agencies not falling under SORM's review authority also have adopted risk management programs. Agencies developing their own risk management policies do so to meet particular needs and circumstances of the agency. Each agency's differing role requires that standards vary. Moreover, SORM reported that smaller agencies with more limited resources have lesser developed risk management policies and practices. As a result, risk management programs do not follow uniform standards.

AT THE CAPITOL COMPLEX

As discussed previously, the responsibility to protect state property and employees in the Capitol Complex has been entrusted to the Texas Department of Public Safety through the Public Safety Commission. This responsibility has been delegated to the Capitol Police. Because of the significance and

nature of the Capitol Building, Capitol Extension and other state buildings in the Capitol Complex, the Public Safety Commission generally grants unlimited public access to these buildings.²⁸

Along with SORM, the Capitol Police provides safety training and training materials to state employees working primarily in the Capitol Complex. It publishes and distributes *Capitol News*, a newsletter widely circulated in the Capitol Complex which often includes safety training tips. The Capitol Police also compiles safety-related brochures on a variety of subjects including dealing with bomb threats and workplace violence. This information is also widely distributed and is used when agencies request safety training from the Capitol Police.

A bomb threat protocol sheet is also distributed by the Capitol Police to guide state employees through a bomb threat incident. This protocol sheet is distributed to all Capitol Complex offices by the Capitol Police and is used in training sessions.

Current procedures detailing steps for dealing with bomb threats are the subject of particular concern. At present, Capitol Police policy is to direct and manage the response for all threats made against facilities within the Capitol Complex. For threats against buildings outside the Capitol Complex, the Capitol Police will assist in assessing threat validity, but abdicate the ultimate decision regarding levels of response to an agency's executive director. Depending on the threat assessment, the Austin Police Department's "Bomb Squad" and Austin Fire Department are also available to provide emergency services.

Conflicts between Capitol Police bomb threat protocol policy and actual practice have been reported. Comments received by the Committee suggest that in at least two (2) instances, Capitol Police sought initial direction from agency executive directors on the course of action to be taken in response to bomb threats made against agencies located in the Capitol Complex.²⁹ This is contrary to policy stating that the Capitol Police will themselves direct and manage a response to a threat made against a building in the Capitol Complex.

The alleged discrepancy between policy and practice suggests two things. First, the Capitol Police rely on agency executive directors to make decisions which they are responsible for under their own policy. Secondly, agency executive directors do not feel adequately prepared to respond to these types of threats.

The Capitol Police also operate a 24-hour communications center for the Capitol Complex. To be certain that Capitol Complex employees are aware of emergency telephone numbers, the Capitol Police report that they frequently distribute a "stick-on" emergency number guide throughout the Capitol Complex. However, this is not done on a regular basis.

The desire for general public access to the Capitol Building, Capitol Extension and other buildings in the Capitol Complex creates limitations on the Capitol Police's ability to more fully reduce the risk of workplace violence. Full and free access, coupled with the decision to refrain from using weapons detection equipment, diminishes the Capitol Police's ability to detect or forestall potential violent incidents.³⁰

The limitations placed on the Capitol Police require that it fine tune its policing methods. In order

to provide security at Capitol Complex buildings, the Capitol Police rely on high police visibility and sophisticated surveillance systems. For example, over 50% of the Capitol Police's commissioned officers are assigned to the Capitol and its grounds. And, a system of video surveillance cameras monitors the Capitol Building 24-hours a day.

The Capitol Police expressed concern about the carrying of licensed handguns in the Capitol Building and Extension. Currently, most weapons are prohibited in these places.³¹ However, concealed handguns carried by a license holder may be carried in any "place and under circumstances where not otherwise prohibited by law."³² Because a prohibition requires posting of notice, and no notice has been posted, licensed handguns are permitted in any part of the Capitol Building, Extension, and grounds. This includes members' offices, meeting rooms and the galleries of both the House and Senate.³³

Although the Public Safety Commission is authorized to make it illegal to carry a licensed handgun in the Capitol Building and Extension, it has not undertaken this action. As a result, licensed handgun carriers have unlimited access to all parts of the Capitol and Extension.

Other state agencies have adopted rules and policies prohibiting the carrying of concealed handguns by licensed carriers in buildings occupied by those agencies. Because these agencies have posted notice, carrying a licensed handgun in these areas subjects a person to prosecution for criminal trespass under Section 30.06 of the Texas Penal Code.

The Capitol Fire Marshal has also developed measures to minimize risks associated with situations which require the evacuation of the Capitol Building and Extension. The State Preservation Board and the State Fire Marshal's Office share oversight of the Capitol Fire Marshal, who prepared and distributed the Capitol Emergency Evacuation Plan.

An interesting note on the current status of the State Capitol Building and Capitol Extension Emergency Evacuation Plan deserves mention. The plan provides information on topics such as emergency phone numbers, evacuation procedures and bomb threats. For evacuation emergencies, the plan calls for periodic training of particular Capitol Building and Extension employees to assist in building evacuations. When asked, the Capitol Fire Marshal could not remember when the last training sessions had been held.³⁴

If the Capitol Fire Marshal fails to follow his own plan, persons working or touring in the Capitol Building or Extension could be placed at greater risk in the event of an emergency evacuation.

It is important to note that other buildings in the Capitol Complex are not as well protected as the Capitol Building and Extension; other buildings rely on less elaborate and more ineffective surveillance and patrol systems. These systems leave much room for improvement. For example, the Capitol Police and the Office of the Attorney General - Internal Investigations Division both provide security services to the William P. Clements, Jr., State Office Building. However, no coordination exists between these two agencies to insure that maximum efficiency is achieved. As a result, gaps in security render both systems almost wholly ineffective; neither knows what the other is doing.³⁵

This inefficiency leaves the William P. Clements, Jr., State Office Building vulnerable. The Committee conducted a “spot check” to see whether the current security system would detect unauthorized entry into the building. On the morning of April 23, 2000, an unmarked SUV was parked on the ground-floor driveway between (and beneath) the building and the parking garage for approximately two hours. An unauthorized person was able to gain access around all of the external facilities (parking structure, trash receptacles, etc.) and to the building itself without showing any meaningful identification or without any intervention from any person including the Capitol Police.

