A Timely Analysis of Legal Developments

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Federal Unemployment Insurance Integrity Act Creates Tough New Standards for Employers Responding to State Unemployment Insurance Claim Notices

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In 2011, Congress passed the Unemployment Insurance Integrity Act (Act) as part of the Trade Adjustment Assistance Extension Act of 2011 (TAAEA).[1] While the TAAEA was primarily concerned with extending retraining assistance for employees displaced by foreign workers, the roughly three-page Act requires states to incorporate provisions into their own unemployment insurance (UI) laws to (1) enhance penalties for fraudulent UI claimants; (2) revise the timing of "new hire" reports; and (3) impose new obligations on employers (and their agents) with respect to responding to unemployment insurance claim notices.

Specifically, the Act provides that states' implementing statutes must "require" employers and their agents to timely and adequately respond to a state UI agency's request for information regarding at least the initial UI claim. Generally, if either an employer or its agent establishes a pattern of failing to timely or adequately respond, the employer's UI account will be charged for the UI benefits even if it is subsequently determined that the claimant was ineligible for UI benefits. There are also potential civil and criminal penalties that can be applied. States are required to adopt implementing laws to be effective on or before October 21, 2013. As of October 1, all but four—Georgia, Michigan, Missouri and Vermont—have so acted.

While perhaps well intentioned, the Act is based on a faulty assumption, and will likely result in increased UI administration costs for states without the anticipated benefit of substantially reducing UI overpayments, as discussed below.

What Triggered This Law?

Historically, many employers, particularly those already paying UI taxes at the maximum rate, have not routinely responded to UI agency Claim notices ("Notices") and simply accepted their reserve account charges as a cost of doing business when former employees apply for UI benefits. Under the Act, rigorous new state provisions are likely to change the way many employers process UI Notices because both employers and their agents are subject to an array of penalties for being "unresponsive" or for inadequately responding to Notices.

1 Sections 251-252 of P.L. 112-40, 125 Stat. 421-422 (2011); 42 U.S.C. §§ 503 *et seq.* (Social Security Act); 26 U.S.C. §§ 3303 *et seq.* (Internal Revenue Code).

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Over the last several years, the amount of UI overpayments made to ineligible claimants has been estimated to be in the billions of dollars. The Act's sponsor appears to assume that employer non-responsiveness to Notices caused these massive overpayments. Such an assumption is not correct because administrative agency errors and employee fraud have been overwhelmingly identified in the government's own reports to be primarily responsible for such overpayments. An April 2013 report by the Federal Reserve Bank in St. Louis found that in 2011, the UI system paid out $108 billion in benefits. Of these payments, $3.3 billion were deemed fraudulent because claimants receiving benefits were found to be earning unreported income.[2]

Another report by the U.S. Department of Labor (DOL) found that between 2009 and 2012, 33 states had error rates of 10 percent or higher, resulting in substantial overpayments of UI benefits to claimants. Alabama, for example, had a three-year average overpayment rate of 16.62 percent, with an estimated $53,191,663 in overpayments made. The DOL estimated, however, that only 2.95 percent of UI overpayments were attributable to employers, while claimants were responsible for 49.25 percent of the overpayments and state UI agencies were responsible for 15.64 percent of the overpayments.[3] Thus, according to the DOL report, claimants and Alabama's UI agency were the cause of more than two-thirds of all overpayments in Alabama. Plainly, the government's own data contradicts the basic premise of the Act—that employers are significantly contributing to the overpayment of UI benefits.

A failure to adopt laws implementing the Act by October 21, 2013 will impact employers' ability to receive full state UI credit against FUTA taxes. As to the four tardy states: (1) Vermont appears to have a pre-existing law that may qualify as conforming with the requirements of the Act; (2) Georgia has not finalized its law and regulations; (3) Michigan's legislation is still pending; and (4) Missouri's enabling bill was vetoed.

What Do These State Laws Mean?

Under the Act, states must adopt laws to require the timely and complete responses to Notices by employers and their agents. The states have taken a variety of approaches in enacting legislation to comply with this obligation. The vagueness of the Act, however, coupled with its thin legislative history and even more tenuous fiscal rationale leaves much open to interpretation.

Employers using a payroll service or unemployment cost management service (individually and collectively "TPA"s) generally provide for such Notices to be routed directly by the state agency to the TPA, which responds as the employer's representative. In almost all cases, existing UI state laws provide a very short statutory period (typically under 10 days from the mailing date) to respond to all Notices. Unfortunately, new state legislation passed in response to the Act requires more information from employers and/or TPA's but does not extend the response period. Thus, meeting a state's information demands may be very challenging for employers and their agents and require the quickest mobilization of more resources to respond.

