



**House
Legislative
Analysis
Section**

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UNEMPLOYMENT COMPENSATION REFORM

House Bills 4815 and 5223 as enrolled
Sponsor: Rep. Juanita Watkins

House Bill 5222 as enrolled
Sponsor: Rep. Ed Giese

House Bill 5224 as enrolled
Sponsor: Rep. Roland Niederstadt

House Bill 5226 as enrolled
Sponsor: Rep. Nick Ciaramitaro

House Bill 5227 as enrolled
Sponsor: Rep. Walter DeLange

Senate Bill 466 as enrolled
Sponsor: Sen. John D. Cherry

Senate Bill 640 as enrolled
Sponsor: Sen. Doug Carl

Senate Bill 641 as enrolled
Sponsor: Sen. Doug Cruce

Senate Bill 644 as enrolled
Sponsor: Sen. David Holmes

Senate Bill 645 as enrolled
Sponsor: Sen. Robert Geake

Senate Committee: Human Resources and Senior
Citizens
House Committee: Labor

House Bill 5229 as enrolled
Sponsor: Rep. Morris W. Hood

Senate Bill 68 as enrolled
Sponsor: Sen. Fred Dillingham

Senate Committee: Human Resources and Senior
Citizens
Second Analysis (1-2-90)

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H.B. 4815 et al (1-2-90)

THE APPARENT PROBLEM:

Although many changes have been made in the Michigan Employment Security Act in recent years, Michigan's unemployment insurance system has been plagued with new problems. In 1988, at the direction of Governor Blanchard, the directors of the Departments of Labor and Commerce conducted a study of the system at labor department round tables and commerce department public hearings throughout the state. The departments' findings and recommendations for change were summarized in "A Report to the Governor on Unemployment Insurance Administration," dated

November 10, 1988. In 1989, from July through September, an ad hoc committee, consisting of representatives from the business and labor communities, under the cosponsorship of the House Labor and the Senate Human Resources and Senior Citizens committees, and with the support of the Departments of Commerce and Labor and the Michigan Employment Security Commission (MESC), met with the legislature to reach agreement on some of the problems identified in the report. The committee, which came to be known as the Ad Hoc Group on Unemployment Insurance Administration, made the following recommendations in a report to the governor.

OVER

MESC Computer Project. According to many sources, the automation of Michigan's unemployment insurance system, which was funded in large part by a solvency tax that was imposed on negative balance employers, has been plagued by massive cost overruns and poor performance and problems some attribute to mismanagement and insufficient accountability within the MESC. A new computer system that reportedly will improve and expand the capacity of the current system is being developed, and it has been suggested that, in addition to providing financial support for the needed improvements, efforts be made to ensure that staff are adequately trained in the use of the new system and that there is sufficient oversight of this new computer project to avoid future complications.

Solvency Tax. The Michigan Employment Security Act provides for the imposition of a "solvency tax" on negative balance employers (i.e., employers whose workers receive 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 federal funds that were originally expected would not be forthcoming. According to a 1985 report by the legislature 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 by MESC staff. Reportedly, certain expenditures allocated to the project were not in fact incurred for that purpose and many now claim that employers should receive a refund.

Nonprofit Reimbursing Employers. Reimbursing employers do not pay unemployment insurance taxes, but rather are obligated to reimburse the unemployment insurance trust fund for benefits paid by the fund to their employees. Employers eligible for reimbursing status are state and local governments, school districts, and nonprofit entities. According to "A Report to the Governor on Unemployment Insurance Administration," submitted by the directors of the Departments of Labor and Commerce, November 10, 1988, there are currently 25 delinquent reimbursement collection accounts totaling \$2,664,489. Of this amount, 61 percent was owed by five nonprofit employers, four of whom are considered to be "uncollectable" since they have filed for bankruptcy as "no asset" cases. An audit of the Unemployment Insurance Trust Fund revealed a "continuing problem with reimbursing nonprofit employers who fail to reimburse the fund for benefits paid to their former employees." The situation is compounded by the fact that the nonprofit employers are not required to file any security to become reimbursing employers. Some have recommended that, to avoid a future monetary drain on the trust fund, all nonprofit employers who elect to be reimbursing employers should post a surety bond or other type of security. On the other hand, some also have suggested that the MESC be given greater flexibility in working with current delinquent employers to help them pay off their obligation to the fund. Currently, the MESC has only two choices for handling delinquent nonprofit reimbursing employers: require them to file a surety bond to secure their obligation, or terminate their status as reimbursing employers. Some maintain that these methods of handling delinquencies do not necessarily guarantee

