

**SFA**

BILL ANALYSIS

Senate Fiscal Agency

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**Senate Bill 97 (Substitute S-1 as reported)****Sponsor: Senator Doug Cruce****Committee: Human Resources and Senior Citizens****Date Completed: 9-22-88****RATIONALE**

The Michigan Employment Security Act provides for the imposition of a "solvency tax" on negative balance employers (i.e., employers whose workers received more in unemployment benefits than the employers paid in unemployment taxes). Revenue from the solvency tax has been deposited in a "contingent fund" and generally used to repay Michigan's Federal unemployment insurance interest-bearing debt. Approximately \$46.4 million in solvency tax revenue, however, also was used to help fund the automation of Michigan's Unemployment Insurance System to computerize benefit payments and employer contributions. The tax revenues were tapped when it became evident that the Federal funds that were originally expected would not be available to help finance the project. According to a 1985 report by the Senate Labor Committee which investigated complaints of massive cost overruns and poor performance of the computer system, the project had been characterized by mismanagement within the Michigan Employment Security Commission (MESC) and insufficient accountability of MESC staff. Reportedly, certain expenditures allocated to the project were not in fact incurred for that purpose and many now claim that employers should be refunded at least the difference between the amount of solvency tax money originally needed for the project (\$18 million) and the amount actually spent (\$46.4 million), and that MESC should be made more directly accountable to the Legislature.

There have been some additional suggestions for amendments to the Michigan Employment Security Act to clarify responsibilities in the sale or transfer of a business, eligibility criteria for unemployment benefits, and the appropriateness of using facts and judgments determined in informal hearings between employers and employees in more formal court proceedings, and to bring Michigan into conformance with Federal law. For example, some have complained that business owners and their attorneys are failing to inform individuals purchasing the businesses that they could be subject to a contribution liability for unemployment compensation which is based on the prior employer's "performance" record on unemployment. Since the new business owners often are unaware of the liability, they not only do not have the opportunity to consider the amount of the liability when negotiating a purchase price for the business, but they also do not realize that they could be subject to fines and penalties for failure to pay the contribution liability.

Further, some argue that employers should notify employees when a plant or business has been closed for a "vacation" rather than for a work stoppage since vacation and holiday payments are considered remuneration for the purpose of determining whether an

individual is unemployed and, therefore, eligible for unemployment benefits. Apparently, there have been instances in which unemployed workers have filed for benefits and discovered that during part of the time they were laid off from work, the plant or business was closed for "vacation" (perhaps to retool machinery or make renovations to the plant), and the individual was considered technically to be on vacation and, therefore, was not eligible to receive unemployment benefits for the vacation period.

In addition, there has been some discussion as to whether findings of fact, judgments, or other decisions made in the course of an informal hearing before MESC referees or other hearing officers should be admitted as evidence in more formal court proceedings or legal actions.

Another problem for some employers has been the requirement in the Act that if an employer's negative balance equaled or exceeded \$100,000 and such amount was more than 300% of the employer's taxable payroll, the employer pay the amount of the negative balance. Although the Attorney General reportedly considers this provision to be unconstitutional and the requirement has never been enforced, accountants for the employers have had to include the negative balance due as a liability of the employer.

Finally, according to the U.S. Department of Labor, the provisions in the Act which grant the MESC discretion to transfer excess solvency tax funds to the Unemployment Compensation Fund and credit employers' accounts with the amounts transferred are inconsistent with the Federal Unemployment Tax Act.

**CONTENT**

The bill would amend the Michigan Employment Security Act to:

- Provide for the refund to employers of excess solvency taxes and interest.
- Delete language allowing solvency tax revenues to be used for the administration of the unemployment insurance automation project.
- Delete provisions under which the MESC can transfer excess funds in the Contingent Fund to the Unemployment Compensation Fund.
- Provide for legislative oversight of the Administration Fund.
- Specify that appointment of the director of the Michigan Employment Security Commission would be made by the Governor with the advice and consent of the Senate, rather than by the members of the MESC as is currently the practice.

- Require an employer selling or transferring his or her business to inform the new employer about his or her unemployment compensation contribution liability.
- Prohibit the use of findings of fact, judgments, conclusions or final orders made by a referee, reviewing court, or board of review in subsequent judicial proceedings.
- Delete language pertaining to the payment of an employer's negative balance amount under certain circumstances.
- Require employers to notify employees of the specific period to which vacation pay would be allocated and of the possibility that the allocation would render the employee ineligible for unemployment benefits during that period.

