

Proposed Study Outline for HJR 35: A Study of Public Employee Bonuses

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INTRODUCTION

The genesis of HJR 35 can probably be traced back to an early January 2009 news article¹ (January 10, 2009, by Charles S. Johnson) divulging nearly \$58,000 in bonuses that the former Secretary of State had committed paying to nine of his former employees.² The bonuses were reported shortly after headline stories the preceding month about bonuses that had been or were to be paid to various corporate officers and employees who were then or had previously been employed by Federal National Mortgage Association (a.k.a. FNMA and Fannie May), Federal Home Loan Mortgage Corporation (a.k.a. FHLMC and Freddie Mac), Bank of America, Merrill Lynch, Citigroup, Lehman Brothers, AIG Insurance, and other companies that were either in bankruptcy proceedings or receiving federal funds under the Troubled Assets Relief Program (TARP) or similar programs.

Shortly after Johnson's article appeared in Montana newspapers, bill draft requests 2100, 2211, and 2271 were submitted by Representatives Bergren, Warburton, and Hunter, respectively. Within a couple of weeks, all three drafts were prepared, introduced, and assigned to the House State Administration Committee. Each of the bills -- HB 358 (Bergren), HB 576 (Warburton), and HB 594 (Hunter) -- was heard by the Committee during mid-February. The three bills each addressed the issue of bonus pay in a slightly different manner from the others. In short:

- SB 358 would have prohibited a statewide elected official to pay the official's [exempt] personal staff any type of bonus, termination pay, performance pay, or other special compensation between the date of the general election

¹ "Secretary of state: Brad Johnson bonuses put on hold", by Charles S. Johnson, Jan. 10, 2009, in *The Missoulian*.

² Secretary of State Brad Johnson had lost his reelection bid in November 2008 and the nine employees were all "exempt", personal staff who served at the pleasure of the Secretary of State.

immediately preceding the expiration of the official's term and the date that the official's term expires.

- HB 576 would have prohibited the governor, the lieutenant governor, the attorney general, the secretary of state, the state auditor, or the superintendent of public instruction from paying to an employee in an "exempt position" a bonus, a monetary payment, or a salary increase, other than a statutorily prescribed increase during the fiscal year in which the state officer is seeking reelection or election to another state office.
- HB 594 would have prohibited a state officer or state employee, including those employees otherwise exempted under section 2-18-103, MCA, from receiving a bonus or any type of monetary payment, other than normal salary or wages, in excess of \$1,000 during a fiscal year.

After considerable discussion among the Committee's members, all three bills were tabled. As an alternative approach to addressing the matter, the Committee commissioned LC 2325, which became HJR 35.

BACKGROUND

Perhaps as a result of the three bills being tabled, HJR 35 was designed in the House State Administration Committee through a series of lively discussions relatively late in the 61st Legislative Session.³ The upshot of these conversations in March 2009 reflects different perceptions among Committee members of the problems or issues to be resolved.

For some individual or groups of members, the problem to be addressed or question to be asked might be characterized as follows:

- What state-agency policies and practices exist regarding bonuses?
- What differences, if any, in policies and practices are there within and among state agencies? What differences, if any, are there in bonus policies and practices for classified and nonclassified employees? These questions imply

³ See Minutes of the House State Administration Committee on March 4, 5, 6, et al., 2009. The draft was eventually approved for introduction on March 31, formally introduced on April 1, heard in and passed by the House State Administration Committee on April 2, and passed the House on April 8. In the Senate, the bill was heard on April 15, passed the Committee (State Administration) on April 16, and the full Senate on April 20.

doubts about the administration of bonuses, both internally and externally.

- How was the money appropriated for merit pay in HB 13 (2007) paid out. For some of these members, the matter is limited to a fact-finding mission, simply, "How was the money used". For others, the matter requires an analysis of the facts found, i.e., were bonuses paid according to established procedures and guidelines?
- Is "bonus pay" considered to be an effective and necessary component of compensation? Why are bonuses paid to classified as well as nonclassified (exempt) employees?
- In the context of bonuses, how are they paid and how should they be paid? Are bonuses paid according to well-defined and clear statewide and agency-specific standards and guidelines? If not, then on what bases are they paid?

LEGAL REQUIREMENTS AND PROHIBITIONS

The principal statutory provisions regarding compensation "bonuses" for state employees are contained in Title 2, chapter 18, part 3, MCA, which is the MCA "part" that generally addresses "State Employee Classification, Compensation, and Benefits". Section 2-18-301, MCA, outlines the legislative policy regarding state employee pay.

