

THE LEGALITY OF PRIVATELY FUNDED MERIT PAY FOR PUBLIC SCHOOL  
TEACHERS

by

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Submitted in partial fulfillment of the requirements of the  
King Scholar Program  
Michigan State University College of Law  
under the direction of  
Professor Bowman  
Fall, 2010

## I. INTRODUCTION

The public education system is under pressure to improve. President Obama has criticized the public school system and called for progressive changes, including “rewarding excellence in teaching with extra pay[,]” encouraging experimentation, and eliminating limits on the number of charter schools.<sup>1</sup> With President Bush’s No Child Left Behind, followed closely by President Obama’s Race to the Top, America’s educational system has been in a perpetual state of upheaval which has brought unprecedented changes to public schools. Some of the changes have caused such upheaval that entire teaching staffs have been fired as a result of suggested reforms.<sup>2</sup>

The Obama administration and the Department of Education are just some of the groups which have proposed merit pay for public school teachers as a method to improve schools. This paper addresses the most important issues which must be considered in implementing a merit pay system for public school teachers, and then focuses on the special issues involved when merit pay is privately funded. This paper does not address the issues of standing to bring a conflict of interest claim.<sup>3</sup> Part II covers the basics of merit pay and the several stakeholders involved in

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<sup>1</sup> Scott Wilson, *Obama Says Public Schools Must Improve*, WASH. POST, Mar. 11, 2009, <http://www.washingtonpost.com/wp-dyn/content/article/2009/03/10/AR2009031000146.html>.

<sup>2</sup> See Jennifer D. Jordan, *Teachers Fired, Labor Outraged*, Feb. 24, 2010, [http://www.projo.com/education/content/central\\_falls\\_trustees\\_vote\\_02-24-10\\_EOHI83C\\_v56.3b42117.html](http://www.projo.com/education/content/central_falls_trustees_vote_02-24-10_EOHI83C_v56.3b42117.html) (detailing Rhode Island Central Falls School Board Trustee decision to terminate all of the teachers, guidance counselors, principal and three assistant principals at the Central Falls High School based on Department of Education requirements that states must fix the lowest performing five schools in one of several methods including “turnaround” where all teaching staff are fired and less than half are rehired).

<sup>3</sup> The problem with standing can be seen in the recent dispute between the Detroit Public Schools and Emergency Financial Manager (EFM) Robert Bobb. The Detroit Board of Education’s lawsuit claimed a conflict of interest in Bobb’s receipt of \$145,000 of supplemental income from a private foundation for services Bobb performed as EFM. The suit was dismissed for lack of standing, but a subsequent Michigan Supreme Court decision may allow similar lawsuits to proceed. See Jennifer Mrozowski, *DPS Manager to Earn \$344k*, DETROIT NEWS, Mar. 3, 2009, [http://detnews.com/article/20090303/SCHOOLS/903030373/DPS-manager-to-earn-\\$344K](http://detnews.com/article/20090303/SCHOOLS/903030373/DPS-manager-to-earn-$344K); Zenobia Jeffries, *DPS Board Fights Back*, THE MICHIGAN CITIZEN, Mar. 14, 2010, available at <http://michigancitizen.com/dps-board-fights-back-p8389-1.htm>; see *Lansing Educ. Ass’n v. Lansing Bd. of Educ.*, No. 138401, 2010 WL 3037733, at \*45 n.42 (Jul. 31, 2010) (Corrigan, J., dissenting) (“Under the majority’s approach, [the suit about Robert Bobb’s pay]

privately funded merit pay for public school teachers. Part III addresses general problems with merit pay, including the lack of evidentiary support and the political consequences of demanding a merit pay system. Part IV covers the laws affecting all forms of merit pay.

Part V focuses on the specific laws which should apply to privately funded merit pay for public school teachers. Those in charge of a school system who are most likely to implement a merit pay system are likely to be public officers. These public officers are charged with the duty to provide a public education and are subject to the conflict of interest rules intended to prevent actions which inhibit the proper fulfillment of the public office.

The conflict of interest rules are broadly interpreted against public officers and result in severe consequences which include disqualification from voting procedures, ouster from office, voiding of contracts where the conflict was present, and fines. In addition to broad prohibitions on personal conflicts, there are two occurrences where merit pay causes a conflict of interest because it prevents the proper fulfillment of office. First, the implementation of merit pay, if based on student performance, creates a conflict of interest which could cause teachers and administrators to choose which students to educate. This is destructive to the public duty to provide a *public* education. Second, it is a conflict of interest for the public officers to allow a private organization to have control in how the merit pay is distributed as this impermissibly subordinates the office to the direction of another organization and causes the teachers to be conflicted in their duty to the public officer administration.

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seems tenable because all they have to allege is an ill-defined ‘substantial interest’ in the management of local schools.”).

## II. MERIT PAY FUNDAMENTALS

Certain issues are present in all forms of merit pay, whether public sector or private sector, or funded from an external source. This section addresses the basics of merit pay, the differences between merit pay and a merit promotion system, the numerous parties with an interest in merit pay for public school teachers and the interests of each group.

### A. Pay for Performance and Merit Pay

One advocated method to improve the school system is to improve teacher performance through the adoption of pay for performance or merit pay. “Pay for performance is a system of rewards (or punishments) intended to shape behavior to specific performance metrics.”<sup>4</sup> Merit pay is considered one form of pay for performance.<sup>5</sup> Merit pay has been used in the private sector for some time, and has been used in Medicare programs involving healthcare providers including hospitals, nursing homes, and other health agencies.<sup>6</sup> Various groups, including the Obama administration, the Department of Education, and private organizations such as the Mackinac Center have called for applying merit pay in the public sector, including public schools. Proponents claim pay for performance will improve student performance by modifying teacher performance. Teachers will be motivated to improve in a system where each teacher’s pay is based on the performance of the teacher’s students.

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<sup>4</sup> Sandra J. Tanenbaum, *Pay for Performance in Medicare: Evidentiary Irony and the Politics of Value*, 34 J. HEALTH POL. POL’Y & L. 717, 719 (2009).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at 717.

The concept of merit pay in the public school system is not a novel concept, as it has been advocated for several years; it was even predicted that the resolution of conflicts over merit pay would be one of the greatest challenges in the early twenty-first century.<sup>7</sup>

It has been suggested that the merit pay system should not be based on individual performance, but should be based on agency performance to produce a workable incentive for both the agency and the employees.<sup>8</sup> Additionally, placing importance on individual performance may not promote cost-effectiveness or motivate employees to fulfill the agency's underlying policies.<sup>9</sup>

## **B. Merit Pay Distinguished from Merit Promotion Systems**

This paper is concerned with merit compensation for a teacher remaining in his or her classification. Although a merit pay system should not be confused with a merit promotion system, some of the concerns which prompted the creation of merit promotion systems are also present in merit pay systems.

A merit promotion system has been described as a system “to recruit, select, supervise, and promote the best qualified persons for public service” and was a system to counter political

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<sup>7</sup> Alan Miles Ruben, *The Top Ten Judicial Decisions Affecting Labor Relations in Public Education During the Decade of the 1990's: The Verdict of Quiescent years*, 30 J.L. & EDUC. 247, 273-74 (2001) (noting that “[n]onetheless, I hope I may be forgiven for prognosticating that a major issue in the first decade of the 21<sup>st</sup> century will involve the restructuring of compensation to include so-called ‘merit pay.’ This concept would link teacher salaries, tenure assignments and promotion to student learning as evidenced by their performance on standardized tests. The call for ‘accountability’ of the teaching profession seems, at this writing, to enjoy widespread popular support. But, just how any such principle can be shaped to take into consideration such influential diversity factors affecting student performance as levels of parental income and education that may differ from one school population to another, remains to be seen. Resolution of the conflicts likely to arise over the attempted implementation of such merit pay programs may well represent the greatest challenge that will face teachers and administrators in the years immediately ahead.”).

<sup>8</sup> Timothy A. Wilkins & Terrell E. Hunt, *Agency Discretion and Advances in Regulatory Theory: Flexible Agency Approaches Toward the Regulated Community as a Model for the Congress-Agency Relationship*, 63 GEO. WASH. L. REV. 479, 533-34 (1995).

<sup>9</sup> *Id.*

patronage appointments which ignored qualifications.<sup>10</sup> Although this appears straightforward, the distinction between merit pay and merit systems has caused confusion. The use of the phrase “merit system” in Michigan’s constitution<sup>11</sup> caused problems even before the amendment was adopted.<sup>12</sup>

Some of the purposes of a civil service system, or merit promotion system, were to protect public employees from political upheaval and political harassment, to promote government service and limit the impact of a changing political atmosphere on government service.<sup>13</sup>

Professor Lydia Segal documented some of the details of political coercion in government, the problems with prosecution, and public ambivalence to the issue.<sup>14</sup> Unfortunately, experience has shown that school administrators may serve as enforcers to implement political agendas at the expense of students and government employees.<sup>15</sup> Past political influence on the job caused public employees, including teachers, to leave their positions after they became demoralized.<sup>16</sup> One of the difficulties in this type of political

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<sup>10</sup> E. Gordon Gee & David J. Sperry, *Education Law and the Public Schools: A Compendium*, C-14 n.1 (Allyn and Bacon, Inc. 1978).

<sup>11</sup> MI. CONST. Art. XI, § 6 (“[E]ach county, township, city, village, school district and other governmental unit or authority may establish, modify or discontinue a *merit system* for its employees *other than teachers under contract or tenure*”) (emphasis added).

<sup>12</sup> 1 OFFICIAL RECORD, CONSTITUTIONAL CONVENTION 1763 (1961) (proposing a pre-vote modification to the amendment which would have changed “merit system” to “civil service system” to avoid confusion between “merit system” and “merit pay”).

<sup>13</sup> *Id.* at 1759 (contrasting a civil service system with a non-civil service system where a change in the political administration causes “a mass housecleaning of employees of loyal service, who sacrifice their jobs upon the altar of political expediency” which perpetuates little kingdoms).