#### Automation Project Costs/Refund

Employers liable for the solvency tax for 1983, 1984, and 1985 would have to be paid \$28,400,000 on a pro rata basis from excess solvency taxes and interest on contributions, penalties, and damages collected under the Act in the contingent fund. The payment to each employer, however, would be reduced by any delinquent solvency taxes owed and by any penalties and interest on such delinquent amount. The amount of the reductions would be applied to the employer's account. The payment to each employer could not exceed the amount actually paid by the employer in 1983, 1984, and 1985. The payment would have to be made to these employers by January 1, 1989, from excess solvency taxes and interest on contributions, penalties, and damages deposited in the Contingent Fund. If payment were not made by January 1, 1989, the payment would have to be made as soon as possible after that date. If the amount available for payment were less than the amount owed, payments would have to be made continuously each year, within six months of the end of the fiscal year, until the entire amount owed had been paid. Further, until the entire amount had been paid, the Commission would not be allowed to use the Contingent Fund for any purpose other than the payment of Federal interest obligations and refunds of interest, damages, and penalties erroneously collected under the Act. The total solvency tax liability for 1983, 1984, and 1985 as reported by employers as of January 25, 1986, would provide the basis for prorating the payments.

The bill also would delete provisions that authorize the MESC to transfer any or all of the excess funds in the Contingent Fund to the Unemployment Compensation Fund, if the Commission determines that there are more funds in the Contingent Fund than needed to pay interest obligations for a reasonable future period, and that require amounts transferred to be credited to employers' experience accounts.

#### Administration Fund

The Act provides that money in the Administration fund that is received from the Federal government is to be spent solely for the purposes and in the amounts found necessary by the appropriate agency of the United States. Under the bill, expenditures from the Fund also would have to be found necessary by the Legislature. (In other words, although funds for the administration of the MESC still would come from the Federal government, they would be subject to the legislative appropriations process and could not be spent without legislative authorization.)

#### Disclosure Requirements

The bill would require an employer, no later than the time of sale or transfer of his or her business, to inform the new employer that he or she could be a successor in interest of the business and subject to contribution liability. If the

employer selling or transferring a business employed an attorney for the transaction, the attorney would have to inform the employer of these disclosure requirements. Failure of the attorney to inform the employer of the requirements would constitute the basis of an action against the attorney. A successor employer who purchased a business from an employer who failed to make the disclosures required by the bill would not be liable for the contribution liability of the prior employer. If the successor employer did not have a contribution rate established at the time of purchase of the business, he or she would be assigned a rate of 2.7% according to the Act.

#### Collateral Estoppel

The bill provides that any finding of fact or law, judgment, conclusion, or final order made by a referee, the board of review or a reviewing court would not be conclusive or binding in any separate or subsequent action or proceeding that did not involve the rights or liabilities of the parties under the Act and would not be admissible as evidence in any separate or subsequent action or proceeding between an individual and his or her current or prior employer brought before a State or Federal court, arbitrator, or judge, regardless of whether the prior action was between the same or related parties or involved the same facts. These preclusions, however, would not apply to any action or proceeding in which the Commission was an interested party or to the application of coordination of benefits with workers' disability compensation benefits.

Exhibits properly admitted into the record at a referee or board of review hearing, and the transcripts of those hearings, could be used in any separate or subsequent action or proceeding only for the purpose of impeaching a witness.

These provisions would apply to any separate or subsequent action or proceeding filed on or after the effective date of the bill.

#### Negative Balance

The bill would delete language that specifies that if an employer's negative balance equals or exceeds \$100,000 on the date the balance was calculated (June 30th of each year) and such balance is 300% or more of the employer's taxable payroll (or total payroll if the employer is a construction employer), an amount equal to the negative balance is due and payable to the MESC by the end of the calendar year in which the negative balance was calculated.

#### Payments for Vacation

The Act generally provides that payments to employees for vacations and holidays constitute remuneration for the purpose of determining whether an individual is unemployed and what unemployment benefits he or she should receive. The bill provides that notice to employees of the allocation of vacation payments would be satisfied if allocation were provided for in the collective bargaining agreement covering the individuals. If there were no designation in the agreement of a period to which vacation pay would be allocated, or for nonrepresented employees, the employer's written notice of the period to which vacation would be allocated would have to be published and conspicuously posted in the employer's establishment in easily accessible places frequented by employees, or delivered to the employee. If the individual were laid off prior to the time of designation, the posting of the employer's notice providing for allocation could not substitute for the requirement that the employer's notice for allocation be delivered to that individual by mail. The notice would have to be mailed no later than five working

days before the beginning of the period to which vacation pay was allocated. The employer's notice providing for allocation would have to indicate the specific period to which vacation pay was allocated and state that the allocation could render the employee ineligible for unemployment benefits during the designated period.

MCL 421.3 et al.

## **FISCAL IMPACT**

The bill would require the State to pay the excess solvency taxes, \$28,400,000 to private sector employers who made solvency tax payments during 1983, 1984, or 1985. These funds would no longer be available for costs related to the unemployment insurance automation project. In addition, the bill would bring the MESC further into the State budget system by providing for the annual appropriation of all funds to be spent from the Administration Fund.