The failures of the security system at the William P. Clements, Jr., State Office Building (just two blocks west of the Capitol Building) are significant. This state office building serves 13 state agencies providing critical and vulnerable functions to the State of Texas.³⁶ For instance, the Office of the Attorney General’s Crime Victims Institute, Special Crimes, Law Enforcement Defense, Prosecutor’s Assistance, General Litigation, and Tort Litigation Divisions all maintain offices in this state office building. The nature of work performed in this building makes it a target for those with anti-government sentiments. Varying degrees of effective security measures at possibly the most vulnerable state office buildings in the Capitol Complex suggest that buildings perceived as less vulnerable might similarly be ineffectively protected.

CONCLUSIONS & RECOMMENDATIONS

Public attention is often focused on rare instances of workplace violence--the unexpected “office gunman” who terrorizes an office full of employees and customers or the shock of violence in schools. These fears complicate the work of those charged with developing workplace violence programs. The challenge of risk managers and security personnel is to prepare for the rare occurrence of workplace violence while identifying and addressing more important, but often overlooked, likely sources of danger. Preparation for rare instances should not stand in the way of identifying risks such as lack of coordination between agencies, poorly lighted parking lots or gaps in employee training.

Although quantifying the level of risk for state buildings and employees is beyond the scope of the Committee’s review, the Committee’s survey of selected state agencies reveals real instances of workplace violence. The types of incidents identified show that no agency is immune from even the most serious types of violence.

Moreover, the results of reviews conducted at the Capitol Complex revealed flaws and gaps in security and safety plans. Because these are possibly the most secure state buildings, failures here suggest similar or more problematic situations may exist in other state buildings throughout the state.

The measures taken by state risk managers and agencies to reduce risks associated with workplace violence are significant. However, gaps and flaws in existing plans render many plans less effective. To this end, the following recommendations are made:

- The generalized training and resources currently held by Risk Management Specialists at the SORM should be supplemented with specialized training in workplace violence prevention methods. SORM, and other risk managers should tap into the Texas Engineering Extension

Service's Law Enforcement Training Academy and its National Emergency Response and Rescue Training Center for specialized training on threat and risk assessment and prevention.

- SORM and GSC should develop a uniform and minimum standards guide on safe workplace requirements. These minimum standards should be considered and made a part of any future Facilities Master Plan developed by GSC or any other state agency responsible for planning future building or renovation projects. Moreover, minimum standards should be included for all new building leases and be included for existing leases up for renewal.
- To address the lack of statistical information to gauge the threat of workplace violence, each agency should report workplace violence incidents and threats to SORM on a semi-annual basis. SORM should develop an appropriate definition of workplace violence and the reporting standards for agency compliance.
- SORM should develop a Risk Management Guide that includes a uniform section that should be adopted by smaller state agencies lacking resources to develop an effective risk management program.
- DPS and the Capitol Police should conduct a thorough review of its "bomb threat" protocol policy and adopt necessary changes to insure effective implementation. The Capitol Police should provide a written explanation and provide guidance to each agency director and agency risk manager in the Capitol Complex.
- The Public Safety Commission and the State Preservation Board should coordinate to post notice in accordance with Section 30.06, Texas Penal Code to prohibit the carrying of licensed concealed handguns in the Capitol Building and Extension. (*See Appendix II: Representative Keel does not join the committee in this recommendation*).
- Each state agency should consider posting notice in accordance with Section 30.06, Texas Penal Code to prohibit the carrying of licensed concealed handguns in each facility under its jurisdiction. (*See Appendix II: Representative Keel does not join the committee in this recommendation*).
- The Capitol Police should conduct a comprehensive review of security services provided by each agency in the Capitol Complex and adopt necessary changes to insure that Capitol Police and other agency security services are effectively coordinated to maximize security services and reduce duplication of services.

ENDNOTES

1. Tex. Admin. Code title 28, §252.101 (1999).
2. Agency survey responses are on file with the House Committee on General Investigating.
3. Tex. Lab. Code Ann. §412.011 (1999).
4. “Risk management, by definition of its component terms, is the management process of planning, organizing, staffing, leading, and controlling an organization's resources to minimize the possibility of loss or injury from various causes of loss. Simply stated, risk management is the process of identifying and controlling an organization's losses.” *Risk Management for Texas State Agencies*.
5. Tex. Admin. Code title 28, §252.101(a) (1999).
6. State Office of Risk Management, *Risk Management for Texas State Agencies* (visited September 27, 2000), <<http://www.sorm.state.tx.us/volumes.htm>>.
7. Letter from Gentry Woodard, office of the General Counsel of the State Office of Risk Management (September 1, 2000) (on file with the House Committee on General Investigating).
8. Tex. Gov. Code Ann. §§2165, 2167 (1999).
9. General Services Commission, *State of Texas Facilities Master Plan 2000* (July 2000).
10. Statutory authority for delegated leasing authority separate from GSC’s authority exists for: Southwest Texas State University; Texas A&M System; Texas Tech University; Texas Agriculture Experiment Station; University of Houston System (system offices, Clear Lake, Downtown, Victoria); University of North Texas (Denton and Health Science Center at Ft. Worth); University of Texas (Dallas, El Paso, San Antonio, Tyler, Health Center at Tyler, Health Science Center at San Antonio, Medical Branch at Galveston, Southwestern Medical Center at Dallas, and Arlington); Texas Workforce Commission; Texas Department of Mental Health and Mental Retardation (residential space and community centers); Texas Youth Commission (residential space); Texas Affordable Housing Corporation (residential space); Texas Alcoholic Beverage Commission; Texas Armory Board, Texas Lottery Commission, State Auditor’s Office; the Legislature.
11. Tex. Gov. Code Ann. §411.062(a) (1999).
12. Tex. Gov. Code Ann. §411.061 states:
“Capitol Complex means the following property that is located in Austin, Texas, to the extent the property is owned by or under the control of the state:

(1) the area bounded on the north by the inside curb of Martin Luther King, Jr., Boulevard, on the east by the outside curb of Trinity Street, on the south by the outside curb of 10th Street, and on the west by the outside curb of Lavaca Street;
(2) the William P. Clements State Office Building located at 300 West 15th Street; and
(3) other locations under the jurisdiction of the capitol police district as may be approved by the director.”