<sup>14</sup> See generally Lydia Segal, *Can We Fight the New Tammany Hall?: Difficulties of Prosecuting Political Patronage and Suggestions for Reform*, 50 RUTGERS L. REV. 507 (1998).

<sup>15</sup> *Id.* at 551-52 (discussing 1993 investigation revealing New York City school board which placed a campaign manager as principal in order to carry out a political agenda by pressuring teachers to politic instead of working on lesson plans. Student test scores “plummeted” and many teachers left the system after they became demoralized by the advancements through politics instead of merit).

<sup>16</sup> *Id.* at 552.

dilemma is that the violations are rarely publicized, and “[e]xperienced political bosses know they can avoid conviction by merely avoiding explicit threats or promises, [and] most bosses now operate with winks and nods and *go through the motions of evaluating people based on merit.*”<sup>17</sup> Although Professor Segal suggested that merit pay based on performance could be one method to prevent the use of political promotions, she also suggested a central monitoring authority should be used to monitor the performance of the merit pay system.<sup>18</sup>

If there is no definite correlation between merit pay and performance, as covered in Part III.A, *infra*, the motivation to enact merit pay should be scrutinized, as there is too much potential for merit pay’s use to punish the politically unpopular.

### **C. Numerous Interested Parties Complicate the Issue**

Merit pay is a controversial issue because it involves concerns which are important to several groups of people. All groups seem to have a goal of providing the best education for students by attracting and retaining qualified and capable teachers while controlling the cost in providing that education. The various groups have different ideas on how to accomplish this goal, including whether and how to use merit pay. The parties with the most relevant interests are the general public, teachers and teachers unions, school administrators, the states or commonwealths, and private organizations which advocate for merit pay. To get an understanding of the potential conflicts involved, the interested parties are discussed with the respective interests.

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<sup>17</sup> *Id.* at 559 (emphasis added) (citing SPECIAL COMMISSIONER OF INVESTIGATION FOR THE NEW YORK CITY SCHOOL DISTRICT, POWER, POLITICS, AND PATRONAGE: EDUCATION IN COMMUNITY SCHOOL DISTRICT 12 81-83 (1993); James Lindgren, *Symposium: Blackmail Morals, The Theory, History, and Practice of the Briber-Extortion Distinction*, 141 U. PA. L. REV. 1695, 1735 (1993)).

<sup>18</sup> *Id.* at 561.

## ***1. General Public***

The general public relies on public education to teach a large number of American children and is interested in getting the most for their substantial taxpayer expense of over \$500 billion annually.<sup>19</sup> The general public wants improvement in the public school system, but does not view merit pay as the most important method to improve student performance. According to a recent TIME survey, sixty-seven percent of those polled believed American public schools are in a state of crisis.<sup>20</sup> Sixty-four percent of those surveyed believed teacher evaluations should *partly* be based on student progress on standardized tests, and seventy-one percent supported merit pay for teachers.<sup>21</sup> Improving teacher effectiveness was considered the second-most important factor in improving *student* performance, falling behind increased parent involvement as the most important factor.<sup>22</sup> Merit pay was not considered the most important factor to improve *teacher* performance; the most important factors to improve teacher performance were better university training and mentoring by experienced teachers.<sup>23</sup>

In spite of the significant education cost, the public acknowledged a fundamental problem affecting public education: teacher salaries are inadequate to attract and retain the best teachers. Sixty-one percent believed teachers were underpaid; seventy-six percent believed the

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<sup>19</sup> See *Fast Facts*, <http://nces.ed.gov/fastfacts/display.asp?id=372> (last accessed Oct. 12, 2010) (stating that nearly 49.4 million children will be enrolled in public elementary and secondary schools in the fall of 2010 with approximately \$540 billion to be spent on their education for the year 2010-2011).

<sup>20</sup> *TIME Poll Results: Americans' Views on Teacher Tenure, Merit Pay and Other Education Reforms*, Sep. 9, 2010, <http://www.time.com/time/nation/article/0,8599,2016994,00.html>.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

smartest people would not go into teaching because of inadequate pay, and seventy-seven percent believed teaching “is among the most under-appreciated professions in the U.S.”<sup>24</sup>

## ***2. Teachers and Teachers Unions***

Teacher unions are typically associated with advocating teacher concerns. The National Education Association (NEA) stated its mission as twofold: advocating for its members, and preparing students to succeed.<sup>25</sup> Merit pay is important to the union because it affects an important condition of employment: the compensation received. According to the NEA, a minimum teacher salary is important in the education process for attracting and retaining educators, and preventing the attrition of teachers to higher paying professions.<sup>26</sup>

Teachers unions often represent non-teaching support staff, giving teacher unions an interest in improving compensation for all represented staff, not just teachers. The NEA does not advocate for support staff pay which is equivalent to teacher pay, but advocates for “an appropriate living wage as starting pay for education support professionals.”<sup>27</sup>

The NEA has reservations about merit pay, but is not completely opposed to the idea of performance pay if the proper steps are followed, including merit pay to supplement a required minimum salary.<sup>28</sup>

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<sup>24</sup> *Id.* (finding sixty-one percent of those surveyed believed teachers were underpaid, while only seven percent believed teachers were overpaid).

<sup>25</sup> *NEA's Vision, Mission, and Values*, <http://www.nea.org/home/19583.htm> (stating its mission is “to advocate for education professionals and to unite our members and the nation to fulfill the promise of public education to prepare every student to succeed in a diverse and interdependent world”).

<sup>26</sup> *See Professional Pay*, <http://www.nea.org/home/ProfessionalPay.html> (stating that low teacher pay results in teachers leaving for higher paying professions. Twenty percent leave by the end of the first year, and almost half leave within the first five years).

<sup>27</sup> *ESPs Deserve a Living Wage*, <http://www.nea.org/home/29173.htm> (stating that “support professionals are woefully underpaid, often barely able to afford to live in the communities they serve. In many parts of the country, school support professionals work two or even three jobs to feed and shelter their families, or earn so little that they qualify for government assistance”).

<sup>28</sup> John Rosales, *Pay Based on Test Scores?*, <http://www.nea.org/home/36780.htm> (describing potential problems with merit pay systems including adequacy of funding, transparency, method of evaluations, a minimum salary and

### 3. *School Administration*

A school district's administration has interests which differ from those of teacher unions. The American Association of School Administrators (AASA) is an organization which represents school district interests and has stated its mission "to support and develop effective school system leaders who are dedicated to the highest quality public education for all children."<sup>29</sup> Administrators may be directly impacted by merit pay decisions because some of the proposed merit pay systems would provide monetary benefits to administrators, even though they are outside of the classroom.<sup>30</sup>

The role of administrators should not be underestimated as their role is critical to the success of the school system, and may cause the system to fail in some cases.<sup>31</sup> The school districts have to administer an effective educational program, but also have to operate a fiscally responsible administration which is constrained by the financial resources available to the district. This is a current problem for many school districts which faced severe shortages necessitating layoffs, school closures, and other cutbacks in spite of infusions of large amounts

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advocating for teacher involvement in negotiating any merit pay system. Two districts with alternative pay systems are noted, but both implement pay levels based on professional development of teachers, not based on student performance).

<sup>29</sup> *About AASA*, <http://www.aasa.org/About.aspx>.

<sup>30</sup> Lorie A. Shane, *Schools Show Interest in Pilot Merit Pay Program*, Oct. 21, 2008, <http://www.educationreport.org/pubs/mer/article.aspx?id=9889> (describing that "[t]he largest amounts would go to core subject teachers, but smaller amounts would be reserved for administrators, support staff and teacher aides for reaching achievement targets." In response to the question "[w]hat about rewarding school principals?" the response was "[m]erit pay needs to be 'fair,' but the concept of fair may vary from district to district. Some districts put more weight on classroom teachers than school leadership, but others may not.").

<sup>31</sup> Arne Duncan, Sec'y of Educ., Remarks of Arne Duncan to the National Education Association – Partners in Reform (Jul. 2, 2009), available at <http://www2.ed.gov/news/speeches/2009/07/07022009.html> ("We don't need a study to tell us that chronically underperforming schools do not have the best principals and teachers. Experience tells us that failing schools usually have poor leadership, and poor leadership usually drives away good teachers. . . . They deserve to be recognized and rewarded. But if they're not up to the job, they need to go.").

of federal stimulus money.<sup>32</sup> The problem is compounded by a lack of uniform legal mechanisms across the states to respond to financial crises.<sup>33</sup>

#### ***4. States, Commonwealths, and the District of Columbia***

Individual school administrators may have an interest in the operation and success of the schools under their control, but the state or commonwealth has an interest in the success of all schools within the territory. The states have a clear interest in balancing a sufficient teacher salary against fiscal responsibility. States with low teacher salaries have experienced a shortage due to the inability to attract and retain teachers, especially in a strong economy.<sup>34</sup> The states also have a clear interest in maximizing student education, which paves the way for advocates who claim merit pay will improve performance.

The importance of state concern in the success of public schools has surfaced with force as many of the states reformed school system operations in order to compete for the Obama administration's "Race to the Top" funding.<sup>35</sup> Forty-six states and the District of Columbia competed for over ten billion dollars in funding by reforming education processes in their jurisdiction through changes in laws and policies affecting education.<sup>36</sup> One of the four key measurements of state reform was the "[r]ecruiting, developing, rewarding, and retaining effective teachers and principals, especially where they are needed most; and [t]urning around

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<sup>32</sup> See Kristi L. Bowman, *Before School Districts Go Broke: A Proposal for Federal Reform*, U. CIN. L. REV. (forthcoming) (Research Paper 08-21 at 3-5, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1698223](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1698223)).

<sup>33</sup> See *id.* at 24-38.