## **ARGUMENTS**

### **Supporting Argument**

By providing for legislative oversight of the Administration Fund and gubernatorial appointment of the director of the Fund, the bill would make the MESC more accountable to the public and would help eliminate some of the conditions that contributed to the gross mismanagement of the unemployment insurance automation project. Further, the bill would bring a measure of equity into the system by returning to negative balance employers the amount of solvency tax revenue spent on cost overruns for the unemployment insurance automation project.

By paying a tax originally intended for a completely different purpose, negative balance employers have been unfairly burdened with financing the lion's share of a project whose costs skyrocketed dramatically over original projections and whose benefits affect all employers.

### **Supporting Argument**

The bill would bring the Act into conformance with Federal law by changing the Act's provisions concerning the use of excess solvency funds, and would delete a requirement for the payment of an employer's negative balance amount that has never been enforced and that may be unconstitutional.

### **Supporting Argument**

The bill would help protect the interests of an individual who purchases a business by requiring the employer selling the business to disclose his or her contribution liability. Such information would be most important to a buyer who wishes to negotiate a fair purchase price and avoid penalties for failing to pay a contribution liability he or she did not know about.

### **Supporting Argument**

The bill would protect the interests of both employers and employees by prohibiting the use of judgments and conclusions made in the course of informal hearings without the presence of attorneys in more formal court proceedings. Since attorneys need not be present at the informal hearings and strict legal protocol is not mandatory, conclusions reached in the hearings should not be used in subsequent legal suits. The bill would be consistent with the recent Michigan Supreme Court decision on Storey v. Meijer, Inc.

### **Supporting Argument**

Requiring the notification of vacation periods would protect employers from having to pay benefits during those periods

because employees did not know about the vacation, and would enable employees to plan for periods of time when they would be ineligible for benefits.

### **Opposing Argument**

Mandating the payment to negative balance employers of \$28,400,000 would be premature and could have serious long-range consequences for the MESC. The \$28.4 million is the difference between the \$46.4 million in solvency tax revenue spent on the automation project and the original cost estimate of \$18 million for the project. The solvency tax account, however, is currently estimated at only \$16 million. The additional \$12.4 million would have to come from the General Fund, a grant from the Federal government, or the penalty and interest fund. The possibility of obtaining a Federal grant or General Fund revenue is always tenuous.

The penalty and interest fund, on the other hand, is used to make up for Federal funding shortfalls and pay such administrative expenses as computer leasing costs and branch office rent, and to avert layoffs. Should the entire amount of this fund be paid to employers, the MESC would be left with virtually no cash flow to balance its budget. Furthermore, the penalty and interest fund is made up of payments from all employers who are delinquent, but the bill would require that it be paid only to negative balance employers.

**Response:** It would be equitable if the penalty and interest fund were paid only to negative balance employers, who have had to finance most of the costs of a project that benefits all employers.

### **Opposing Argument**

Requiring legislative approval of the expenditure of all funds, including Federal funds in the Administration Fund, may be considered by the U.S. Department of Labor to be contrary to the Federal Unemployment Tax Act (FUTA) and the Social Security Act. The Department of Labor has interpreted provisions in these Acts to mean that only the Secretary of Labor may determine how Federal funds are to be spent. A State legislative change in the distribution of expenditures of Federal funds could result in Michigan's failure to comply with FUTA and the Social Security Act. If that occurred, Michigan's employers could lose their FUTA tax credit (estimated at approximately \$1.2 billion for 1989), and the Agency could lose its Federal administrative grants (estimated at approximately \$130-135 million for FY 1989).

**Response:** Simply requiring legislative approval for the expenditure of Federal funds would not necessarily result in the State's failure to comply with Federal law. The State's continued compliance would depend entirely on how the Legislature appropriated the funds, what types of rules, restrictions or eligibility or performance criteria the appropriations were conditioned upon, if any, and whether the funding levels and conditions were inconsistent with Federal legislation.

### **Opposing Argument**

The solvency tax revenues were designed to be used to automate the unemployment insurance system, and to the extent that the project still needs to be finished, the tax revenues should continue to be used for that purpose. The most appropriate way to obtain funds to reimburse negative balance employers who have borne more than their fair share of the costs of this project is to pursue legal remedies against the consultants on the project and the company that installed the faulty system in the first place.

**Response:** Pursuing legal action against the consultants and the company could take years, and conceivably could cost more than the employers would be awarded or than

they would collect in refunds—hardly an equitable solution. Moreover, the contract for the project may not have included any performance criteria, reporting requirements, or other conditions that would enable the State or others to obtain monetary and legal remedies for cost overruns and misallocation of funds.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.