that the employers' obligations to the fund will be met. In some cases, they say, a surety bond can cost the employer almost as much as the employer's obligations to the fund, and revoking an employer's reimbursing status will not necessarily enable the employer to meet his or her obligations any sooner or with any less difficulty. It has been suggested, therefore, that the MESC be given the third option of requiring delinquent employers to file irrevocable letters of credit or other security to protect the interests of the fund.

Negative Balance Employers. The Michigan Employment Security Act provides that, if an employer's negative balance equals or exceeds \$100,000 and that balance equals or exceeds 300 percent of the employer's taxable payroll (or total payroll if the employer is a construction employer), the employer is required to pay an amount equal to the negative balance by the end of the calendar year. When this provision was enacted in December 1982, some apparently believed it was the intent of the legislature that the provision be used by the MESC to make employers who leave the state accountable for any large negative balances in their unemployment compensation experience accounts. The commission proposed an administrative rule in 1983 to implement the provision according to the assumed intent and submitted the rule to the attorney general for approval. The attorney general denied approval, citing questions of legality. The MESC, therefore, annually has waived the requirement that employers pay off any large negative balances — an option that the MESC is allowed to exercise under the act. Some believe that it is doubtful that any MESC rule to implement what is purported to be the intent of the legislature would receive approval from the attorney general, and recommend that the negative balance payoff requirement be repealed.

Adjudication Review. The MESC adjudication process handles disputes about the eligibility of an individual to receive benefits, which are then charged to the employer's account and reflected in that employer's tax rate for the next five years. According to the review conducted by the Departments of Labor and Commerce, this adjudication process is a major source of complaints about the unemployment compensation system: both claimants and employers allege that the other side is favored. Currently, MESC employs the following procedure:

- A worker files a claim for unemployment insurance benefits at a local MESC office. A claims examiner issues a determination stating whether the worker is eligible for benefits. A determination may be a "monetary determination," which establishes benefit levels, or a "non-monetary determination," which establishes eligibility. If both worker and employer are satisfied with the determination, the process ends here.
- If either party disagrees with the determination, a redetermination may be requested. This is the first step appeal, and also occurs at the branch office level, by a claims examiner.
- Should either party disagree with the redetermination, the next step is a referee hearing, followed by appeal to the Board of Review and, ultimately, the courts, beginning at the circuit court level.

One major problem, uncovered by the report, is a widespread lack of knowledge about the process of a referee hearing.

Customer Service. The most consistent finding from the 1988 review conducted by the Departments of Labor and

Commerce, and from subsequent meetings with legislators and representatives of the business and labor communities, was frustration at being unable to obtain answers from MESC regarding tax and benefit matters. There were complaints of rudeness, poor response time, inability to discover the appropriate person to begin an inquiry, multiple contacts that were not recorded, and failure by MESC to correct administrative errors. Although the act contains a provision for providing assistance to employers in interpreting the provisions of the act and representing claimants at hearings, the provision expired on April 1, 1986, without ever having been implemented.