<sup>34</sup> John Sanchez, *2001 Survey of Florida Public Employment Law*, 26 NOVA L. REV. 191, 196 (2001) (Discussing Florida's shortage of teachers and substitute teachers where Florida teacher salary was approximately \$5000 below the national average. "Apparently, 'low pay, a lack of respect and the strong economy' make the job unattractive").

<sup>35</sup> See *Nine States and the District of Columbia Win Second Round Race to the Top Grants*, Aug. 24, 2010, <http://www.ed.gov/news/press-releases/nine-states-and-district-columbia-win-second-round-race-top-grants>.

<sup>36</sup> See *id.*

their lowest-performing schools.”<sup>37</sup> As part of the recruitment, reward and retention of effective teachers and principals, the Department of Education specifically considered and *encouraged incentives to all school employees and not just teachers* to promote employee performance to produce improved student performance.<sup>38</sup> The states have the difficult job of trying to maximize student education while balancing a sufficient teacher salary to attract and retain teachers against the need for fiscal responsibility.

### ***5. Private Organizations and Merit Pay Advocates***

Private *external* organizations are a unique party in merit pay for public school teachers. There is no private sector equivalent for external advocates of merit pay in an organization; an employer wishing to operate a merit pay system does so with its own funds - there is little need or interest for any external advocacy. An outside organization’s attempt to change and control another organization’s operations should be critically examined for underlying purpose.

A private organization with an interest in merit pay should be viewed as attempting to influence the education process based on the goals of the particular organization.<sup>39</sup> Some private foundations’ stated goals impliedly suggest merit pay as a possibility. The Eli and Edythe Broad Foundation stated that its mission is to “dramatically transform urban K-12 public education through better governance, management, *labor relations* and competition.”<sup>40</sup> The Broad

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<sup>37</sup> *See id.*

<sup>38</sup> Duncan, *supra* note 31 (discussing the Chicago pilot program bargained with the local union where “incentives for good performance went to every adult in the school, including custodians and cafeteria workers, and not to just the individual teachers.”).

<sup>39</sup> Detroit Public School claimed a conflict of interest in a private organization’s payment to Robert Bobb for services performed as Emergency Financial Manager. Plaintiffs’ attorney George Washington stated that a conflict of interest exists when private groups give money to public employees; “Bobb getting paid from these foundations, who have an agenda, is one step removed from getting cash in a paper bag[.]” Zenobia Jeffries, *Who’s Paying Bobb?*, THE MICHIGAN CITIZEN, May 30, 2010, available at <http://michigancitizen.com/whos-paying-bobb-p8639-1.htm>.

<sup>40</sup> *Mission and Overview*, <http://www.broadeducation.org/about/overview.html> (last accessed Oct. 30, 2010) (emphasis added).

Foundation Founders' Message does not mention teacher merit pay, but states that they "look forward to supporting labor organizations with the courage and vision to radically innovate collective bargaining *in ways that benefit teachers and students.*"<sup>41</sup> One of the K-12 education goals of the Gates Foundation is to "graduate all students college-ready" and stressing that "teachers matter more to student achievement than any other factor inside schools."<sup>42</sup>

Merit pay advocates have acknowledged that top performing school systems in other countries recruit teachers who performed in the top third of their academic class, but that *teacher pay is an obstacle to attracting top academic performers to become teachers in the United States.*<sup>43</sup> It is difficult to tell the position of the Broad Foundation or the Gates Foundation, but some, like the Mackinac Center, have suggested supplementing traditional teacher salary schedules with compensation from private foundations.<sup>44</sup>

## **6. Politicians**

Given the lack of evidence correlating merit pay with performance gains, and the willingness to advance merit pay as a vehicle for change, it is possible that politicians are using merit pay as a way to earn political credit with the public. It appears that some politicians are equivocating change with success in spite of the lack of evidentiary support.

One politician's attempted use of merit pay did not provide political credit when he pushed for merit pay for public school teachers. California Governor Arnold Schwarzenegger was forced to retract demands he made on the California legislature to implement a merit pay

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<sup>41</sup> *Id.* (emphasis added).

<sup>42</sup> *Topics: Effective Teaching*, <http://www.gatesfoundation.org/college-ready-education> (last accessed Oct. 30, 2010).

<sup>43</sup> See *Merit Pay in Public Education: The Time is Now*, Oct. 22, 2010, <http://www.compensationcafe.com/2010/10/merit-pay-in-public-education-the-time-is-now.html>.

<sup>44</sup> Shane, *supra* note 30 (stating the Mackinac Center's suggested implementation where Michigan schools are partnered with private foundations to fund merit pay for public school teachers).

system in spite of raising record amounts of campaign funds to support the initiatives.<sup>45</sup> He demanded the legislature implement a merit pay system on public school teachers and demanded a change in the system to allow easier terminations for unsatisfactory performance.<sup>46</sup> Contrary to his previously successful efforts at reform, the initiative failed because teachers waged an effective campaign in opposition to the changes and because the legislature refused to negotiate Schwarzenegger's changes.<sup>47</sup>

The negative political consequences Governor Schwarzenegger faced should be expected when someone attempts to implement merit pay by political force where there is a lack of public support, a lack of evidence to support merit pay, and merit pay fails to address the underlying concern that teachers are underpaid and underappreciated.

#### **D. Summary**

The number of legal issues and number of parties involved complicate the issue of merit pay in the public sector in comparison to the private sector. There are several groups with important interests in the operation and funding of public education. The credit to be given any group's interest can only be assessed after determining the general problems with merit pay, the legal issues surrounding all merit pay, and the legal issues specifically applicable to private funding of merit pay for public school teachers. In spite of the claims and political aspirations that advocates hope to gain by implementing merit pay systems, the many complexities involved in successfully implementing a merit pay program to shape employee behavior caused economist

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<sup>45</sup> Elizabeth Garrett, *The Promise and Perils of Hybrid Democracy*, 59 OKLA. L. REV. 227, 262-63 (2006).

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 261-63.

James Robinson to conclude that “policy makers ‘should adopt a stance of intellectual humility and a tone of cautious optimism.’”<sup>48</sup>

### **III. PROBLEMS WITH MERIT PAY OR PAY FOR PERFORMANCE GENERALLY**

Merit pay systems have been scrutinized for failing to produce conclusive performance improvements in non-school settings where merit pay was used. Merit pay in the public school system is a recent development which provides little information to interpret its possibility of success. Recent surveys suggest that there is no correlation between merit pay and student performance in a public school where merit pay was used.

In a non-educational setting, merit pay has caused negative consequences of particular concern to the public sector, including the rejection of individuals from government-funded care because of potential negative impacts on merit pay. This section will address the inconclusive connection between merit pay and performance in both a non-educational and educational context. Additionally, the problem of patient rejection from healthcare services will also be addressed because the merit pay influence to reject patients could also be applicable to teachers and school administration decisions to retain or reject students.

#### **A. Problems with Implementation**

##### ***1. Inconclusive Results***

Merit pay has come under fire for failing to conclusively produce an actual improvement in performance in non-school settings. This is problematic since the purpose of merit pay is to provide an incentive to increase performance. Merit pay is a waste of resources if measurable improvement can not be achieved.

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<sup>48</sup> Tanenbaum, *supra* note 4, at 722.

Meredith Rosenthal, Assistant Professor of Health Economics and Policy at Harvard School of Public Health, testified before Congress to the lack of evidence supporting medical pay for performance.<sup>49</sup> The lack of evidence supporting a connection between merit pay and improved performance has not slowed proponents from implementing merit pay under the potentially false belief that performance improvements will be achieved.<sup>50</sup>

Positive merit pay results may be the result of number manipulation to obtain positive results. One potential negative consequences of merit pay is skewed performance data based on provider choice of participants most likely to produce a positive outcome. The fact that results were manipulated through a discriminatory selection process has not stopped merit pay implementation even where the selection process had an adverse effect on the general public; merit pay programs were implemented by Congress even after the Congressional testimony by Professor Rosenthal about the lack of evidence supporting medical pay for performance and that some of the positive results were due to selection of healthier patients by healthcare providers to improve their results.<sup>51</sup>

Doctor Tanenbaum of the Ohio State University speculated that even if pay for performance in Medicare shows positive results, it may compromise healthcare, causing providers to focus on measurements and avoid patients who are less likely to produce positive results, such as sicker patients or patients who are less compliant.<sup>52</sup> The logical result is that providers under a merit pay system are more likely to reject patients needing treatment, thus

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<sup>49</sup> *Id.* at 723 (describing testimony of Meredith Rosenthal before the House Subcommittee on Employer-Employee relations where positive results were attributed to better documentation and selection of healthier patients by healthcare providers).

<sup>50</sup> *Id.* at 718 (stating that pay for performance in Medicare was considered an important strategy of the Bush administration's health care agenda, enjoyed bipartisan support, and was adopted with "scant empirical support for its effectiveness").

<sup>51</sup> *Id.* at 723.

<sup>52</sup> *Id.* at 735.

limiting the healthcare services available to those in need. Taken further, the desire to increase personal income through merit pay may lead to the use of other factors to discriminate in patient selection, such as the ability to seek and respond to treatment based on socioeconomic status and race.

Merit pay has substantial influence on how professionals perform their jobs, as seen by the patient selection process used in the Medicare pay for performance system. The implementation of a merit pay system in public schools will likely create a similar motivation for some teachers and schools to act similarly to the medical providers, favoring the attendance of those more likely to produce positive results. This may result in the preference for more talented students and the rejection of those with less talent. The result is that public education may cease to support the children with the most need for education. This is a conflict of interest with a public school's duty to provide a *public* education. As discussed in Part V, *infra*, the conflict of interest rules are not usually applicable to teachers, but may cause severe consequences to the school officials who enact a merit pay system which prevents the proper fulfillment of the public duty of providing a public education.