13. *Overview of TLE Division and Services*. Materials from David McEathron, Chief Traffic Law Enforcement Division, Texas Department of Public Safety to Sunset Commission staff (November 1997).
14. Tex. Gov. Code §411.062(f) (1999).
15. National Institute for Occupational Safety and Health, U.S. Dept. Health and Human Services, Pub. No. 96-100, *Current Intelligence Bulletin 57: Risk Factors and Prevention Strategies* (1996).
16. Id.
17. Id.
18. Id.
19. Interview with Randall K. Elliston, Major, Texas Department of Public Safety - Capitol Police District (January 20, 2000).
20. Texas Department of Public Safety - Capitol Police District. *Capitol Police District Crime Statistics 1995-1999*.
21. Texas Natural Resources Conservation Commission. *Workplace Violence Survey Response*. September 5, 2000 (on file with House Committee on General Investigating).
22. Texas Health and Human Services Commission. *Workplace Violence Survey Response*. August 28, 2000 (on file with House Committee on General Investigating).
23. General Services Commission. E-mail correspondence from Carlos J. Hodge to Matt Kelly. August 1, 2000.
24. Texas A&M University System. *Workplace Violence Survey Response*. August 30, 2000 (on file with House Committee on General Investigating).
25. Texas Department of Transportation. *Workplace Violence Survey Response*. August 8, 2000 (on file with House Committee on General Investigating).
26. Telephone Interview with Gary Anderson, Executive Director, Texas Public Employees Association (April 17, 2000).

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27. Tex. Admin. Code tit. 28, §252.101.
 28. Tex. Admin. Code tit. 37, §1.4.3.
 29. Agencies providing comments wished to remain anonymous to avoid problems with the Capitol Police.
 30. Interview with Randall K. Elliston, Major, Texas Department of Public Safety - Capitol Police District (January 20, 2000).
 31. Tex. Admin. Code 37, §1.4.6 states:
Firearms, explosive weapons, illegal knives, clubs, and knuckles, as defined in the Texas Penal Code, §§46.01, and prohibited weapons as defined in the Texas Penal Code, §§46.06, are not permitted in state buildings or on state grounds covered under these rules, except in the possession of:
(1) a licensed peace officer;
(2) as to a handgun or nightstick, a properly licensed private security officer while working under an approved department contract and the contract authorizes the use of an armed guard; or
(3) as to a concealed handgun, a person who is licensed to carry a concealed handgun, under Texas Civil Statutes, Article 4413(29ee), provided that such a person may only carry a handgun in a place and under circumstances where not otherwise prohibited by law.
 32. Id.
 33. Tex. Penal Code Ann. §§30.06, 46.035(c), 46.035(i) (1999).
 34. Telephone Interview with John Nichols, Capitol Fire Marshal (August 24, 2000).
 35. Interview with Harold Henderson, Chief, Internal Investigations Division, Office of the Attorney General (August 22, 2000).
 36. The following agencies maintain offices in the William P. Clements, Jr. State Office Building: Office of the Attorney General; State Commission on Judicial Conduct; State Office of Administrative Hearings; Department of Information Resources; Texas Public Finance Authority; State Office of Risk Management; Commission on Jail Standards; State Pension Review Board; Texas Bond Review Board; Texas Food and Fibers Commission; General Services Commission; and Texas Commission for the Blind (cafeteria).

APPENDIX I

WORKPLACE VIOLENCE SURVEY

1. How serious is the threat or problem at [agency]?
2. Provide examples and statistical information (frequency, type, cost, result or incident, etc.) on history of workplace violence at [agency]?
3. What does [agency] currently do to mitigate the threat or problem?
4. Where does [agency] fall short on addressing the problem? What resources do you need to mitigate or prevent these problems? What cost do you associate with corrective action?
5. What legislative remedies (or other suggestions) are necessary for these agencies to properly address this problem?
6. Any other information you deem important for the committee to know in reviewing the individual agency position in this issue?

APPENDIX II

**DOCUMENT ON FILE WITH
HOUSE COMMITTEE ON GENERAL INVESTIGATING**

The State Use Program

BACKGROUND

The State of Texas has a clearly articulated policy of encouraging and assisting “persons with disabilities to achieve maximum personal independence by engaging in useful and productive employment activities.”¹ Texas has put this policy into practice by establishing the Texas Council on Purchasing from People with Disabilities (“Texas Council”) and its concomitant mandatory State Use Program.² This program gained attention after a dispute over program information and ensuing litigation over competitive bidding was filed against the Texas Council by the Texas Industries for the Blind and Handicapped (“TIBH”). Questions about the program also aired after the Texas Council approved, then suspended, inclusion of certain postage meters on the State Use Program’s list of mandatory purchases. As a result of the dispute and problems between the Texas Council and TIBH, and the questions of product inclusion in the State Use Program, the House Committee on General Investigating was asked to review the program and processes by which disabled workers are afforded priority in certain state procurement, including the roles of the General Services Commission (GSC), the Texas Council, and TIBH.

In January, 2000, Lieutenant Governor Rick Perry asked the Senate Committee on State Affairs to review Texas’ State Use Program and the benefit provided to persons with disabilities. In his charge, Lieutenant Governor Perry directed the Senate Committee on State Affairs to “examine the powers and duties of the Council on Purchasing from People with Disabilities (the Council); funding methods for the Council staff and activities; the Council’s oversight of the central non-profit and community rehabilitation program work centers; the utilization by and satisfaction of customers with goods and services provided under the program; the nature of disabilities required for participating in the program; and the adequacy of rules governing the State Use Program, including whether standards of eligibility for work center products and services should be added to statute. The committee shall also ensure the appropriate nature and amount of involvement by people with disabilities in the production of goods and provision of services.”³

Senate Finance Committee Chairman William R. Ratliff also requested a review by the State Auditor’s Office because of concerns about program abuses. The State Auditor’s Office released its report in September, 2000. The “Key Points of the Report” and “Executive Summary” are included in this report as “Appendix I.”

Because the charge to the House Committee on General Investigating and the Senate Committee on State Affairs related to the same subject matter and arose from similar concerns, the House and Senate committees worked together in examining the issue. The committees held joint public hearings on the matter on March 20, and April 25, 2000. Testimony was received from the Texas Council, TIBH, GSC, Community Rehabilitation Programs (CRPs), various advocacy groups, other state agencies providing employment services to disabled workers, representatives from for-profit and non-profit corporations, and others affected by the administration of the State Use Program.