In general, the new state laws penalize an employer for "willfully" making a false statement or "willfully" failing to disclose a "material" fact related to termination of an employee with penalties generally imposed based on a "pattern" of such failures.

Currently, many states excuse an employer or TPA from responding to a Notice under certain circumstances, e.g., a layoff, where eligibility for unemployment insurance benefits arises as a matter of law. For example, the California Employment Development Department (EDD) form Notice of Unemployment Insurance Claims Filed (DE 1102C/2/Rev S (9/07)) specifically directs that "No reply is required if the claimant was laid off due to lack of work and no other eligibility issue has been identified." Query: when will these forms be updated and will California and other states now require responses under all circumstances?

For an employer already paying a state's highest UI rate (and one likely to remain at such level for an extended period whether or not further benefits are charged), failing to respond to a Notice does not usually result in higher UI taxes. In the past, an employer in these circumstances may have opted not to respond to a Notice, assuming there was little to be gained by opposing an award of benefits. Now, particularly given the array of penalties possible for non-compliance, increased attention to such Notices is warranted. Furthermore, as government-imposed penalties are not generally deductible business expenses at either state or federal levels, avoiding the imposition of such penalties takes on added importance.

2 David L. Fuller, B. Ravikumar and Yuzhe Zhang, "Who Is Concealing Earnings and Still Collecting Unemployment Benefits?" The Regional Economist, Federal Reserve Bank of St. Louis, April 2013, *available at* http://www.stlouisfed.org/publications/re/articles/?id=2359.

3 *See* U.S. Department of Labor, Unemployment Insurance Improper Payments By State, Alabama, *available at* http://www.dol.gov/dol/maps/state/AL.htm.

The states have also taken different approaches to what constitutes a "pattern of failure" that will trigger penalties. For example, Alabama defines the phrase as two or more "offenses" (suggesting criminal conduct) without defining an actual time period for such pattern to evolve (such as per calendar year).[4] Further, under Alabama's statute, an untimely response that is fully accurate is still an offense, meaning that being even a day late may allow the state to charge an employer's account for benefits wrongly paid.

Some states have taken a slightly different approach, giving employers a bit more flexibility. For example, Kansas defines "pattern of failure" as the greater of two offenses or more than two percent of claims during the past year.[5] Other states, such as Hawaii, have enacted an almost strict liability standard, with a single offense constituting a "pattern of failure."[6]

As to penalties, the Act specifically allows states to impose stricter standards than required by the Act.[7] Several states have imposed monetary and potential jail time penalties in addition to prohibiting an employer's account from being relieved of the underlying benefit charges. For example, California legislation permits a fine against an employer and/or its agent ranging between two and ten times the weekly benefit amount (for a maximum penalty of $4,500) if the employer "willfully makes a false statement of representation or willfully fails to report a material fact concerning termination …"[8] Ironically, very significant penalties were possible in California under some circumstances in previously existing law, but were seldom pursued.

State Laws Can Impose Penalties on More Than Just an Employer

While the Act requires states to impose information requirements on employers and their agents, none of the laws attempt to define who is an "agent." Some state laws expand "employee" to extend to an employer's "officers" and other "employees." With respect to "agents," they most likely include TPAs. Indeed, since passage of the Act, there has been a marked increase in TPA information demands to their clients, strongly suggesting that they view themselves to be potentially liable as agents.

Balancing State's UI Information Demands in the Face of Potential Post-Employment Litigation

While state laws implementing the Act will be in full force very soon, it appears that most state UI agencies are ill-prepared to implement, let alone enforce, these laws. While states seem ill-prepared, TPAs are seriously and aggressively pursuing information from client employers. Consequently, demands by TPAs and state UI agencies for rapid and complete responses may accelerate. These new laws are likely to create tension between employers and their TPAs. While TPAs seek information to protect themselves from liability, employers may have overriding business reasons for not contesting UI claims, particularly when post-employment litigation is anticipated and the filing of such claims and responses may accelerate the discovery process.

Given the potential for state-level penalties, written separation agreements with terminating employees which provide that an employer will not contest UI claims should be avoided. Also, given the new penalties, an early legal review of all terminations is recommended. Also consider that any information provided to a TPA, whether or not used, may potentially compromise its privileged status. In sum, an employer should carefully and promptly consider its UI response particularly when there is a high probability or threat of litigation.