2-18-301. Purpose and intent of part -- rules. (1) The purpose of this part is to provide the market-based compensation necessary to attract and retain competent and qualified employees in order to perform the services that the state is required to provide to its citizens.

(2) It is the intent of the legislature that compensation plans for state employees, excluding those employees excepted under 2-18-103 or 2-18-104, be based on an analysis of the labor market as provided by the department in a biennial salary survey. The salary survey must be submitted to the office of budget and program planning as a part of the information required by 17-7-111.

(3) Except as provided in 2-18-110, pay adjustments provided for in 2-18-303 supersede any other plan or systems established through collective bargaining after the adjournment of the legislature.

(4) Pay provided for in 2-18-303 may not be increased through collective bargaining after adjournment of the legislature.

(5) Total funds required to implement the pay increases provided for in 2-18-303 for any employee group or bargaining unit may not be increased through collective bargaining over the amount appropriated by the legislature.

(6) The department shall administer the pay program established by the legislature on the basis of merit, internal equity, and competitiveness to external labor markets when fiscally able.

(7) The broadband pay plan must consist of nine pay bands. Each pay band must contain a salary range with a minimum salary and a maximum salary. The department shall adopt an entry salary, market salary, and maximum salary for each occupation within each pay band. These salary ranges are also known as occupational pay ranges.

(8) Based on the biennial salary survey, the department shall:

- (a) identify current market rates for all occupations;
- (b) establish pay band levels; and
- (c) set occupational pay ranges for all occupations.

(9) The department may promulgate rules not inconsistent with the provisions of this part, collective bargaining statutes, or negotiated contracts to carry out the purposes of this part.

(10) Nothing in this part prohibits the board of regents from engaging in negotiations with the collective bargaining units representing the classified staff of the university system. (Emphasis added.)

Section 2-18-303, MCA, outlines procedures for administering the broadband pay plan. The section does not provide a detailed map for plan administration or a recipe of required ingredients or measures on which judgment about need, appropriateness, effectiveness, etc., might be made. In relevant part, section 2-18-303, MCA, states:

2-18-303. Procedures for administering broadband pay plan. (1)...

(2) (a) Effective October 1, 2007, and October 1, 2008, the appropriation that represents 6/10 of 1% of the salary for each full-time equivalent position must be allocated to each agency to distribute to its employees for reasons including but not limited to market progression, job performance, or employee competencies.

(b) To the extent that this distribution applies to employees within a collective

bargaining unit, the distribution is a negotiable subject under Title 39, chapter 31. The amount of money allocated to agencies and available to distribute to members of each bargaining unit must be determined by multiplying the salaries of the total number of full-time equivalents in the bargaining unit by 6/10 of 1%.

(c) The allocation described in subsection (2)(b) may not be distributed to members of a collective bargaining unit until the employer's collective bargaining representative receives written notice that the employee's collective bargaining unit has ratified a pay addendum to the collective bargaining agreement specifying the distribution.

(3) An employee's base salary may be no less than the pay band entry salary for the employee's assigned occupation.

(4) (a) (i) A member of a bargaining unit may not receive the pay increase provided for in subsection (1)(b) until the employer's collective bargaining representative receives written notice that the employee's collective bargaining unit has ratified a collective bargaining agreement.

(ii) If ratification of a collective bargaining agreement, as required by subsection (4)(a)(i), is not completed by the date on which a legislatively authorized pay increase is implemented, members of the bargaining unit must continue to receive the compensation that they were receiving until an agreement is ratified.

(b) Methods of administration consistent with the purpose of this part and necessary to properly implement the pay adjustments provided for in this section may be provided for in collective bargaining agreements.

(5) The current wage or salary of an employee may not be reduced by the implementation of the broadband pay plan.

(6) (Emphasis added.)

The option of "bonuses" as a component of pay administration can easily be inferred from the statutory language in 2-18-301(6) and 2-18-303(2)(a). In the first instance, the Department of Administration is required to administer the pay program on the basis of "merit, internal equity, and competitiveness to external labor markets". In the second case, appropriated funds in excess of statutory increases in base pay (in FY 2008 and 2009) were left to managers to determine on the bases of "reasons including but not limited to market progression, job performance, or employee competencies".

The two code sections recognize "merit", "job performance", and "external labor markets" as reasons for pay increases and neither code section prohibits the recognition in the form of a "bonus".