The report that follows summarizes testimony, interview results and materials surveyed as a result of the interim charges. Finally, the report contains conclusions and recommended actions to the 77th Legislature.

STATE USE PROGRAM: THEN AND NOW

The State Use Program was set up in 1975 when the Legislature established a pilot program giving preferential contracts to blind or visually impaired Texans who manufactured products for sale to state agencies.⁴ The Texas Industries for the Blind and Handicapped (TIBH) was formed three years later to help implement the program.

Since 1978, TIBH has been intricately involved in the State Use Program. Moreover, TIBH has been the only organization authorized by the Texas Council to serve as a central non-profit agency (CNA).

Until 1981, the State Use Program targeted vendors employing blind and visually impaired Texans. The Legislature then expanded the program to include all disabilities and to establish set-aside contracts.

In 1995, the Legislature renamed the agency and made other changes.⁵ Along with a new name, the Texas Council's board membership was amended to include a nine-member board appointed by the governor.⁶ The Texas Council, which meets quarterly, is charged with furthering the state's policy of assisting and encouraging persons with disabilities to achieve personal independence by engaging in useful and productive employment activities.

Chapter 122 of the Human Resources Code contains the authorizing statute for the Texas Council and establishes its bounds. Chapter 122 requires the establishment of the State Use Program; requires the Texas Council to designate a central non-profit agency (CNA) to administer the program; and requires the use of CRPs to further employment opportunities for disabled workers. The program serves a population of the disabled community not reached by other programs--those typically having trouble obtaining mainstream employment and often requiring more structured environments.

Employment opportunities for disabled workers are created through combined efforts of the Texas Council, the CNA and CRPs. The Texas Council approves products and services that can be used by state agencies and political subdivisions and also sets prices. The CNA is responsible for cultivating and developing products needed by state agency users and for fostering the relationship between the state agency user and the provider of products and services. CRPs accomplish their role by employing persons with disabilities.

Participation in the State Use Program is mandated for state agencies and voluntary for political subdivisions. Agencies are required to purchase products and services provided by a CRP if the product or service meets established specifications.⁷ Political subdivisions, although not required, can purchase products or services from a CRP.⁸

When a state agency or political subdivision purchases a product or service through the State Use Program, it does not have to comply with statutory competitive bidding requirements. Instead, prices for products and services are set by the Texas Council based on its assessment of fair market price determination.⁹ In making this determination, the Texas Council is required to “ensure that the products and services offered for sale, offer the best value for the state or a political subdivision.”¹⁰ To this end, prices for services and products recommended by the CNA for inclusion in the State Use Program are reviewed by a Pricing Subcommittee (a subcommittee of the full-council) and presented to the Texas Council for approval.¹¹

The Texas Council serves primarily to set program policy and monitor program effectiveness. The Texas Council’s duties can be summarized to include the following:

- 1) approving community rehabilitation programs under which persons with disabilities produce products or perform services for compensation;¹²
- 2) determining fair market value of products and services manufactured or provided by persons with disabilities and offered for sale to state agencies by community rehabilitation programs;¹³
- 3) ensuring that the products and services for sale offer the best value for the state;¹⁴ and
- 4) testing products and services before offering them to the state to ensure quality.¹⁵

The Texas Council is not authorized to employ its own staff. To fulfill its obligations, it receives administrative, clerical, legal and other support from GSC in accordance with legislative appropriation.¹⁶ GSC provides an attorney on a part-time basis and an administrative assistant dedicated 50% to activities related to the State Use Program. GSC’s costs are reimbursed by the Texas Council, which receives fees derived from a percentage of TIBH’s management fee.¹⁷

However, since 1998, GSC has requested minimal funding through legislative appropriation to provide support for the Texas Council.¹⁸ TIBH has indicated that it fully anticipated \$100,000 in support from GSC and budgeted accordingly.¹⁹ However, GSC’s own legislative appropriation request envisions only minimal support to the Texas Council. A review of GSC’s past legislative appropriation requests and its actual expenditures to support the Texas Council are summarized in the tables below.

Table 1.
General Service Commission
Legislative Appropriation Requests
FY 1996 -2003²⁰

FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
0	0	42,000	42,000	26,266	29,162	29,162	29,162

Table 2.
General Service Commission
Expenditure Data
FY 1995-2003²¹

	FY 1995 (actual)	FY 1996 (actual)	FY 1997 (actual)	FY 1998 (actual)	FY 1999 (actual)	FY 2000 (est.)	FY 2001 (budgeted)	FY 2002 (requested)	FY 2003 (requested)
Salary & Wages	0	7,744.00	13,416	14,016.00	14,054.00	15,149.0 0	14,318.00	14,318.00	14,318.00
Other Personnel Costs	0	423.82	876.37	1,490.21	430.79	1,294.85	1,240.00	1,240.00	1,240.00
Operating Costs	0	14,647.35	9,488.05	8,946.92	13,841.27	18,084.7 0	13,604.00	13,604.00	13,604.00
Capital Expenditures	0	0	0	0	2,020.74	0	0	0	0
Total	0	22,815.17	23,780.42	24,453.13	30,346.80	34,528.5 5	29,162.00	29,162.00	29,162.00

The Legislature envisioned that combined efforts would administer the State Use Program. Along with voluntary board membership and limited assistance from the GSC, the State Use Program heavily relies on TIBH for the program’s administration. In fact, the Texas Council is required to contract with a CNA to “manage and coordinate the day-to-day functions of the program.”²² For all practical purposes, TIBH is and has been the program administrator for the State Use Program. TIBH’s duties can be summarized to include the following:

- 1) recruiting and assisting CRPs in developing and submitting applications for the selection of suitable products and services;
- 2) facilitating the distribution of orders among CRPs;
- 3) managing and coordinating day-to-day operations of the program, including the general administration of contracts with CRPs; and
- 4) promoting increased supported employment opportunities for persons with disabilities.²³

Since 1978, TIBH has been intricately involved in the State Use Program and has served as the sole CNA. TIBH’s performance as CNA is subject to review by the Texas Council. The Texas Council is required to review the services provided by a CNA each year to make sure the CNA complies with the contract specifications.²⁴ Moreover, at least once during each two-year contract period, the Texas Council is required to review and renegotiate the contract with a CNA.²⁵

TIBH is authorized to collect a management fee from CRPs for products and services a CRP sells through the State Use Program. This management fee is computed as a percentage of the selling price of

the product or service and must be approved by the Texas Council.²⁶ The fair market value for products and services offered for sale through the State Use Program is established with consideration given to the management fee set by TIBH and approved by the Texas Council.