Fraud Control According to the above report submitted to Governor Blanchard by the directors of the Departments of Labor and Commerce, fraud in the unemployment insurance program can occur in both the collection of taxes and the payment of benefits. Employers may seek to avoid paying unemployment taxes or to reduce the amount they pay by agreeing to lay off workers, who then draw benefits while continuing to work without wages, by under-reporting wages, or through neglecting to inform a buyer of the business' outstanding unemployment tax liabilities. Claimants may seek to establish or continue claims for which they are not eligible, or they may attempt to increase the amount of benefits they receive by failing to report earnings they receive while collecting benefits, by falsifying reports of efforts to find work, by not reporting refusal of work, or by reporting nonexistent dependents. During a fraud detection process initiated October 1, 1988, the Departments of Labor and Commerce investigated claimant fraud. MESC instituted a cross match of wage record information collected for the Income Eligibility and Verification System (IEVS) with claimant records. The program matched the unemployment insurance claimant file against employer reported wage records and permitted MESC to identify potential fraud involving claimants' non-reporting or under-reporting of earnings while collecting benefits. The period chosen for the cross match was the quarter ending June 30, 1988. Requests were sent to employers for wage verification of 21,000 claims filed in that period, and from 16,000 responses received, MESC branch offices reviewed 2,000 cases that showed potential for overpayment. Nine hundred cases of overpayment — or less than one-half of one percent of the total claims — were found; of these, 600 were found to be unintentional and the remainder intentional. Restitution was sought for the \$767,000 paid out in overpayments. Although the MESC reportedly devotes substantial resources to fraud detection programs, some feel that these programs would be more effective if they were consolidated into a new fraud control program (instead of their current housing in three different bureaus in the Department of Labor) and if improvements were made to the data processing system to support the new program.

MESC Detroit Offices Apparently, in the course of inspecting various office sites to determine where to house the MESC computer system, inspectors from the Bureau of Construction Codes discovered that the 70-year-old building in Detroit, in which MESC headquarters are located, is in need of structural improvements to bring it into compliance with building codes. The building's elevator, for example, apparently must be modernized, provisions must be made for fire suppression and alarm systems, and various structural and weatherizing improvements, including caulking windows and patching the building facade, must be made before the building can be considered adequate to house the new computer system.

As a result of the Ad Hoc Committee's discussions, the coalition proposed a package of legislation that would, with one exception, be funded completely from the MESC Penalty and Interest Account (this account is accrued from payments from employers who are delinquent in meeting their unemployment insurance obligations).

THE CONTENT OF THE BILLS:

The bills would amend the Michigan Employment Security Act to establish that an employer who conspired to defraud the unemployment insurance system would be guilty of a felony, and to require that MESC develop an emergency backup plan for its computer system, establish a claimant and employer advocacy program, provide waivers for laid-off workers, and operate an employee training program. The bills would also require the disclosure of potential unemployment tax liabilities by the seller of a business, create a Stabilization Fund, provide pro rata refunds to employers who paid solvency taxes during 1983-85, require that nonprofit reimbursing employers file a surety bond, letter of credit, or other security with the MESC, delete requirements that certain negative balance employers pay their negative balance by the end of a calendar year, and appropriate money for computer system improvement and expansion project and staff training, for improvements to the MESC Detroit offices, and for fraud control systems.

House Bill 4815 Under the act, it is a misdemeanor for an employer to make a false statement or misrepresent facts for the purpose of obtaining or increasing a benefit, or avoiding making payments required under the act. Under the bill, it would be a felony for an employer to require a person, as a condition of employment, to make a false statement or misrepresent facts in order to obtain or increase a benefit or to avoid or reduce a contribution or other payment required under the act. The felony would be punishable by imprisonment for ten years, a fine of not more than \$5,000, or both.

MCL 421.54

House Bill 5222 The bill would require that MESC finalize an emergency backup plan for its current computer system within six months of the effective date of the bill. The plan, funded in the amount of \$1.5 million from the penalty and interest account in the contingent fund, would be placed in a reserve. The appropriation would be considered a work project and would not lapse at the end of the fiscal year, but would continue to be available for expenditure.