## ***2. Inconclusive Results Based on Student Performance***

In addition to the lack of evidence linking merit pay to improvement gains, additional complications are presented when merit pay is linked to the performance of someone other than the employee, such as tying a teacher's pay to the performance of the teacher's students. Merit pay which attempted to tie teacher pay to student performance failed to produce results on a number of occasions. In 2006, the Florida legislature implemented the STAR program as one method to compensate for teacher salaries which were well below the national average. The program tied teacher merit pay to student improvements in the Florida Comprehensive

Assessment Test (FCAT).<sup>53</sup> The plan was replaced following teacher protests that there was an undue emphasis on FCAT scores and that not enough teachers were rewarded; the new plan considered additional factors, including principal ratings.<sup>54</sup>

Several recent reports cast doubt on a school district's ability to rely on performance-based compensation to improve student performance. A study by researchers for the National Center on Performance Incentives (NCPI) at Vanderbilt University<sup>55</sup> showed that there was essentially no overall impact on student performance over a three year period even though the study involved a large monetary incentive of up to \$15,000 to motivate teachers to improve student performance.<sup>56</sup> The NCPI's stated purpose is to answer the question "[d]o financial incentives for teachers, administrators, and schools affect the quality of teaching and learning?"<sup>57</sup>

Some benefits were gained for fifth graders taught by teachers who received performance bonuses, but there was no effect which carried over when those students were tested in the sixth grade.<sup>58</sup> Additional factors may have influenced the performance gain, including that the improvements may have been the result of a threatened state takeover of the district during the final year of the study.<sup>59</sup> Union and teacher opposition was not a factor in the study; the merit

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<sup>53</sup> John Sanchez, *2006-2007 Survey of Florida Public Employment Law*, 32 NOVA L. REV. 141, 160 (2007).

<sup>54</sup> *Id.*

<sup>55</sup> The NCPI is funded by the Department of Education. *About NCPI*, <http://www.performanceincentives.org/about-ncpi/index.aspx>. The NCPI has stated its mission is to "conduct independent scientific research on the role of performance incentives in education." *Our Mission*, <http://www.performanceincentives.org/about-ncpi/Our-Mission/index.aspx>.

<sup>56</sup> Stephen Sawchuk, *Study Casts Cold Water on Bonus Pay*, available at <http://www.edweek.org/ew/toc/2010/09/29/index.html> (follow "Study Casts Cold Water on Bonus Pay" hyperlink); see also *NCPI Researchers Announce Results of POINT Experiment*, available at <http://www.performanceincentives.org/news> (follow "NCPI Researchers Announce Results of POINT Experiment" hyperlink).

<sup>57</sup> *About NCPI*, *supra* note 55.

<sup>58</sup> *NCPI Researchers Announce Results of POINT Experiment*, *supra* note 56.

<sup>59</sup> *Agreed: Merit Pay No Quick Fix for Public Education*, <http://www.thenewstribune.com/2010/09/27/1357832/agreed-merit-pay-no-quick-fix.html>.

pay experiment was implemented voluntarily with the involvement of the School Board, the Education Association and the Department of Education.<sup>60</sup>

The NCPI study may be the most detailed to date, but it is not the first study to show a merit pay system failed to improve student performance. Mathematica Policy Research Inc. recently released a study which showed no improvement in the Chicago Teacher Advancement Program when compared to similar schools which did not use the program.<sup>61</sup>

In spite of the results, mandatory merit systems are still pursued even though the debate over its effectiveness is very much alive.<sup>62</sup> Additional funding for merit systems has been awarded for school systems notwithstanding the fact that prior merit pay systems in the school system produced no results.<sup>63</sup>

Even those calling for changes to improve schools admit that pay for performance is not a simple issue to tackle.<sup>64</sup> The Mackinac Center for Public Policy advocates for education reform including teacher merit pay, but the Center acknowledged that teacher effectiveness is “notoriously difficult to measure” due to the many variables which may be present.<sup>65</sup> An

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<sup>60</sup> *NCPI Researchers Announce Results of POINT Experiment*, *supra* note 58.

<sup>61</sup> Valerie Strauss, *Chicago’s Teacher Performance-Based Pay Didn’t Work – New Analysis*, WASH. POST, June 1, 2010, <http://voices.washingtonpost.com/answer-sheet/research/analysis-of-chicagos-teacher-p.html>.

<sup>62</sup> *Education Experts Say Gov. Christie’s Teacher Merit Pay Can Do More Harm than Good for Students*, [http://www.nj.com/news/index.ssf/2010/09/nj\\_educators\\_say\\_gov\\_christies.html](http://www.nj.com/news/index.ssf/2010/09/nj_educators_say_gov_christies.html) (describing Democratic Assembly Education Committee Chairman Patrick Diegnan’s concerns with Republican Governor Chris Christie’s plan to implement a statewide merit pay system which uses student test data for at least fifty percent of each teacher’s evaluation).

<sup>63</sup> Rebecca Harris, *Chicago Wins More Federal Funds for Teacher Merit Pay*, Sep. 23, 2010, <http://www.thefundchicago.org/index.php?tray=content&tid=top41&cid=107F20> (describing the award of thirty-four million dollars in federal grant money to Chicago Public Schools with an additional \$706 million from other sources although the previous Chicago School merit pay program had been found to have “no effects on student achievement or teacher turnover.”).

<sup>64</sup> *See Merit Pay in Public Education: The Time is Now*, *supra* note 43 (detailing public education merit pay views of private consultant and avowed government performance advocate Howard Risher, PhD, MBA).

<sup>65</sup> Ryan McCarl, *The Myth of the ‘Highly Qualified’ Teacher*, Oct. 29, 2010, <http://www.educationreport.org/pubs/mer/article.aspx?id=13909> (stating that “[t]eacher effectiveness, however, is notoriously difficult to measure. Because there are many variables that influence how much a student learns in a

accurate assessment of teacher performance should extend beyond simply measuring student performance; it should account for other concerns, such as emotional support, instructional support, and organization to get a more accurate picture of a teacher's performance.<sup>66</sup>

Due to the lack of a correlation between merit pay and performance, merit pay could be a triple failure; it is a present failure for two reasons. First, it does not produce an increase in measurable performance and second, it fails to provide a solution to the underlying problem that teacher salaries are generally considered inadequate and therefore fails to solve the problem of retaining teachers. Merit pay fails the future public need as it is unlikely that the speculative nature of merit pay will provide the salary expectation needed to attract good teachers.

## **B. Summary**

The lack of evidence supporting a relationship between merit pay and performance improvements is problematic outside of the school setting where pay is based on individual performance, and becomes even more tenuous where pay is based on the performance of a third party, such as a student in public school. If there is no definite correlation between merit pay and performance, the motivation to enact merit pay should be questioned. The motivations for implementing could be varied and speculative, ranging from the political clout expected from implementing change, the desire to punish the politically unpopular, or a naïve belief that merit pay works in spite of the lack of supporting evidence.

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particular academic year, it is not always easy to fairly and accurately judge the performance of individual teachers in order to reward them for excellence or help them improve”).

<sup>66</sup> See *Merit Pay in Public Education: The Time is Now*, *supra* note 43.

#### **IV. LEGAL FRAMEWORK OF MERIT PAY**

Teacher merit pay is not illegal *per se*. If a merit pay system is implemented, it must be planned and administered very carefully to avoid running afoul of several statutes and contractual bargaining requirements. Merit pay can not be used as a method to cause illegal discrimination.

Although *private funding* of merit pay has not been addressed by court cases or law reviews, there are several complications which arise from the improper implementation of a merit pay system whether the merit pay is privately funded or not. This section addresses the most important laws which arise in the implementation of all merit pay systems, including national and state employment relations acts, and anti-discrimination laws.

##### **A. Merit Pay is Not Illegal *Per Se***

Some laws affect all forms of merit pay. Merit pay systems, including those for teachers, are not illegal *per se*, as merit pay systems have been reviewed several times without being held illegal. This does not mean that all merit pay systems will be legal. There are several instances where merit pay systems for teachers violated law or supported a cause of action based on the method of implementation.

##### **B. Laws Which Affect Merit Pay**

No law comprehensively addresses merit pay, but there are several laws which may be violated if a merit pay system is implemented improperly. Improper implementation of merit pay systems has been the basis for various claims where the system was based on measurable performance of the *individual*, without adding the additional complication of basing merit pay on a third person's performance as contemplated by merit systems basing teacher salary on student performance.

The U.S. Constitution provides protections which can not be abridged by the states. The fact that a merit promotion system is mandated by a state legislature does not grant immunity to schools which violate a teacher's First Amendment rights in order to quash criticism of the method of merit pay implementation. A school which denied a merit promotion to a teacher allegedly because he voiced criticism of merit pay promotion systems opened itself to retaliation claims even where the merit system was mandated by the state legislature.<sup>67</sup> The laws which protect teachers must be respected in the implementation and administration of merit pay systems.

### ***1. National Labor Relations Act and State Employment Relations Acts***

#### ***a. Restrictions on implementation***

The National Labor Relations Act (NLRA) establishes certain protected employee rights including union activity<sup>68</sup> and restricts an employer's ability to unilaterally change terms and conditions of employment.<sup>69</sup> The denial of merit pay in retaliation for union activity may support an unfair labor practice claim for interfering with protected rights.<sup>70</sup> The NLRA does not

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<sup>67</sup> See *Warren v. New Hanover County Bd. of Educ.*, 410 S.E.2d 232, 233-36 (N.C. Ct. App. 1991) (reversing trial court's dismissal of federal and state constitutional free speech claims that a public school teacher was allegedly denied a merit promotion because he published a survey showing dissatisfaction with the state legislature's merit pay promotion system. The teacher had received "very positive evaluations" for teaching performance and had thrice received the award of Teacher of the Year at his school before publishing the results of the survey, but received unfavorable evaluations and was denied promotion following publication.).

<sup>68</sup> 29 U.S.C. § 157 ("Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all such activities").

<sup>69</sup> 29 U.S.C. § 158 ("It shall be an unfair labor practice for an employer . . . to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in [29 U.S.C. § 157]"); see also 29 U.S.C. § 159(d) ("to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment.").