What the law does preclude is the golden parachute-type of bonus paid to an employee who is walking out the state-employment door. Curiously, the prohibition is codified in part 3 of Title 18, chapter 2, i.e., "Leave Time", at section 2-18-631(2), MCA. In relevant part, the language reads as follows:

2-18-621. Unlawful termination -- unlawful payments. (1)

(2) (a) An employee who terminates employment is entitled to receive only:

(i) payments for accumulated wages, vacation leave as provided in 2-18-617, sick leave as provided in 2-18-618, and compensatory time earned as provided in the rules or policies of the employer; and

(ii) if the termination is the result of a reduction in force, severance pay and a retraining allowance as provided for in 2-18-622.

(b) An employee who terminates employment may not receive severance pay, a bonus, or any other type of monetary payment not described in subsection (2)(a)(i) or (2)(a)(ii).

(3) Subsection (2) does not apply to:

(a) retirement benefits;

(b) a payment, settlement, award, or judgment that involves a potential or actual cause of action, legal dispute, claim, grievance, contested case, or lawsuit;

or

(c) any other payment authorized by law. (Emphasis added.)

STUDY ISSUES

The reasons for and concerns underlying HJR 35, as contained in the "whereas" clauses, include:

- controversy over bonuses promised by an outgoing statewide elected official to exempt, personal staff resulted in proposed statutory restrictions on bonuses for certain types of employees and at certain times;
- the proposed statutory restrictions were aimed at different issues related to bonus payments, implying a lack of agreement on the problem to be resolved

through legislation;

- insufficient information and the House State Administration Committee members' inability to agree on the best way to resolve the perceived problems;
- the desire for a thorough examination of pay policies and practices concerning bonuses paid to state employees;
- the perceived need for a systematic approach to restricting bonus compensation through legislation.

Revisiting the discussions of the bonus pay issue among the House State Administration Committee's members indicates some confusion about state pay policies and practices in general. Various Committee members voiced concerns and misconceptions about the broadband pay plan in general, as well as distinctions between pay bands and occupational pay ranges and differences among performance-based pay, merit pay, competency-based pay, incentive pay, and statutory pay (increases), and about distinguishing the application of same between classified versus nonclassified (exempt) employees. There was also confusion about the authority of the Department of Administration versus individual agencies in establishing and administering pay policies. Finally, there was clearly a desire among Committee members that the study examine "bonus pay" as broadly as possible, including agencies funded with general fund appropriations, agencies funded with nongeneral fund appropriations, and agencies funded with combinations of general and nongeneral fund appropriations.

DIRECTION FROM THE LEGISLATURE

General directions to the Committee for conducting the study are contained in the "resolved" clauses of HJR 35. Those directions:

- review each state agency's policies and practices on providing bonuses and compare and contrast how bonuses are paid to classified versus nonclassified employees within and among the agencies;
- examine how money appropriated for the 2008-2009 biennium under section 2-18-303(2), MCA, was used. This was the 6/10 of 1% of payroll to be used for market progression, job performance, or employee competencies, etc.
- examine bonuses paid since July 1, 2007, and determine if they were paid according to established guidelines and procedures;

- determine whether bonuses are considered an effective or necessary pay administration tool;
- identify and analyze issues and options related to how bonuses are or should be paid; and
- develop findings and conclusions and offer recommendations, including any necessary implementing legislation, on how best to meet various policy goals.

Although the resolution states that the study should be conducted within the context of various policy goals, it appears that it is the actual payment of bonuses that is to be assessed within the policy goals mentioned. Those policy goals are:

- transparency to avoid possible impropriety or the appearance of impropriety;
- accountability and oversight to ensure established procedures are followed and that there is ongoing monitoring and periodic review of policies and practices;
- equity within and among agencies to ensure that there is a sound rationale for flexible policies, variable practices, and exceptions; and
- definition and clarity in statewide as well as agency standards and guidelines governing how and why bonuses are to be given to employees in classified as well as nonclassified positions.