The role of providing employment opportunities for people with disabilities falls to the CRPs. CRPs are the community-based government or non-profit organizations that, through work performed by disabled workers, make products or perform services for sale through the State Use Program.²⁷ Sales made through the State Use Program generate funds to compensate disabled workers for the work they perform. In order to participate in the State Use Program, CRPs must meet criteria set by and approved by the Texas Council.²⁸

Over the years, the employment opportunities with CRPs for people with disabilities has seen steady growth. In 1995, the Texas Council reported that 180 CRPs provided employment to 4,602 disabled Texans through the State Use Program paying over \$11 million in wages to disabled workers.²⁹ By 1999, the Texas Council reported that 159 CRPs employed 5,767 disabled Texans and paid them over \$16.8 million in wages.³⁰

THE DISPUTE

The Texas Council (along with its predecessor) and TIBH had had a longstanding and apparently positive relationship since 1978. TIBH has been the sole CNA since the State Use Program was first authorized. However, in 1998, questions arose over this longstanding relationship and caused several members of the Texas Council to consider whether TIBH was the best provider for these services.³¹ To answer this question, the Texas Council authorized the issuance of an invitation for bid (IFB) for CNA services in early 1998. The Texas Council had hoped that the invitation for bids would ensure the program was served by the most qualified non-profit corporation. Instead, the action sparked controversy engulfing the State Use Program and calling its effectiveness into question.

The Texas Council's desire to confirm that TIBH was the most suitable provider of CNA services was appropriate. The Texas Council is required to review the services provided by TIBH.³² As it stood in 1998, TIBH was largely the Texas Council's sole source of information for pricing and contracting data, and for information on product or service inclusion in the State Use Program. The Texas Council had to rely almost entirely on data and analysis compiled by TIBH to gauge the State Use Program and TIBH's own effectiveness. Not having an external source of information or the capability to verify TIBH's analysis, the Texas Council elected to issue an IFB to test TIBH's effectiveness.

In response to the Texas Council's 1998 authorization for the issuance of the IFB, TIBH filed suit in Travis County District Court against the Texas Council and its chairman in his official and personal capacity and the General Services Commission and its executive director in his official and personal capacity. The lawsuit challenged the Texas Council's authority to use a competitive process to select a CNA. TIBH pointed to ambiguous statutory provisions and legislative history to support its contention that the Texas Council lacked authority to designate a CNA by a competitive bid procedure. The suit also alleged that the provisions of the IFB requiring TIBH to deliver all files, records, reports and documentation

to the Texas Council amounted to an unlawful confiscation of TIBH's assets.³³ It also asserted that TIBH could not be forced to give the successor CNA an orientation briefing.³⁴ In sum, TIBH alleged that the Texas Council exceeded its statutory authority when it authorized the IFB for CNA services.

In March, 1998, after hearing TIBH's request for a temporary injunction, the 345th District Court of Travis County issued an order prohibiting the Texas Council from: requiring TIBH to turn over its files, records, reports or documentation to anyone; requiring TIBH to train or brief any successor CNA; and awarding a CNA through the invitation for bid. The court order was intended to preserve the status quo until all issues in the lawsuit could be litigated or settled.

After TIBH filed suit against the Texas Council, a flurry of legal maneuvers by TIBH and the Texas Council further aggravated tensions between the two. For example, the Texas Council asked the Attorney General for opinions on whether a CNA is restricted from engaging in lobbying activities by state or federal law; and whether the Texas Council had authority to obtain services from the State Auditor to conduct audits of a CNA. In each instance, TIBH submitted briefs to the Attorney General that not only attacked the substance of each request, but also argued that an opinion should not be rendered because the requests were improper.

In what appeared to be a positive move, both parties participated in mediation to resolve the dispute. As a result, the Texas Council rescinded its request for opinions from the Attorney General and TIBH dropped its lawsuit against the Texas Council and the GSC.

This positive step was short-lived and was ineffective at restoring a positive working relationship. In fact, even TIBH's non-suit sparked controversy. Because the original suit resulted in an order that prohibited the Texas Council from taking certain actions, questions remained about the effect the dismissal had on the order. Again, briefs were filed and the Texas Council's request for clarification was denied by the Travis County District Court. The Texas Council appealed the denial for clarification to the Court of Appeals for the Third District of Texas. A decision from the Third Court of Appeals is still pending.

The State Use Program has also faced criticism about the types of employment opportunities created for disabled workers. Continuing calls for higher skilled and higher paying jobs are at the forefront of suggested improvements to the program.³⁵ Jobs currently provided through the program consist primarily of janitorial or custodial-type services. Of the \$51 million purchases made in 1999 through the State Use Program, only \$9 million was for the manufacture of products.³⁶ Moreover, during this same period, 72% of disabled workers employed through the State Use Program were paid between \$5.00 and \$5.99 per hour, 13% were paid between \$6 and \$6.99. Only 15% were paid more than \$7.00 per hour.³⁷

Both the Texas Council and TIBH have attempted to expand the program into areas that might provide higher paying and higher skilled job opportunities. However, most of these efforts have been unsuccessful. For example, in 1997, TIBH recommended and the Texas Council approved a proposal by a CRP to have disabled workers assemble computers for sale to state agencies under the set aside program. GSC, however, noted that the proposal conflicted with statutes governing the purchase of automated information systems.³⁸ An Attorney General opinion sought by GSC settled the matter by

finding that this type of equipment purchase through the State Use Program was precluded by law.³⁹

In yet another unsuccessful attempt to expand the program into possibly more productive areas, the Texas Council approved a recommendation by TIBH to include postage meters to the list of products on the State Use Program. The proposal made by a Houston-based CRP, Southeast Keller Corporation (SEK) would provide postage meters to state agencies through the State Use Program.