<sup>70</sup> See generally *Del. State Univ. v. Del. State Univ. Chapter of Am. Ass'n of Univ. Professors*, No. Civ.A. 1389-K, 2000 WL 33521111, at \*1 (Del. Ch. May 16, 2000) (discussing the appropriateness of deferral to the Delaware Public Employee Relations Board's finding of a violation for refusing to grant access to information related to the

normally apply to teachers because they are public employees<sup>71</sup> who are often covered under one of several similar state laws (employment relations acts) which give protections similar to the NLRA.<sup>72</sup>

The employment relations acts generally require employers to bargain with the designated bargaining representative about terms and conditions of employment including merit pay; employer attempts to avoid the bargaining obligation have generally been unsuccessful.<sup>73</sup>

A school district may be legally required to negotiate prior to implementing a merit pay system. Where a collective bargaining relationship exists, a district's ability and methods used to implement a merit pay system must meet the requirements of the NLRA or the applicable employment relations act. A merit pay system is a term or condition of employment which is considered a mandatory subject of bargaining which must be addressed with the employee's designated bargaining representative prior to implementation.<sup>74</sup> An employer is not obligated to

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Merit Compensation Program related to an alleged unfair labor practice for retaliatory denial of merit pay based on union activity).

<sup>71</sup> 29 U.S.C. § 152(2) ("The term 'employer' . . . shall not include the United States . . . or any State or political subdivision thereof . . .").

<sup>72</sup> See Cent. Mich. Univ. Faculty Ass'n v. Cent. Mich. Univ., 273 N.W.2d 21, 25-27 (Mich. 1978) (holding merit promotion and retention systems were not within the educational sphere outside of the scope of bargaining requirements, but were "other terms and conditions of employment" and mandatory subjects of bargaining under the Michigan Public Employee Relations Act M.C.L. 423.215).

<sup>73</sup> Matthew M. Bodah, *Significant Labor and Employment Law Issues in Higher Education During the Past Decade and What to Look for Now: The Perspective of an Academician*, 29 J.L. & EDUC. 317, 321 (2000) ("In every jurisdiction covered by a collective bargaining statute, there is some obligation for employers to negotiate or at least meet and confer with their employees' bargaining representative before amending a condition of employment. Generally, employers that have tested the boundaries of this bargaining obligation have been unsuccessful. A California appeals court, for example, found that a state university had committed an unfair labor practice when it unilaterally suspended payment of a merit increase after the expiration of an agreement. Similarly, the Supreme Judicial Court of Massachusetts held that the commonwealth had violated the compensation clause of its agreement with community college employees when it unilaterally instituted a furlough program several months into a contract.").

<sup>74</sup> See NLRB v. Katz, 369 U.S. 736, 745-46 (1962) (holding merit increases are mandatory subjects of bargaining and a unilateral implementation is a refusal to negotiate in violation of the National Labor Relations Act unless it was maintenance of the status quo consistent with a long-standing practice of granting merit reviews); see also 29 U.S.C. § 159(d) ("to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment."); see also Pasco County Sch. Bd. v. Fla. Pub. Employees Relations

find agreement with the representative, and may be allowed to implement unilateral changes from its last offer when it has bargained to impasse with the union; but an employer may commit an unfair labor practice if it unilaterally implements a merit pay system without definable objective procedures and criteria, even where it has bargained in good faith to impasse.<sup>75</sup>

The method used to implement a merit system impacts which employees are part of a collective bargaining agreement and affects the rights of some employees under an employment relations act. For an employee to be protected under certain provisions of the NLRA or employment relations acts, they generally must be part of an appropriate bargaining unit which is based on a community of interest standard. The presence of a merit system may help create a community of interest among the employees which affects the composition of the bargaining unit and the included employees.<sup>76</sup>

The persons who author the merit pay recommendations may lose some of the protections under the NLRA or employment relations acts. Generally, persons who recommend promotion, or effectively recommend promotion, are considered supervisors, are excluded from the bargaining unit and from most of the protections under an employment relations act. The

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Comm'n, 353 So.2d 108, 126 (Fla. Dist. Ct. App. 1977) (adopting language from Katz that a unilateral change in terms or conditions of employment during a contract negotiation violates the duty to bargain in good faith under the Florida Public Relations Act).

<sup>75</sup> Lawrence M. Goodman, *Merit Pay Proposals and Related Compensation plans – Detroit Typographical Union v. NLRB and McClatchy Newspapers Revisited*, 18 LAB. LAW. 1, 1-2 (2002) (discussing the tension between the D.C. Circuit decision and the NLRB's rule that an employer violates the Act when it implements a merit pay plan after impasse which lacks "definable objective procedures and criteria"); see also Allan H. Weitzman & Stuart J. Goldstein, *Merit Pay Proposals and Related Compensation plans: Detroit Typographical Union v. NLRB and McClatchy Newspapers Revisited*, 17 LAB. LAW. 495, 496-97 (2002).

<sup>76</sup> *Town of Richmond v. R.I. State Labor Relations Bd.*, No. PC 02-4786, 2004 WL 2821626, at \*3 (R.I. Super. Ct. Oct. 15, 2004) (finding the Town Council's established merit system was a factor which supported finding a community of interest for several clerks).

persons evaluating employees for merit pay awards may be considered supervisors who are excluded from the protections of the NLRA or state employment relations acts.<sup>77</sup>

*b. Continuing obligations during the collective bargaining relationship*

Merit pay systems may alter an employer's obligation under an employment relations act to provide information to the bargaining representative. The implementation of a merit program where a collective bargaining relationship exists may trigger a duty to disclose information on how the merit program is administered; refusal to provide relevant requested information can be an unfair labor practice.<sup>78</sup>

A collective bargaining relationship affects the process used to evaluate employee merit pay grievances because the employees may have to exhaust their administrative remedies when protesting evaluations used for merit pay purposes; procedures vary depending on the collective bargaining agreement.<sup>79</sup>

State statutes specifically addressing merit pay impact the state employment acts, but not the NLRA. The state statutes may affect the bargaining requirement by making bargaining mandatory, or by prohibiting bargaining as it relates to a merit promotion system.<sup>80</sup> Similarly, a

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<sup>77</sup> See *NLRB v. Hilliard Dev. Corp.*, 187 F.3d 133, 144-45 (1st Cir. 1999) (enforcing NLRB's petition for enforcement and the NLRB's finding that nurses aides were not statutory supervisors notwithstanding the employer's claim they were supervisors excepted from the National Labor Relations Act because they effectively recommended merit increases; there was not a direct correlation between the evaluations and the merit increases awarded each year because the evaluations were subject to review and independent assessment).

<sup>78</sup> *Del. State Univ. v. Del. State Univ. Chapter of Am. Ass'n of Univ. Professors*, No. Civ.A. 1389-K, 2000 WL 33521111, at \*1 (Del. Ch. May 16, 2000) (discussing the appropriateness of deferral to the Delaware Public Employee Relations Board's finding of a violation for refusing to grant access to information about the Merit Compensation Program related to an alleged unfair labor practice for retaliatory denial of merit pay based on union activity).

<sup>79</sup> *Grinins v. N.Y. City Dept. of Educ.*, No. 110383/08, 2009 WL 1110639, at \*2-3 (N.Y. App. Div. Apr. 6, 2009) (denying petition for relief for failure to exhaust administrative remedies where teacher claimed his unsatisfactory ratings negatively impacted his employment, including future merit pay increases) (citing *Villalba v. N.Y. City Dept. of Educ.*, 853 N.Y.S.2d 881 (N.Y. App. Div. 2008)).

<sup>80</sup> See N.H. REV. STAT. ANN. § 273-A:3(III) ("Matters regarding the policies and practice of any merit system established by statute, charter or ordinance relating to recruitment, examination, appointment and advancement

state statute may prescribe the administrative procedures which must be followed before pursuing court intervention following denial of a promotion under a merit system.<sup>81</sup> State statutes which require bargaining should *not* be viewed as waiving the conflict of interest rules discussed in Part V, *infra*.

The implementation of a merit pay system in the context of a bargaining relationship creates numerous details to successfully negotiate and properly administer, requires adequate evaluation criteria as its foundation, and produces commitments throughout the operation of the merit pay system and bargaining relationship. Failure to properly plan or administer a merit pay system may result in an unfair labor practice finding under the NLRA or employment relations acts.

## **2. *Anti-Discrimination Laws***

### *a. Discriminatory Use of Merit Pay*

Merit pay systems may not be used to illegally discriminate based on factors such as race. The use of a National Teachers Examination (NTE) to evaluate teachers for hiring or continued employment supported a discrimination claim where the test results were known to create a disproportionate exclusion of African American teachers based on prior implementation as part of a merit pay system.<sup>82</sup> Although a bona fide merit pay system may be used to defend against disparate impact claims,<sup>83</sup> the use of an arbitrary merit system is not a valid defense; the fact that the school district implemented the requirement without having investigated or studied the

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under conditions of political neutrality and based upon principles of merit and competence shall not be subjects of bargaining . . .”).

<sup>81</sup> *Williams v. New Hanover County Bd. of Educ.*, 409 S.E.2d 753 (N.C. Ct. App. 1991) (holding a teacher could appeal her denial of promotion to the Superior Court after appealing to the local board of education based on N.C. GEN. STAT. § 115C-305).

<sup>82</sup> *Baker v. Columbus Mun. Separate Sch. Dist.*, 462 F.2d 1112, 1114 (5th Cir. 1972).