STUDY DESIGN

The HJR 35 study can be approached in four phases that are, simultaneously, distinct and overlapping. As envisioned, the four study phases will follow the underpinnings of the resolution itself:

- Phase I Build a foundation of facts and evidence regarding public employee compensation defined, described, or recognized as bonus pay, performance-based pay, merit pay, competency-based pay, incentive pay, statutory pay (increases), and the like.
- Phase II Identify and analyze specific factors perceived by the Committee to be relevant to further discussion of state employee compensation referred to as bonus pay, performance-based pay, merit pay, competency-based pay, incentive pay, statutory pay (increases), and the like.
- Phase III Develop, through Committee discussion and action, findings and conclusions about the policy principles upon which Montana's public

policies and practices should be centered as those policies and practices address employee compensation generally referred to as bonus pay, performance-based pay, merit pay, competency-based pay, incentive pay, statutory pay (increases), and the like. Included in this phase should be Committee findings and conclusions regarding the potential fiscal and administrative implications of those policy principles.

Phase IV Identify, through Committee discussion and action, legislative options for addressing the fiscal, administrative, and ethical soundness of any "bonus-type" of compensation for Montana state employees.

Phase I: Building a foundation

Compiling facts and evidence about bonus-type compensation paid or payable to Montana state employees will be ongoing throughout the study, but will largely be "front loaded". Within the context of the remainder of this proposed study plan, the terms "bonuses" and "bonus-type" compensation include performance-based pay, merit pay, competency-based pay, and incentive pay. The term does not include statutory pay increases akin to cost of living adjustment. This phase of the proposed study design includes the following elements:

- A recent history of bonus-type pay to public employees of Montana state government. The history will be limited to fiscal years 2008 and 2009 because data for those years should be available. Staff will provide an overview of statutory requirements, restrictions, authority, etc. The implications of relevant, Montana-specific case law, if any, will also be examined and interpreted.
- A summary of the rationale for the current bonus pay-related statutes and the administrative rules, policies, and practices adopted or used to implement the statutes.
- The experience and concerns of stakeholders in state employee compensation, i.e., representatives or groups potentially affected by the nature, scope, structure, and application of bonus-type pay, plus other groups considered by the Committee or staff to be directly impacted by potential changes to existing public employee compensation requirements and limitations.

Phase II: Narrowing the focus

The HJR 35 study request is focused on bonus pay for state employees: how it is

authorized, when, where, and how it used, and whether the legislature should establish additional or revise existing policies or guidelines. The proposed study plan provides an opportunity for the Committee to more clearly identify its own priorities within the guidelines provided in HJR 35. Periodically, the Committee may wish to refine, clarify, or reestablish the its priorities. Additionally, the Committee members will have ongoing opportunities to articulate their individual concerns, questions, and hypotheses. This phase of the study will include:

- an issues and options decision tool, prepared by staff, that the Committee can use to clarify priorities and narrow the focus of the study. The objective of this exercise is to establish in relatively clear terms categories of or specific questions about state employee bonus pay, including: statutory limitations; administrative rule requirements; agency practices; comparability between classified and nonclassified employees; the need for and advisability of bonus-type pay; perceptions about propriety and ethics in compensation actions; and overall goals and objectives of the Committee regarding the desired outcome of and outputs from the study.
- compiling or analyzing additional information, including information identified as necessary or useful to the Committee's future discussions or goals. The information may be provided by the "stakeholders" or the Committee's staff, or it may involve provoking more dynamic interaction between the Committee and others, such as a panel of experts or through topic-specific seminars conducted by topic/subject experts.

Phase III: Scrutinizing alternatives

The questions and concerns identified, refined, and prioritized by the Committee in Phase II will provide the basis for continuing research and analysis. Subsequently, the accumulation of information and understanding by the Committee members will promote the development of findings from which the Committee can draw conclusions. This phase of the study will include:

- fleshing out bonus pay-type options identified by the Committee as being worthy of further examination, possibly including fiscal analysis;
- compiling, analyzing, and reporting information directly related to the policy options identified by the Committee. This information may be available from current resources or it may have to be developed by staff, stakeholders,

- Committee members, or others;
- establishing formal findings by examining and discussing the information. (Staff can develop decision tools to assist in this exercise.)
 - drawing conclusions from the findings adopted previously to help form the basis for recommendations, including proposed legislation, that may be developed in Phase IV.

Phase IV: Legislative options and Committee recommendations

The findings and conclusions developed in Phase III may lead the Committee to develop options for legislative consideration, including draft legislation. In fact, that is the guidance provided in HJR 35. The options should be carefully crafted to address the legislatively controllable factors and inputs relevant to public employee compensation, including bonus pay.

For example, the Committee could propose that the 62nd Legislature adopt legislation to require, restrict, or initially authorize action by the Department of Administration, department directors, or state human resource professionals or to expand the statutory authority or duties already provided to or required of state agencies, human resource professionals, and individual supervisors.