SEK's proposal would use postage meters manufactured and owned by Francotyp-Postalia, Inc., (Francotyp) one of a few corporations authorized by the United States Postal Service to manufacture and own postage meter equipment. SEK employees would be "involved in assembling, programming, testing, installing and servicing postage meters, scales, and related equipment" it received from Francotyp.⁴⁰ SEK indicated that it employed four disabled workers to work on the postage meters contract and projected total sales of \$370,326.16.⁴¹ At the time, the Texas Council lauded the program as an example of future partnerships that merge both products and services.⁴²

Not everyone celebrated the alliance. Pitney Bowes, Inc., criticized the decision by the Texas Council to include the Francotyp postage meters in the State Use Program.⁴³ Pitney Bowes pointed to the failure by the Texas Council to adopt rules that would provide meaningful guidance the Texas Council, TIBH or a CRP or provide any meaningful limitation to participation in the State Use Program. As a result, Pitney Bowes contended that CRPs could minimally serve as a receiving and shipping agent for any for-profit corporation looking to get an unfair advantage over other non-State Use Program suppliers of products and services.

Pitney Bowes complained that the use of a CRP (in this case, SEK) in this fashion was not envisioned or approved by the Legislature.⁴⁴ It maintained that the use of the program in this way could allow a for-profit corporation to receive preferential treatment and avoid the competitive bidding procedure required for most state agency purchases. In such an instance, Pitney Bowes pointed out that the for-profit corporation could receive an unfair advantage over non-State Use Program participants because state agencies must purchase products offered through the State Use Program. This would effectively preclude purchases from vendors not participating in the State Use Program.

Pitney Bowes further argued that use of the State Use Program in this fashion would not serve the statutory policy of creating employment opportunities for disabled workers.⁴⁵ As an offer of proof, Pitney Bowes pointed to the level of involvement by disabled workers in the processes undertaken by SEK and Francotyp in the postage meter proposition. SEK and Pitney Bowes disagreed on the amount and type of work performed by disabled workers. Thus, the Texas Council was left to decide whether the postage meters were an appropriate item for the State Use Program. With little guidance in statute or in its own rules (as Pitney Bowes pointed out), the Texas Council suspended its approval of SEK's proposal until its own rules could be amended to address the issues presented by service contracts for future undefined services as well as the rental and sale of products not owned by a CRP.⁴⁶

CONCLUSIONS & RECOMMENDATIONS

Without doubt, the policies behind the State Use Program provide valuable employment opportunities for disabled Texans. Over 5,700 disabled workers were employed through the State Use Program in 1999.⁴⁷ In spite of this positive record, the problems and disputes that plague the program highlight shortcomings in the State Use Program. Saving this important program from further disintegration requires statutory changes by the Legislature and the promulgation of administrative regulations by the Texas Council.

The dysfunctional relationship between the Texas Council and TIBH is largely the result of ambiguous statutory language. Chapter 122 of the Human Resources Code is unclear about the authority and duties of the Texas Council. TIBH has utilized these ambiguities to thwart the Texas Council's attempts to issue IFBs and to gather information to review TIBH's performance. The ambiguities in Chapter 122 will likely provide continued disagreement between the Texas Council and TIBH unless resolved during the 77th Legislative Session.

Ineffective administrative regulations for the State Use Program give no meaningful guidance to the CNA or CRPs and allow for potential program abuses.⁴⁸ CRPs like SEK invest substantial efforts and resources to develop products and services that are subject to later controversy. Moreover, poorly defined and vague regulations can easily be manipulated to allow State Use Program participants to gain commercial advantage over non-program participants while not significantly advancing the program's stated purpose.

Further, TIBH is unwilling to accept state supervision over its activities. From (1) TIBH's efforts to prevent the Texas Council from reviewing information necessary to monitor and evaluate the program to (2) its management response to the State Auditor's findings (See "Appendix I"), it is abundantly clear that TIBH is not amenable to oversight over its activities. However, TIBH has indicated that it has taken steps to address many of the recommendations in the State Auditor's report.⁴⁹

The structure of the State Use Program permits self-dealing. The Texas Council relies heavily upon TIBH recommendations when deciding whether to offer a product or service for sale through the State Use Program. With TIBH collecting a "management fee" from sales made through the program, there is always incentive to recommend a product or service offering. Although no allegation of self-dealing is made, this flaw in the current system validates concerns regarding conflicts of interest.

The Texas Council lacks the ability to effectively administer the State Use Program.⁵⁰ Effective administration of the program requires that the Texas Council undertake a wide variety of duties including, but not limited to, policy development and implementation, oversight of CNA performance, establishing criteria for CRP recognition, program expansion and other highly involved activities. Even though GSC is required to provide support, the Texas Council is left to fulfill its statutory responsibilities with no staff of its own. The problems seen in the State Use Program are largely the result of this fact.

GSC has also failed to provide adequate management oversight, guidance and support to the State Use Program. GSC is required to provide "legal, clerical, administrative, and *other necessary support* to the [Texas C]ouncil in accordance with legislative appropriation."⁵¹ (Emphasis added.) With

no staff of its own, the Texas Council is constrained to the limited resources (part-time legal counsel and clerical support) provided by GSC.⁵² GSC has made no significant effort (Table 1 and 2) to provide additional management oversight, policy or administrative support to the Texas Council. To make up for this shortage, the Texas Council has been forced to rely on largely unreviewed reports and advice from TIBH. GSC has a unique vantage point from which to provide insight and management oversight to the State Use Program. GSC's inadequate cooperation and support compounded the problems the Texas Council faced.

GSC also failed to comply with its statutory duty to provide monthly reports of agency purchases outside the State Use Program.⁵³ State agencies are mandated to purchase products or services available through State Use Program. However, purchases can be made outside of the State Use Program when the product or service does not meet reasonable requirements or "requisitions made cannot reasonably be complied with."⁵⁴ GSC has never filed these reports with the Texas Council as required by law.