Under the bill, an emergency would exist when the commission determined by majority vote that, due to computer problems, it would be unable to service claimants or employers on a statewide, regional, or local basis over a prolonged period of time. The emergency plan would be not required after the commission determined that the computer system improvement and capacity expansion project was fully operational, or 36 months after the effective date of the bill, whichever occurred first. Unexpended funds remaining in the reserve account would then revert to the penalty and interest account.

MCL 421.6c

House Bill 5223 Within six months after the effective date of the bill, MESC would be required to establish a claimant and employer advocacy program to provide information, consultation, and representation services relating to the referee or board of review appeal levels, or both. The program would be funded from the penalty and interest account in the contingent fund. The appropriation would

be considered a work project and would not lapse at the end of the fiscal year, but would continue to be available for expenditure until three years after the services began, when the commission would be required to vote on whether to continue the program or not. For fiscal year 1989-90, \$5 million would be appropriated, of which not more than \$500,000 could be expended, and the maximum amount of expenditure for each of the subsequent three fiscal years could not exceed \$1.5 million per year. Up to 60 percent of the maximum expenditure each year would be used for claimant related costs, and up to 40 percent would be used for employer related costs. The commission would be required to develop standards for individuals providing advocacy assistance services (under the bill, these services could be supervised by but not be provided by MESC or state employees), and to make an annual report to the legislature on the program's operation within 60 days after the program's first anniversary date.

Note Under the bill, the advocacy assistance program could not commence until \$21 million in excess solvency taxes for 1983, 1984, and 1985 is refunded to employers, as proposed in Senate Bill 68. Similarly, the payments required under Senate Bill 68 could not be made until the advocacy assistance program had been approved by the commission.

MCL 421 5a

House Bill 5224 Currently, under the act, an unemployed individual is eligible to receive benefits only if he or she registers at an employment office that he or she is seeking and is available to perform suitable full-time work. These requirements may be waived by MESC if the individual is laid off and the employer notifies the commission in writing that the layoff is temporary. Under the bill, the employer could also notify the commission by computerized data exchange.

MCL 421 28

House Bill 5226 The bill would amend the act to require MESC to operate an employee training program to provide more effective service to claimants and employers. The program would be funded by an annual appropriation of \$1 million from the penalty and interest account in the contingent fund.

MCL 421 6e

House Bill 5227 The bill would require the seller of a business, or the seller's real estate broker or other agent, to provide the buyer with an account of the business' outstanding unemployment tax liability, unreported unemployment tax liability, and the tax payments, tax rates, and cumulative benefit charges for the most recent five years, together with a listing of all individuals currently employed and all employees separated from employment in the past twelve months. Under the bill, the form provided to the buyer would also specify such other information, as determined by MESC, as would permit the buyer to estimate future unemployment compensation costs. Under the bill, failure to provide accurate information would be a misdemeanor punishable by imprisonment for not more than 90 days, a fine of not more than \$2,500, or both. The seller, or the seller's agent, would also be liable for any consequential damages resulting from failure to comply, although the agent would not be liable if he or she exercised good faith in complying with the disclosure of information. This remedy would not be exclusive and nothing in the bill could be construed to decrease the

liability of the buyer as a successor in interest or to prevent the transfer of a rating account balance.

MCL 421 15

House Bill 5229 Under the bill, a reserve would be established in MESC's Penalty and Interest Account to create Stabilization Fund. The bill would appropriate \$3.5 million for the fiscal year ending September 30, 1990. The fund would offset the effects on state budgeted staffing levels of unanticipated cuts in federal administrative funds, and could be drawn upon when authorized by a majority vote of the commission. Expenditures from the fund would be authorized by MESC by an affirmative majority vote. The appropriation would be considered a work project and would not lapse at the end of the fiscal year, but would continue to be available for expenditure.