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4 *See* Ala. Code §25-4-78, which states in relevant part:

> Any other provision of this chapter to the contrary notwithstanding, effective October 21, 2013, the unemployment compensation account of an employer shall be charged when the unemployment compensation agency determines that an overpayment has been made to a claimant as a result of both of the following:
>
> (i) The overpayment occurred because the employer, or an agent of the employer, failed to respond timely or adequately to a request from the unemployment compensation agency for information relating to an unemployment compensation claim.
>
> (ii) The employer, or an agent of the employer, has established a pattern of failing to respond timely or adequately to a request from the unemployment compensation agency for information relating to an unemployment compensation claim on two or more occasions.

5 K.S.A. § 44-710(c)(3) ("(ii) 'pattern of failure' means repeated documented failure on the part of the employer or the agent of the employer to respond, taking into consideration the number of instances of failure in relation to the total volume of requests. An employer or employer's agent failing to respond as described in (c)(3)(A) shall not be determined to have engaged in a 'pattern of failure' if the number of such failures during the year prior to such request is fewer than two, or less than 2%, of such requests, whichever is greater.").

6 Haw. Rev. Ann. § 383-33 ("Any redetermination issued on or after October 1, 2013, on the basis of information furnished by the employer or the agent of the employer after the prescribed period shall be effective upon the date of the redetermination. The entire amount of benefits overpaid due to the employer's or agent of the employer's failure to respond timely or adequately to the agency's request for information as required shall be charged against the account of the noncomplying employer.").

7 26 U.S.C. § 3303(f)(2).

8 Cal. Unempl. Ins. Code § 1142.

As noted above, both the U.S. DOL's and Federal Reserve's studies attribute a relatively small percentage of UI benefits overpayment to employers' action or inaction,[9] while an overwhelming percentage is attributable to agency error and claimant fraud. Thus, the Act addresses a very small employer problem—akin to using an A-bomb to clear a storm drain. To ensure the necessary prompt responses—or at least consideration of an employer's options within a very short window—it is advisable that employers develop a process for reviewing the circumstances of all terminations, whether employee- or employer-initiated, even before any claim is received.

New Game Plan For Responding To UI Claims

There are a variety of steps employers can take to address the Act's requirements. These include:

- **Review Applicable State Laws**. An employer should become familiar with the new state laws in jurisdictions where it has employees and adopt procedures for promptly screening UI notices.
- **Augment Training**. An employer should train staff to recognize claims and Notices for UI benefits so as to be able to properly and quickly route them to the appropriate personnel. Because Notices are often sent to the employer's field office, employees with mail-screening responsibilities should be trained to recognize UI-related claims and expeditiously forward the Notices to the appropriate personnel.
- **Review and Revise Employer's Address of Record**. An employer with multiple locations (particularly with multi-state locations) typically uses a local office address rather than a centralized address for all states' payroll tax correspondence. Likewise, when using a TPA, an employer's correspondence is often sent to a central TPA-processing site and handled independently. Employers should review and consider modifying their registered addresses to ensure a timely and centralized response. For employers who use a TPA, ensure the TPA promptly notifies their client employers of Notices.
- **Designate a UI Czar**. Designate a person (or a small number of people) to be in charge of, and responsible for, all UI claims and/or coordination with a TPA, if used. For maximum effectiveness, the designee (the UI Czar) should have ready access to the personnel information necessary to timely respond to UI claims and authority to coordinate responses with any TPAs. To be most effective, a UI Czar should receive immediate notice of all terminations or quits, whether voluntary or not, so documentation can be collected in anticipation of a UI claim.
- **Review TPA Contractual Arrangements**. Employers contracting for TPA services should review these arrangements and establish a workable process for responding to UI notices going forward.
- **Avoid Agreements with Employees not to Contest UI Benefit Claims**. An employer should not agree (in writing or orally) that it will not contest a claim for UI benefits. Furthermore, when employment litigation seems probable, consult with counsel, preferably before termination, but at a minimum before providing any UI claim response.
- **Monitor**. Set up a process for monitoring state-level UI regulatory and litigation developments on a state-by-state basis regarding the Act's implementation. Expect more burdensome laws.
- **Lobby**. The modification or repeal of the Act and its state level legislation are worthy goals. Consider adding this item to the employer's legislative agenda.

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9 See footnotes 7 and 8, *supra*.