The State Use Program has served to provide employment opportunities for many disabled persons. In spite of this positive record, fundamental flaws in the program's design and implementation renders the program difficult to administer, diminishes the program's integrity and leaves it vulnerable to abuse. To this end, the following recommendations are made:

- The Texas Council should have clear statutory authority to select one or more CNA's through generally accepted competitive bidding procedures for this type of service.
- The Texas Council should have clear statutory authority to establish advisory committees.⁵⁵ Advisory committees should at a minimum assist the Texas Council in reviewing the program's effectiveness and recommend innovative ideas which create higher skilled and higher paying employment opportunities for the disabled.
- The Texas Council should have clear statutory authority to select one or more CNA's for periods not to exceed 5 years. After this initial period, the Texas Council should either renegotiate another agreement for a period not to exceed 5 years or terminate the agreement and seek other CNA services through the competitive bid process. A CNA agreement with the Texas Council should include a term that allows for the Texas Council to terminate the agreement at any time upon providing at least 30 days notice and substantial evidence of a CNA's failure to fulfill its obligations under the agreement.
- The Texas Council should have clear statutory authority to obtain financial and any other type of information from any CNA (including TIBH) or CRP it deems necessary to fulfill its obligation to oversee the State Use Program. Records from a CNA or CRP should respect privacy interests of any employee of a CNA or CRP recognized by law except that a compensation package of any CNA employee or subcontractor is relevant to the State Use Program and should not be protected from disclosure.
- The Texas Council should have clear statutory authority to employ its own dedicated staff to

provide management oversight to the State Use Program and to provide the necessary policy guidance and administrative support to the Texas Council. Funding for the additional staff should come from the management fee charged to CRPs by the CNA. The shifting of responsibilities from the CNA (TIBH) to the newly dedicated staff should reduce the amount of any increases in the management fees assessed to CRPs. Also, efficiencies associated with improved management and marketing efforts should help maintain management fees at reasonable levels.

- The Texas Council should be authorized to review the management fee charged by the CNA to a CRP on an annual basis. The fee charged to CRPs must be reasonable and based on actual services provided by the CNA, plus cost of staff for the Texas Council. To review the appropriateness or to gather information on the financial condition of any CNA, the Texas Council should be authorized to request any level of audit services it deems appropriate from the State Auditor's Office.
- Any dispute between or amongst the Texas Council, a CNA or any CRP should first be subjected to Alternative Dispute Resolution procedures before access to the courts is permitted. This requirement must not constitute authorization to sue and should not modify the remedies already available and recognized under the law. Moreover, this does not limit the Texas Council's ability to request opinions of the Attorney General as permitted by law.
- The Texas Council should adopt conflict of interest rules that apply to the CNA and CRPs to avoid confusion and abuses of the State Use Program.
- GSC should assign an employee (preferably at the deputy executive director level) a role to ensure GSC's responsibilities to the State Use Program are met and to ensure State Use Program policies and initiatives are coordinated with GSC's statewide procurement function.
- The Texas Council should include rules addressing certification of CRPs desiring to participate in the State Use Program. CRP approval should be made with primary consideration of creation of employment opportunities for disabled persons. To this end, the Texas Council should have clear authority to define the maximum or minimum percentage of disabled labor a CRP must employ for eligibility of a product or service in the State Use Program. The Texas Council should have authority to assure compliance with these requirements.
- The Texas Council should adopt rules that give substantive and meaningful guidance to partnerships between CRPs and other non-profit or for-profit organizations. Partnerships between a CRP and for-profit organizations should be approved by the Texas Council before authorized for inclusion in the State Use Program.
- The Texas Council should adopt rules defining "value-added" and "direct labor" for products manufactured or services provided for sale through the State Use Program.
- GSC should be statutorily required to include the State Use Program in state agency procurement

policy manuals.

- The required annual report by the Texas Council should include employment data on sheltered workshops and supportive employment from CPR's participating in the State Use Program. Included in this report should be the number of disabled and non-disabled workers employed, and the average and range of weekly earnings for disabled and non-disabled workers.
- Each state agency should be required to designate a staff member to assure that mandatory provisions of the State Use Program are followed. Each state agency should be required to report purchases of products or services (available through the State Use Program) made outside of the State Use Program to GSC. Reports may be based on a sampling of purchases performed through post-purchase audits. GSC should be required to include this information in its exception reports to the Texas Council.
- The Texas Council should be authorized by statute to adopt a definition of "disability" to qualify for CRP employment under the State Use Program. In adopting a definition, the Texas Council should seek and consider advice from disability advocacy groups, the Texas Rehabilitation Commission and the Texas Commission for the Blind.
- The governor should be allowed greater flexibility when appointing members to the Texas Council. The governor should be allowed to select the nine-member council from a list that includes persons with disabilities, private citizens conversant with the employment needs of persons with disabilities, representatives from community rehabilitation programs that represent different disabilities, and representatives from state agencies or political subdivisions that purchase a significant amount of products or services sold through the program. The governor should be required to include at least one representative from each category listed above and should make every effort to ensure that each category is proportionately represented on the Texas Council.

ENDNOTES

1. Tex. Hum. Res. Code §122.001 (1999).
2. Because preferential treatment is given to certain vendors, the program is also widely known as the “State Set-Aside” Program.
3. Letter from Rick Perry, Lieutenant Governor to the Senate Committee on State Affairs (January 27, 2000)(on file with the House Committee on General Investigating).
4. Acts 1975, 64th Leg., p. 2391, ch. 734, §16.
5. When first established in 1975, the state agency was called the Texas Committee on Purchases from Blind-Made Products and Services. In 1981, the name was changed to the Texas Committee on Purchases of Products and Services of Blind and Severely Disabled Persons.
6. The persons appointed to the Texas Council must be: three private persons conversant with employment needs of persons with disabilities; three representatives of CRPs representing different disability groups; three representatives of state agencies or political subdivisions that purchase a significant amount of products or services from persons with disabilities. Tex. Hum. Res. Code §122.003(a) (1999).
7. Tex. Hum. Res. Code §122.008 (1999).
8. Tex. Hum. Res. Code §122.017 (1999).
9. Tex. Hum. Res. Code §122.015 reads:
Determinations of Fair Market Value:
 - (a) In determining the fair market value of products or services offered for sale under this chapter, the subcommittee established under Section 122.007 (b) and the council shall give due consideration to the following type of factors:
 - (1) to the extent applicable, the amounts being paid for similar articles in similar quantities by federal agencies purchasing the products or services under the authorized federal program of like effect to the state program authorized by this chapter;
 - (2) the amounts which private business would pay for similar products or services in similar quantities if purchasing from a reputable corporation engaged in the business of selling similar products or services;
 - (3) to the extent applicable, the amount paid by the state in any recent purchases of similar products or services in similar quantities, making due allowance for general inflationary or deflationary trends;
 - (4) the actual cost of manufacturing the product or performing a service at a community rehabilitation program offering employment services on or off premises to persons with disabilities, with adequate weight to be given to legal and moral imperatives to pay workers with disabilities equitable wages; and
 - (5) the usual, customary, and reasonable costs of manufacturing, marketing, and distribution.
 - (b) The actual cost of manufacturing a product or performing a service consists of costs directly associated with a contract and includes costs for labor, raw materials used in the production of the product, storage, and delivery. Actual costs do not include a cost associated with an individual's preparation to perform the work activity.
 - (c) The fair market value of a product or service, determined after consideration of relevant factors of the