<sup>83</sup> See Part IV.B.2.b., *infra*.

validity and reliability of the NTE or the arbitrary cutoff number used to determine which teachers would be hired or re-employed was specifically noted by the court.<sup>84</sup>

A merit pay system can not be used for the purpose of gender discrimination. The denial of a merit pay increase may trigger an EEOC investigation into pay and promotion claims and may also be relevant to a determination of a hostile work environment.<sup>85</sup> The fact that a salary increase may be obtained by other methods will not prevent a claim that the merit system is used to facilitate gender discrimination.<sup>86</sup> Similarly, a claim does not fail because the alleged discriminatee was approved for merit pay most of the time where the merit pay system discriminated based on the amounts awarded.<sup>87</sup>

*b. Merit Pay as a Defense to Discrimination Claims*

The use of merit pay systems has been discussed as a tool for plaintiffs to show discrimination. A bona fide merit pay system may be used as a shield by employers to defend against discrimination in pay claims under the Equal Pay Act and Title VII.<sup>88</sup> Although Title VII prohibits discrimination in compensation, it also provides:

[I]t shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a *bona fide* seniority or *merit system*, or a system

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<sup>84</sup> Baker v. Columbus Mun. Separate Sch. Dist., 462 F.2d 1112, 1114 (5th Cir. 1972).

<sup>85</sup> Velez v. Novartis Pharm. Corp., 244 F.R.D. 243, 256, (S.D.N.Y. 2007) (finding it reasonable for the EEOC to investigate pay and promotion claims as part of a gender discrimination claim where part of the complaint specifically referenced denial of merit pay raises).

<sup>86</sup> Kovacevich v. Kent State Univ., 224 F.3d 806, 813-16 (6th Cir. 2000) (affirming the district court's award of judgment as a matter of law for defendant university for Age Discrimination in Employment Act (ADEA) based on 11th Amendment immunity, but finding an Equal Pay Act violation claim could proceed where Congress had properly abrogated 11th Amendment immunity from Equal Pay Act claims) (citing Kimel v. Fla. Bd. of Regents, 528 U.S. 62 (2000), Timmer v. Mich. Dept. of Commerce, 104 F.3d 833 (6th Cir. 1997)).

<sup>87</sup> *Id.* at 814 (noting the plaintiff was approved for merit awards seven of eight times she applied, but her award was reduced twice and disallowed once by the Dean of the College of Education).

<sup>88</sup> See Herman v. Roosevelt Fed. Sav. & Loan Ass'n, 432 F.Supp. 843 (E.D. Mo. 1977), *aff'd*, 569 F.2d 1033 (8th Cir. 1978); see also 42 U.S.C. § 2000e-2(h) ("it shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a bona fide seniority or merit system").

which measures earnings by quantity or quality of production . . . provided that such differences are not the result of an intention to discriminate . . . .<sup>89</sup>

After a plaintiff has established a prima facie case under the federal Equal Pay Act, a bona fide merit pay system can be used to justify the difference in pay and shift the burden back to the plaintiff to show the district's justification was pretextual.<sup>90</sup> This begs the question: what does bona fide mean? A merit system "must be an organized and structured procedure whereby employees are evaluated systematically according to predetermined criteria [and] the system must be based on actual performance which can be evaluated" that the employees are aware of and is not based on sex.<sup>91</sup> The Fifth Circuit has voiced concern that a broad interpretation of the exception would allow the exception to swallow the rule against discrimination, and the exception should accordingly be narrowly interpreted.<sup>92</sup>

A school district's desire to improve faculty may be an overriding purpose to survive an equal protection claim, but the policies and procedures used to implement the faculty improvement must be clearly related to the purpose of improving the faculty.<sup>93</sup>

The standard used by employers to award merit pay most often appears to measure *individual performance*, and not the performance of a third person.<sup>94</sup> The use of a third person

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<sup>89</sup> 42 U.S.C. § 2000e-2(h).

<sup>90</sup> *Nixon v. State*, 625 A.2d 404, 407-10 (Md. Ct. Spec. App. 1993) (affirming judgment in favor of the state under the Maryland Equal Pay for Equal Work Act where the plaintiff was denied promotion because she lacked a doctoral degree from an accredited institution but claimed discrimination based on another professor's awarded promotion; the court found in part that plaintiff did not perform work comparable to the promoted professor, and the merit system did not discriminate based on sex).

<sup>91</sup> *EEOC v. Aetna Ins. Co.*, 616 F.2d 719, 725 (4th Cir. 1980).

<sup>92</sup> *Weeks v. S. Bell Tel. & Tel. Co.*, 408 F.2d 228, 235 (5th Cir. 1969).

<sup>93</sup> *Baker v. Columbus Mun. Separate Sch. Dist.*, 462 F.2d 1112, 1114 (5th Cir. 1972).

<sup>94</sup> *See Coe v. Cascade Wood Components, Inc.*, 1988 WL 125893, No. 86-1641-FR, at \*7-8 (D. Or. Nov. 23, 1988) (finding the employer failed to establish its affirmative defense of a merit system using a variety of performance measurements, including "ability and skill, speed and accuracy, experience (including versatility), dependability, and attitude" after plaintiff had proven prima facie case of claimed violations of the Equal Pay Act and Title VII).

may cast serious doubt on an employer's ability to claim a defense based on a bona fide merit system when viewed in light of the recent studies showing a lack of correlation between merit pay and performance. This applies to the award of individualized teacher merit pay based on student performance.

*c. Merit Pay Based on Agency Performance May Inhibit Discrimination Claims*

School districts may have an interest in seeking merit pay based on performance of the school instead of performance of the individual teachers or their students. Merit pay based on agency performance, discussed in Part II.A, *supra*, could be a method of avoiding a discrimination claim as pay would be affected for a group instead of an individual. Merit pay based on agency performance would also reduce or eliminate concerns of inhibiting cooperation between teachers within a school, which may be an incident of the competitive nature of individualized merit pay. Merit pay based on an individual school's overall performance would not help a state's desire to promote inter-district cooperation to improve student education state-wide as individual teachers may be reluctant to share information with their potential competition.

**3. State Statutes Mandating Method of Merit Increases**

A district can violate the law even where a merit pay system is dependent upon tenure and not upon performance. A district violated state law when it entered into an agreement with the union which allowed faster merit increases; the state Education Code required incremental salary steps based on the number of years of service and a "uniform allowance for years of training and years of experience."<sup>95</sup> Some teachers lost credit for years of seniority which

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<sup>95</sup> *Adair v. Stockton Unified Sch. Dist.*, 77 Cal. Rptr. 3d 62, 64-70 (Cal. Ct. App. 2008) (finding the district violated the uniformity requirement of Cal. Education Code § 45028 where the new system penalized teachers with 17 to 20 years experience as compared to teachers with 18 to 26 years experience).

resulted in disparate treatment in violation of the uniformity required by the state Education Code.<sup>96</sup>

Merit pay systems based on identifiable performance measures can be distinguished from merit systems based on seniority. Merit systems which are held as a seniority system do not support a cause of action under Title VII because a bona fide seniority or merit system is outside of Title VII's scope.<sup>97</sup> A system implemented as part of a "facially neutral bona fide seniority system" is unavailing to a plaintiff even if a disparate impact results unless the plaintiff shows that the system was adopted because of its discriminatory impact.<sup>98</sup>

### **C. Contractual and Statutory Retirement Effects**

The adoption of a merit pay system may have the unplanned consequence of changing the amount of retirement pay an employee receives. Some, including the Mackinac Center, have argued that retirement pay will not be affected in the case of privately funded merit pay.<sup>99</sup> Performance Salary awards, similar to merit pay, may be included in calculation of retirement benefits where the Performance Salary award was considered compensation tied directly to employee performance.<sup>100</sup> Merit pay should be a form of compensation under a broad

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<sup>96</sup> *Id.* at 69-71 (finding the district violated the uniformity requirement of Cal. Education Code § 45028 where the new system penalized teachers with 17 to 20 years experience as compared to teachers with 18 to 26 years experience).

<sup>97</sup> *Sanchez v. City of Santa Ana*, 928 F.Supp. 1494, 1504-05 (C.D. Cal. 1995); 42 U.S.C. § 2000e-2(h) ("it shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a bona fide seniority or merit system").

<sup>98</sup> *Sanchez v. City of Santa Ana*, 928 F.Supp. 1494, 1504-05 (C.D. Cal. 1995).

<sup>99</sup> *Shane, supra*, note 30 (stating that merit pay should be treated as self-employment income which is not considered part of the employee's salary for retirement calculations or for workers compensation).

<sup>100</sup> *Tollefson v. Wyo. State Ret. Bd.*, 79 P.3d 518, 523-24 (Wyo. 2003) (construing Performance Salary awards as salary for retirement calculations where the contract did not classify Performance Salary awards as gratuitous bonuses and left no doubt that the district intended the payments as part of a compensation scheme which determined how employees earned their salary in spite of the district's contention the awards were discretionary bonuses which should not be included for retirement payment purposes ).

interpretation of “compensation” which is the basis for retirement pay.<sup>101</sup> Merit pay may also be included in the definition of compensation by statute.<sup>102</sup> Merit pay, even if provided from a private source, should be viewed as compensation which increases the compensation received for services performed on which retirement pay is calculated.

## **E. Summary**

Teacher merit pay is not illegal *per se*. There are several legal obligations which impact the successful implementation of a merit pay system, including systems for teachers. Merit pay may not violate employee rights, including bargaining rights, the right to be free from illegal discrimination, and miscellaneous state statutory rights which regulate merit increases. Laws may require additional consequences as a result of merit pay, including an increase in retirement pay.

## **V. PRIVATE FUNDING FOR TEACHER MERIT PAY**

Merit pay in the public sector presents additional concerns compared to merit pay in the private sector. In the private sector, the only groups with a general interest in merit pay are the employer, the employees and their unions. The general public and the states are not involved in private sector merit pay unless a law is violated. Outside organizations are not concerned because it is highly unlikely a private organization will fund merit pay for another employer’s workers. Teacher merit pay has been addressed in several ways, but *private funding* of merit pay

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<sup>101</sup> See generally *Slee v. Pub. Sch. Employees Ret. Sys.*, No. 277890, 2008 WL 4276479, at \*2-5 (Mich. App. Sep. 16, 2008) (holding that compensation should be broadly interpreted for retirement purposes, but did not include the reimbursement of FICA taxes).