If the Committee determines that no action should be taken at this time, it should consider: 1) making a clear statement to that effect; and, 2) supporting the statement with findings and conclusions developed as a result of the study.

PROPOSED COMMITTEE MEETING SCHEDULE AND WORK PLAN

HJR 35 requires the study to be completed prior to September 15, 2010. Unrecognized in the resolution, however, are the other duties and responsibilities assigned to the Committee by statute, the study required in House Bill 659, or any issues determined to be priorities by Committee members.

In broad terms, the Committee's budget will allow for about seven meetings (maybe eight) but fewer if the meetings are 2-day ventures. A good portion of the Committee's first meeting (June 26, 2009) will have been devoted to organizational matters, including introductions to and overviews provided by the respective staffs of the agencies for which the SAVA has monitoring responsibilities. Depending on the nature and scope of issues other than HB 659 and HJR 35 that the Committee may

address, the Committee should anticipate devoting perhaps one-half of each of the first few meetings to the HJR 35 study.

The proposed meeting dates for the Committee to engage in HJR 35-related activities are:

- Friday, June 26, 2009 (study plan review only)
- Friday, October 30, 2009
- Friday December 11, 2009
- Friday, January 22, 2010
- Friday, March 5, 2010
- Thursday/Friday, April 22-23, 2010.

Following are preliminary outlines of tentative HJR 35-related items for each of the proposed meetings:

Friday, October 30, 2009

- ▶ Staff briefing on the history, nature, scope, and theory of bonus pay-type of compensation for Montana state employees.
- ▶ Briefing on administrative rules adopted by and the administrative practices employed within state agencies in regard to bonus pay.
- ▶ Briefings on the benefits and drawbacks of existing bonus pay policy and practices as perceived by agency executives, program managers, human resource professionals, and employee representatives.
- ▶ Committee work session to identify core areas of interest and concern and, if advisable, to focus the study. If the Committee wants information regarding bonus-type pay policies or practices of other states or plans, identify the states to be examined *and the reasons for selecting each state identified*.
- ▶ Committee requests for additional research and analysis.

Friday, December 11, 2009

- ▶ Responses to Committee requests from previous meeting(s).
- ▶ Briefing on how money appropriated for the 2008-2009 biennium under section 2-18-303(2), MCA, was used. This was the 6/10 of 1% of salaries appropriated in HB 13 (Ch. 81, L. 2007) to be used to establish or increase compensation on the basis of market progression, job performance,

employee competencies, etc. The briefing would include the examination of bonuses paid since July 1, 2007, to determine if they were paid according to established guidelines and procedures.

- ▶ Briefing on current trends and practices in employee compensation, including bonus pay-types of compensation. This could include a compilation of research and analysis comparing and contrasting options such as market-based pay, performance-based pay, competency-based pay, merit pay, incentive pay, and statutory pay increases.
- ▶ Comparison of Montana's public employee compensation plans, including bonus-type compensation, with current trends and best practices; Committee identification of favored alternatives.
- ▶ Committee discussion to focus and pinpoint future work on the study; direct additional research and analysis.
- ▶ Develop preliminary findings and conclusions?

Friday, January 22, 2010

- ▶ Responses to Committee requests from previous meeting(s).
- ▶ Briefing(s) on additional information related to questions about Montana state public bonus-type pay or public employee compensation more generally.
- ▶ Refine findings and conclusions previously developed.
- ▶ Develop, refine, or adopt new or additional findings and conclusions.
- ▶ Identify potential options to foster bonus pay reforms.
- ▶ Direct additional research and analysis or draft legislation.

Friday, March 5, 2010

- ▶ Responses to Committee requests from previous meeting(s).
- ▶ Briefing on additional information, research, analysis.
- ▶ Establish, revise, adopt final findings and conclusions.
- ▶ Discuss options previously identified; propose and discuss additional options.
- ▶ Contingently or finally recommend options, including draft legislation, for legislative consideration.
- ▶ Review, revise, and adopt proposed outline of Committee report to the Legislature.

Thursday/Friday, April 22-23, 2010

- ▶ Final responses to Committee requests from previous meeting(s).
- ▶ Adopt final findings and conclusions.
- ▶ Adopt final recommendations, including draft legislation or recommendations to continue status quo.

If the Committee is unable to conclude its work on HJR 35 at the April, 2010 meeting, completion and closure might be accomplished through a conference call or Committee wrap-up during part of a subsequent meeting.

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