foregoing type, may not be excessive or unreasonable.

10. Tex. Hum. Res. Code §122.007 (1999).
11. Id.
12. Tex. Hum. Res. Code §122.003(j) (1999).
13. Tex. Hum. Res. Code §122.007(a) (1999).
14. Id.
15. Tex. Hum. Res. Code §122.007(d) (1999).
16. Tex. Hum. Res. Code §122.012 (1999).
17. Tex. Hum. Res. Code §§122.019(e)(f) (1999).
18. Source: Legislative Budget Board.
19. Interview with Lyndal R. Remmert, President, TIBH Industries, Inc. (September 26, 2000).
20. Importantly, the first legislative appropriation request cycle which GSC could have requested funding to support the Texas Council was in 1996 for FY 1998-99. Source: Legislative Budget Board.
21. Source: Legislative Budget Board.
22. Tex. Hum. Res. Code §122.019(a)(3) (1999).
23. Tex. Hum. Res. Code §122.019 (1999).
24. Tex. Hum. Res. Code §122.019(c) (1999).
25. Tex. Hum. Res. Code §122.019(d) (1999).
26. Tex. Hum. Res. Code §122.019(e) (1999).
27. Tex. Hum. Res. Code §122.002(3) (1999).
28. Tex. Hum. Res. Code §122.003(j) (1999).
29. Texas Council on Purchasing from People with Disabilities, Annual Report (1995) (compiled by TIBH).
30. Texas Council on Purchasing from People with Disabilities, Annual Report (1999) (compiled

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- by TIBH).
31. *The State Use Program: Hearing on Interim Charges before the House Committee on General Investigating and the Senate State Affairs Committee, 76th Legislature (2000)*(statement of Meg Pfluger and Bobby Templeton, members of the Texas Council on Purchasing from People with Disabilities) (March 20, 2000).
 32. Tex. Hum. Res. Code §122.019(c) (1999).
 33. *See TIBH Industries, Inc. v. Dr. Robert Swerdlow, Texas Council on Purchasing from People with Disabilities, Texas General Services Commission, and Tom Treadway, Cause No. 98-01686* (345th Judicial District Court, Travis County, Texas, filed March 11, 1998).
 34. Id.
 35. Letter from Belinda Carlton, Executive Director, Coalition of Texans with Disabilities to Pete P. Gallego, Chairman, House Committee on General Investigating (March 16, 2000).
 36. Texas Council on Purchasing from People with Disabilities: Open Meeting (statement of Dr. Robert Swerdlow, Chairman, Texas Council on Purchasing from People with Disabilities) (September 24, 1999).
 37. Texas Council on Purchasing from People with Disabilities, Annual Report (1999) (compiled by TIBH).
 38. Tex. Gov. Code §2157 (1999).
 39. Attorney General, Opinion DM-496 (1998).
 40. Letter from Carl S. Richie (representing Southeast Keller Corporation) to Carlos Martinez, House Committee on General Investigating (March 2, 2000) (on file with House Committee on General Investigating).
 41. Texas Council on Purchasing from People with Disabilities: Open Meeting (statement of Mary Williams, Southeast Keller Corporation) (March 26, 1999).
 42. Texas Council on Purchasing with Disabilities: Open Meeting (statement of Byron E. Johnson, council member, Texas Council on Purchasing with People with Disabilities) (March 26, 1999).
 43. Letter from Joe Bill Watkins, representing Pitney Bowes, to Senator William Ratliff, Chairman, Senate Finance Committee (October 18, 1999) (on file with House Committee on General Investigating).
 44. Id.
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45. Id.
 46. The Texas Council made its decision in an Open Meeting on March 24, 2000.
 47. Texas Council on Purchasing from People with Disabilities, Annual Report (1999) (compiled by TIBH).
 48. The Texas Council approved revised administrative regulations for publication in the Texas Register. Publication in the *Texas Register* is slated for October 13, 2000. After a comment period and final revisions, the Texas Council intends to adopt new rules. Indications are that administrative regulations will be formally adopted in December 2000.
 49. Interview with Lyndal R. Remmert, President, TIBH Industries, Inc. and Fred Weber, Vice President, TIBH Industries, Inc. (September 26, 2000).
 50. Council members of the Texas Council on Purchasing from People with Disabilities serve on a voluntary basis and have dedicated inordinate amounts resources to further the state's policy of providing employment opportunities to persons with disabilities. Their dedicated efforts are acknowledged here.
 51. Tex. Hum. Res. Code §122.012(a) (1999).
 52. Criticism is not levied against GSC for what it did do; instead it is criticized for what it did not do. Criticism is especially unwarranted against the dedication and efforts of Erica Goldbloom, Chester Beattie, Juliet King and other GSC staff members assigned to assist the Texas Council.
 53. Office of the State Auditor, Report No. 01-001: An Audit Report on the State Use Program (September 2000).
 54. Tex. Hum. Res. Code §122.016 (1999).
 55. Tex. Gov. Code §2110.001 requires that advisory committees be authorized by statute.

APPENDIX I

**DOCUMENT ON FILE WITH
HOUSE COMMITTEE ON GENERAL INVESTIGATING
OR CAN BE ACCESSED ON LINE AT:**

<http://www.sao.state.tx.us/Reports/report.cfm?report=2000/01-001>.