<sup>102</sup> Public School Employees Retirement Act of 1979, M.C.L. 38.1303a(1), (2)(h) (“[C]ompensation’ means the remuneration earned by a member for service performed as a public school employee [and] includes salary and wages and all of the following . . . [m]erit pay as established by a reporting unit for the purpose of rewarding achievement of specific performance objectives.”).

has not been addressed by court cases or law reviews. The legality of private funding of teacher merit pay is a groundbreaking new area of law which has not been adequately analyzed.

This section addresses the special issues regarding merit pay in the public sector; the most important issue is conflict of interest rules. Conflict of interest rules are generally applicable only to certain groups of public employees – public officials. The conflict of interest rules place broad restrictions on public officers, prohibiting acts which benefit the officers or the people close to them. Conflicts of interest cause harsh consequences, including disqualification from the voting process, ouster, and fines for the conflicted official, and the invalidation of contracts entered into by a conflicted office.

Teacher merit pay is usually authorized by school board members, or some other body of persons who qualify as public officers. Public officers are subject to special rules called conflict of interest rules. Public officers who authorize a merit pay system may violate conflict of interest rules and invoke severe consequences as a result. A public officer or board is conflicted if the officer obtains a personal profit as a result of official action, including the authorization of merit pay, even if the profit is for services actually performed for the schools in good faith, without fraud, and for services which benefited the school system. The conflict of interest rules are interpreted broadly, and extend much farther than personal profit. Conflict of interest rules includes direct or indirect benefits to the officer even if there is no financial harm to the school.

The most basic conflict of interest rule which may be violated is *any action which prevents the proper fulfillment* of the applicable public office. This includes the duty to provide a public education for a public officer in the public school system. This conflict may be present where a school board authorizes merit pay in which some outside organization is allowed to determine how the merit pay will be awarded. The loss of control of teacher salaries creates a

conflict which is non-actionable against the teacher who must choose between performing duties set by the school district administration to provide a public education, or performing duties for the purpose of maximizing the chance to receive merit pay from the private organization.

The conflict does not create consequences against the conflicted teacher unless the teacher violates a local conflict of interest policy. The consequences for the *conflicted public officer*, however, are severe. The officer is disqualified from the voting processes where a *potential or actual* conflict exists, which may include voting on merit pay. Failure to abstain from the deliberation and voting process where a conflict exists could result in the ouster of the public officer school board member, and the possible imposition of fines depending of the circumstances and the applicable state statutes. If a conflicted board authorizes merit pay as a contractual arrangement, the contract may be invalidated as a result of the conflict.

#### **A. What Law Should Apply? Public Officers Distinguished from Public Employees**

The use of merit pay in public employment is of special significance in analyzing merit pay legality issues. To determine what law applies, it is necessary to determine which laws apply to the various persons involved. Public employees as a set of people, includes public officials as a subset. Public school teachers and administrators are considered public employees, and the laws affecting public employees are applicable. As public employees, teachers are not covered by the same laws as school board members who are classified as public officers. Additional laws and rules apply to public officers. Merit pay may have impact on both teachers and school administrators, but the legal consequences are much more prominent and applicable to the public officers who enact a merit pay system.

Although public officials and officers are always public employees, the reverse is not necessarily true; not all public employees are public officers.<sup>103</sup> An office has been defined as “a public station conferred by the appointment of government. The term embraces the idea of tenure, duration, emolument and duties fixed by law. Where an office is created, the law usually fixes its incidents, including its terms, its duties and its compensation.”<sup>104</sup> Several factors are relevant to determine if an individual is a public officer holding a public office, or is a public employee.<sup>105</sup> School board members possess several qualities which favor public officer status, including: they are usually appointed or elected, the conditions of board membership are customarily defined by statute, and the members are subject to the laws of public officials.<sup>106</sup>

Public employees, on the other hand, hold positions of public employment which lack the required elements of a public office, such as positions which are not created by law.<sup>107</sup> An employment position which arises out of contract, as opposed to arising out of statute, does not

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<sup>103</sup> *Corsall v. Gover*, 174 N.Y.S.2d 62, 64-68 (N.Y. Sup. Ct. 1958) (finding that a public school teacher does not hold public office); *see also Seymour v. W. Dakota Vocational Technical Inst.*, 419 N.W.2d 206, 207-08 (S.D. 1988) (holding appellant was not a public officer because the position was not created or prescribed by law notwithstanding that appellant held positions as instructor, farm supervisor and department head at a vocational institute).

<sup>104</sup> *Metcalf & Eddy v. Mitchell*, 269 U.S. 514, 520 (1926) (finding neither plaintiffs held official positions where they took no oath of office, could accept concurrent employment, duties were set by contracts and not by statute).

<sup>105</sup> There are several factors which favor a determination that an individual is a public officer serving a public office, including: the position is created by law; the position is designated as a public office; the duties and qualifications of the position are prescribed; the position exercises some portion of sovereign power; the position is for a fixed term; the position requires an oath or bond requirement; the position carries liability for misfeasance in office; and the position has greater independence in comparison to regular employees. 2 RAPP, EDUCATION LAW, § 6.01[2] (Matthew Bender 2010) (stating that “[a]n individual is apt to be considered an officer of a public educational institution when that individual’s salary is fixed by statute; term of office is defined and specific; title is prescribed by law rather than an individual or board; duties are significant; and, performance is relatively free from the commands of a superior.”).

<sup>106</sup> 1 RAPP, *supra* note 105 § 3.04[1].

<sup>107</sup> *Seymour v. W. Dakota Vocational Technical Inst.*, 419 N.W.2d 206, 207-08 (S.D. 1988) (holding appellant was not a public officer because the position was not created or prescribed by law notwithstanding that appellant held positions as instructor, farm supervisor and department head at a vocational institute).

rise to the status of a public office.<sup>108</sup> By this standard, a school administrator may be a public officer, but a public school teacher is not because a teacher's employment arises out of contract.<sup>109</sup> A school superintendent was held to be a public officer where appointment to the "term of office" was provided by state statute, contained a term limitation, and was not created under a private contract even if terms similar to a private contract were used in resolving the remaining employment terms.<sup>110</sup> A determination must be made on a case-by-case basis whether an employee is a public officer.

This paper deals only with the conflict of interest rules applicable to public officers. Other conflict of interest rules, such as those arising out of local contracts or employment policy manuals may have additional impact on the administration of merit pay. Considerations from these conflicts are not considered.

## **B. Sources of Conflict of Interest Rules**

The public officer determination is important because public officers are held to a higher standard than public employees; public officers are bound by conflict of interest rules.<sup>111</sup>

Conflict of interest rules can arise out of the common law or by statute.<sup>112</sup> The common law approach examined whether an incompatibility existed which *prevented the proper fulfillment of*

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<sup>108</sup> *Metcalf & Eddy v. Mitchell*, 269 U.S. 514, 519-20 (1926) (finding neither plaintiffs held official positions where they took no oath of office, could accept concurrent employment, duties were set by contracts and not statute).

<sup>109</sup> *See* 2 RAPP, *supra* note 105 § 6.01[2] (stating that a school superintendent is sometimes considered an officer, but a teacher is not usually considered an officer); *see also* *Corsall v. Gover*, 174 N.Y.S.2d 62, 68 (N.Y. Sup. Ct. 1958) (finding that a teacher does not hold public office and stating "it is well established by authority that a teacher is not a public officer, but is only an employee of the board of education").

<sup>110</sup> *Smith v. Bd. of Educ. of Ludlow*, 111 F.2d 573, 575 (6th Cir. 1940); *cf.* *Main v. Claremont Unified Sch. Dist.*, 326 P.2d 573, 578-83 (Cal. App. 1958) (holding school superintendent was not a public officer; existence of an employment contract was inconsistent with public officer status), *disapproved by* *Barthuli v. Bd. of Trustees*, 566 P.2d 261, 263 (Cal. 1977).

<sup>111</sup> 2 RAPP, *supra* note 105 § 6.01[2] (stating that officers are limited by rules of incompatibility of office, nepotism, conflict of interest, and are usually excluded from tenure).

<sup>112</sup> *Gee & Sperry*, *supra* note 10 at C-24 (stating "[p]rohibitions on conflicts of interest may result from common law precedent or may be statutorily [sic] created.").

*the public office.*<sup>113</sup> Under the common law conflict of interest doctrine of *incompatibility*, if the conflict of interest is due to the acceptance of a public office which is incompatible with the first, then the public officer is considered to have impliedly resigned the first public office upon acceptance of the incompatible public office.<sup>114</sup>

Statutory conflict of interest rules have been applied in many jurisdictions. The statutory conflict of interest statutes are generally supposed to “take school personnel out of the areas of politics and business so that potential conflicts will not occur.”<sup>115</sup> In some cases, school officials must avoid even *potential* conflicts of interest unless a special statute or constitutional amendment allows the potential conflict.<sup>116</sup>

### ***1. Personal Consequences of a Conflict of Interest***

A conflict of interest can cause a conflicted individual to be ousted from office under both the common law and state statutes. A member of the county board of education was ousted from office and the position declared vacated based on a conflict of interest where he was a member of one board while an employee of another county’s board; serving on one board while employed by another board violated state statutory rules, while serving as a member of the board while employed by the same board violated the state’s common law rule against conflicts of interest.<sup>117</sup>

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<sup>113</sup> *See id.*

<sup>114</sup> *Corsall v. Gover*, 174 N.Y.S.2d 62, 64-68 (N.Y. Sup. Ct. 1958) (finding no conflict of interest in holding both positions of city mayor and teacher since the common law doctrine of incompatibility of office is inapplicable because a teacher does not hold public office).

<sup>115</sup> *Gee & Sperry*, *supra* note 10 at C-25.