MCL 421 6d

Senate Bill 68 The bill would amend the Michigan Employment Security Act to provide for a pro rata repayment to employers of \$21 million from the solvency tax account and the penalty and interest account in the contingent fund. MESC would be required to make a good faith effort to locate each employer eligible for receipt of a payment. Payment would be made within six months after the effective date of the bill, and funds that were not needed to make the required payments would be returned from the solvency tax account to the penalty and interest account. The bill would also require legislative approval of deposits and expenditures from the administrative fund and would delete language that permits solvency tax revenues to be used for the unemployment insurance automation project.

MCL 421 10

Senate Bill 466 Currently under the act, the MESC may require a nonprofit reimbursing organization that has become delinquent to file and execute a surety bond to secure its obligations, or may terminate the organization as a reimbursing employer. Under the bill, the MESC could require delinquent nonprofit reimbursing organizations to file an irrevocable letter of credit or other security that the MESC had approved. A nonprofit organization that elected to become a reimbursing employer on or after the effective date of the bill would also be required to file and execute a surety bond or an irrevocable letter of credit or other security that the MESC had approved. The requirements would not apply to any nonprofit reimbursing employer who paid \$100,000 or less remuneration per year for employment.

MCL 421 13a et al

Senate Bill 640 Currently, an employer whose negative balance equals or exceeds \$100,000, and if the balance equals or exceeds 300 percent of the employer's taxable payroll (or total payroll, in the case of a construction employer), the employer is required to pay the MESC an amount equal to the negative balance by the end of the calendar year. The negative balance due is subject to interest, penalty, assessment and collection requirements, and the MESC is granted the discretion of determining the manner of the payment and of cancelling any part of the negative balance due. Negative balance amounts paid to the MESC are paid into the unemployment compensation fund and credited to the employer's experience account, and the amount of a negative balance that is cancelled is restored to the employer's experience account. Senate Bill 640 would delete these provisions.

Senate Bill 641 Under the bill, the \$19 45 million that, under Senate Bill 646, would be appropriated from the penalty and interest account in the contingent fund for the fiscal year ending September 30, 1990, would be expended for continuing work on the MESC computer system improvement and capacity expansion project. The bill would require that \$1 million of this amount be used for training staff in use of the improved computer system. In addition, the MESC would be required to appoint a computer project oversight committee of up to 15 members which would be composed of computer system specialists from the private sector and MESC employees involved in the project. The committee would be required to review MESC staff reports on the status of the project on a quarterly basis, and to provide a short written summary report on the review, including its comments, to the MESC, the Department of Management and Budget, and the Senate and House Labor and Appropriations subcommittees on Regulatory Affairs. The committee, upon request, would also be required to serve in an advisory capacity to the commission. The appropriation provided for in the bill would be considered a work project and would not lapse at the end of the fiscal year but would continue to be available for expenditure. Unexpended funds remaining at the end of three years after the effective date of the bill would revert to the MESC Penalty and Interest Account in its contingent fund. (Note: The bill specifies that the appropriation be considered a work project which would not lapse at the end of the fiscal year, but which would continue until the project is completed. The bill also specifies that after three years any funds from the appropriation that are not expended will revert to the penalty and interest account. The language apparently does not address the conflict that could occur if the project was not completed in the three-year period.)

MCL 421 6b

Senate Bill 644 The bill would appropriate \$2 7 million from the penalty and interest account in the contingent fund for the fiscal year ending September 30, 1990, to fund improvements in the MESC Detroit offices. With the approval of the MESC \$950,000 would be spent for elevator modernization, \$1 2 million for fire suppression and alarm systems, and \$550 000 for exterior and other repairs. The appropriation would be considered a work project and would not lapse at the end of the current fiscal year but would continue to be available for expenditure until the project was completed.

MCL 421 6f

Senate Bill 645 The bill would appropriate \$425,000 from the penalty and interest account in the contingent fund for the fiscal year ending September 30, 1990, to be used by the MESC to secure automated systems for the fraud control and collections division. The bill would also require that the MESC operate an increased fraud control and investigation program that would be funded in the amount of \$1 million annually from the penalty and interest account. The \$425 000 appropriation would be considered a work project and would not lapse at the end of the fiscal year but would continue to be available for expenditure until the project was completed.

MCL 421 6g

Senate Bill 646 would make a supplemental appropriation for the MESC for fiscal year 1989-90.

FISCAL IMPLICATIONS:

According to Michigan Employment Security Commission and Department of Labor estimates, all costs incurred by the bills would come from the MESC Penalty and Interest Account (an account that collects fees from employers who do not pay unemployment insurance bills on time, or who violate some other regulation) in its contingent fund. The bills would have no effect on general funds. The Penalty and Interest Account balance was reported at \$30 7 million as of October 1, 1989, and it is estimated that about \$6 5 million will be received by the account each year.

The following outlines the cost of each bill in the package.

Note: Senate Bill 646 would provide for a separate fiscal year 1989-90 supplemental appropriation of \$57 575 million from the MESC Penalty and Interest Account in its contingent fund, \$55 575 million of the appropriation would implement the above package of bills, and \$2 million would be placed in reserve in the solvency tax account.

ARGUMENTS:**For:**

The bills would permit work to start on a new MESC computer system. A 1986 independent audit requested by Governor Blanchard noted that MESC has been beset with many problems — many of them not of its own making, nor within its power to correct. MESC's computer system went on line in stages in 1984 and 1985. It was supposed to improve unemployment fund collections from employers, reduce long lines at the 53 local MESC offices by speeding benefit payments, and keep better records. Instead, state officials say the computer frequently breaks down and delays payment of unemployment claims, bugs in the computer have also resulted in overcharges of millions of dollars in taxes to businesses. Thousands of automobile workers, laid off during the industry's annual "model changeover" period, have waited for unemployment checks for an average of five weeks for each of the last three years. The new computer — which would use about \$50 million in software saved from the old system — would be much faster, and could handle four times as many claims as the botched system.

For:

By providing for legislative oversight of the Administration Fund, the bills would make MESC more accountable to the public and would help eliminate conditions that contributed to the mismanagement of the unemployment insurance automation project. Requiring legislative approval of expenditures from the Administration Fund also would be consistent with Executive Order 1986-87, which transferred budgeting, accounting, and other MESC management functions to the Department of Labor, and would be consistent with legislative control over other departmental appropriations. The bills would also bring a measure of equity into the unemployment insurance taxation 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 designed 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.

For:

The bills would require MESC to operate an employee training program to provide more effective service to claimants and employers. Since, according to the conclusion reached by the Departments of Labor and Commerce in their 1988 study, dissatisfaction with the quality of service received from MESC was the universally most consistent complaint received, and more complaints are lodged against MESC than any other agency or department of government in Michigan, an employee training program would meet a very real need in that system. The above study resulted in videos being made available in public libraries and MESC branch offices to educate both business and labor on the referee hearing process; in combination with the proposed claimant and advocacy program, and the promise that the new computer system will handle four times as many claims as the current system, the bills should pave the way to improve MESC's negative image.

For:

The bills 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 wished to negotiate a fair purchase price and avoid penalties for failing to pay a contribution liability he or she did not know about.

For:

Senate Bill 466 would require future nonprofit organizations who elect to become reimbursing employers to demonstrate their financial responsibility by filing a surety bond or other type of security, and should protect the unemployment insurance trust fund from further depletion by delinquent reimbursing employers.

Against:

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 project's consultants, who pushed the cost of the computer up by collecting \$29.9 million for its services, 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 or cost-effective solution.

Against:

To ensure proper oversight of the new MESC computer system, the oversight committee should be selected by the legislature, not the MESC.