<sup>116</sup> *Gee & Sperry*, *supra* note 10 at C-26 (“[i]t thus appears fairly certain that school officials and personnel cannot hold two public offices or be in positions where potential conflict exists unless so allowed by special statutes or constitutional amendments”).

<sup>117</sup> *Culpepper v. Veal*, 272 S.E.2d 253, 254 (Ga. 1980) (affirming the trial court’s holding that the Board of Education member was ousted from his office and the position vacated because he was a member of the Ware County Board of Education while also employed by the Brantley County Board of Education).

## ***2. The Law Applicable to Public Officers***

There are several facets to the conflict of interest rules applicable to public officers which are broadly interpreted. The conflict of interest rules prohibit the use of office for personal profit, voting on an issue where a public officer is conflicted, and could cause the avoidance of contracts entered by a conflicted body.

### *a. Personal Profit Creates a Conflict*

A special standard is reserved for public officers which includes conflict of interest rules prohibiting personal benefit to the officer.<sup>118</sup> Public officers are responsible to represent the interests of the public, and are not allowed to use their office for personal profit, or to further their own interests, even if there is no detriment to the public.<sup>119</sup> The element of personal profit prohibits public officers from arranging compensation for themselves, even for services performed in good faith, without fraudulent intent and entered pursuant to the advice of counsel; “an elected official derives equally his authority and compensation from the law and, when both are defined in the law, he can no more enlarge the one than the other.”<sup>120</sup>

A conflict of interest may exist even without direct personal benefit. A conflict of interest in the context of a public official performing the sworn duty of the office has been defined generally as “a clash between the public interest and the private pecuniary interest of the individual concerned.”<sup>121</sup> Conflict of interest problems arise where the officer’s interests are

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<sup>118</sup> 2 RAPP, *supra* note 105 § 6.01[2] (stating that officers are limited by rules of incompatibility of office, nepotism, conflict of interest, and are usually excluded from tenure).

<sup>119</sup> *Buchignani v. Lexington-Fayette Urban County Gov’t*, 632 S.W.2d 465, 467 (1982) (holding defendant was prohibited from operating a commissary for profit in the county jail based on the principle that the holder of a public office may not directly or indirectly use the office for profit even though there was no evidence to show the defendant had violated the public trust in his office as all parties admitted the commissary contributed to the security of the detention center and benefited the county by its cost effectiveness).

<sup>120</sup> *Id.*

<sup>121</sup> *Gardner v. Nashville Hous. Auth. of Metro. Gov’t of Nashville*, 514 F.2d 38, 41 (6th Cir. 1975).

contrary to the public's interest, even where the officer gains no direct benefit. A conflict of interest issue arises for a public officer who uses the public office in a manner to further the officer's interests in a manner which is counter to the public interest even in the absence of bad faith.<sup>122</sup>

The tension between personal pecuniary interests of the officer and the public interest has been compared to a servant's inability to serve two different masters.<sup>123</sup> The prohibition extends beyond personal interests, and prevents a public official from acting as an agent for another in conflict with the official's duties to the public; the public official is disqualified even if there is only the *appearance* of a conflict.<sup>124</sup> The public official is not allowed to place himself in any position which may present a conflict with the duties owed to the public or to create the temptation of acting contrary to the public interest.<sup>125</sup>

The public official is also prohibited from creating relationships which *could* create the temptation or potential for abuse of power for the official's personal benefit.<sup>126</sup> Failing to fully

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<sup>122</sup> Cotlar v. Warminster Twp., 302 A.2d 859, 861-62 (Pa. Commw. Ct. 1973) (ordering return of compensation that township supervisors had no statutory authority to give themselves notwithstanding the supervisors acted under the advice of counsel, in good faith and without fraudulent intent; the compensation was for road inspections the supervisors assigned to themselves and performed by themselves without approval from township auditors as required by statute).

<sup>123</sup> Anderson v. Zoning Comm'n, 253 A.2d 16, 19 (Conn. 1968) (stating "[t]he reason for the establishment of [the principle that an official may not use official power to further his own interest] is obvious: a man cannot serve two masters at the same time and the public interest should not be entrusted to an official who has a pecuniary, personal or private interest which is or may be in conflict with the public interest").

<sup>124</sup> Lake De Smet Reservoir Co. v. Kaufman, 292 P.2d 482, 484 (Wyo. 1956) (holding that the superintendent of the water division should have disqualified himself from deciding plaintiff's case because the plaintiff had paid the superintendent for services rendered the year before and plaintiff owed money to the superintendent at the time of the decision; the appearance of a conflict of interest was sufficient to require disqualification).

<sup>125</sup> Anderson v. Zoning Comm'n, 253 A.2d 16, 19 (Conn. 1968) (stating "[a] public official owes an undivided duty to the public whom he serves, and he is not permitted to place himself in a position which would subject him to conflicting duties or expose him to the temptation of acting in any manner other than in the best interest of the public").

<sup>126</sup> Brown v. Kirk, 355 N.E.2d 12, 14-16 (Ill. 1976) (holding tenants of the Public Housing Authority were prohibited from serving as commissioner of the Authority because a conflict of interest violated the Housing Authorities Act which prohibited acquiring a direct or indirect interest in any project and required full disclosure); *see also* Hoskins v. Walker, 315 N.E.2d 25, 28 (1974) (stating "[t]he obvious purpose to be served in limiting

disclose an interest adverse to the public is considered a betrayal of the public trust and a breach of confidence.<sup>127</sup> Conflict of interest concerns are not applicable to all public employees, but they apply to *all* public officials.<sup>128</sup>

It is clear that conflict of interest rules cause severe consequences to the conflicted public officer. Public officers can not use the office for personal gain, whether or not the gain is pecuniary. In the context of merit pay for public school teachers, a public officer is conflicted if the officer obtains a benefit from the merit pay. If the interest is counter to the public interest, then a conflict exists which may cause the public officer's removal. Although this seems harsh, the removal should be encouraged in order to maintain the integrity of the power entrusted to the public office.

*b. Disqualification from Board Voting Process Based on a Conflict of Interest*

In addition to the personal consequences, a conflict of interest affects an officer's ability to vote in an official capacity. It has been held a conflict of interest where an "administrative official 'votes on a matter in which he has a direct personal and pecuniary interest'" and is of a special concern when the public official obtains personal gains from inside information.<sup>129</sup>

School board members who have a conflict of interest must, at a minimum, recuse themselves from the voting process in which the conflict exists and may be prohibited from

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membership on the State Board of Education to persons not actively engaged in or connected with any school or school system is to prevent any potential conflict of interests and to prevent placing people on the Board whose other interests would naturally tend to promote or favor one segment of the State's educational structure over another").

<sup>127</sup> *Anderson v. City of Parsons*, 496 P.2d 1333 (Kan. 1972) (stating "[i]f he acquires any interest adverse to those of the public, without a full disclosure it is a betrayal of his trust and a breach of confidence") (citing *United States v. Carter*, 217 U.S. 286 (1910)).

<sup>128</sup> *Hous. Auth. v. Dorsey*, 320 A.2d 820, 822 (Conn. 1973) (stating "[t]his [conflict of interest] policy is not limited to a single category of public officer but applies to all public officials").

<sup>129</sup> *Evans v. Hall*, 396 A.2d 334, 335-36 (N.H. 1978) (finding sufficient allegation to support a cause of action against a member of the planning board who allegedly interfered with plaintiff's plan to purchase land when the member purchased the land herself after plaintiffs sought the member's assistance in her official capacity).

serving on the board if the conflict is extensive.<sup>130</sup> Failure to recuse oneself may result in disqualification of that board member's vote, *even if it is only a potential conflict*.<sup>131</sup> If a conflict of interest exists, the member is not allowed to participate in the deliberations because "any official action taken is considered tainted and must be invalidated."<sup>132</sup> Where a member's interest is involved, the member may only participate where the interest is limited to an interest shared in common with members of the public.<sup>133</sup>

There are four common situations where disqualification is required:

- (1) 'Direct pecuniary interests,' when an official votes on a matter *benefiting the official's own property or affording a direct financial gain*;
- (2) 'Indirect pecuniary interests,' when an official votes on a matter that *financially benefits one closely tied to the official, such as an employer or family member*;
- (3) 'Direct personal interest,' when an official votes on a matter that *benefits a blood relative or close friend in a non-financial way, but a matter of great importance . . .*; and
- (4) 'Indirect personal interest,' when an official votes on a matter in which an *individual's judgment may be affected because of membership in some organization and a desire to help that organization further its policies*.<sup>134</sup>

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<sup>130</sup> 1 RAPP, *supra* note 105 § 3.06[3][f][iii]; *Bd. of Educ. v. Kennedy*, 951 A.2d 987, 999-1000 (N.J. 2008) (holding removal of board member was required based on a substantial conflict of interest where member and spouse filed an allegation of an insufficient individualized educational program to accommodate her son and included a demand for payment from the Department of Education for services the spouse provided to her son. "[W]hen a . . . claim includes a request for specific monetary relief, we believe that a line has been crossed and a substantial conflict between a board member and the board can be found to exist").

<sup>131</sup> 1 RAPP, *supra* note 105 § 3.06[3][f][iii]; *West v. Jones*, 323 S.E.2d 96, 100-02 (Va. 1984) (holding that city council member also employed as a school principal had a personal interest which disqualified him from participating in appointments to the school board under the Comprehensive Conflict of Interests Act of 1984 since the member's vote *could* be compromised by inappropriate conflicts; proof of actual compromise was not required to disqualify the council member).

<sup>132</sup> *Friends Ret. Concepts v. Bd. of Educ. Borough of Somerville*, 811 A.2d 962, 970 (N.J. Super. Ct. Law Div. 2002).

<sup>133</sup> *West v. Jones*, 323 S.E.2d 96, 101 (Va. 1984); *Friends Ret. Concepts v. Bd. of Educ. Borough of Somerville*, 811 A.2d 962, 968 (N.J. Super. Ct. Law Div. 2002).

<sup>134</sup> *Friends Ret. Concepts v. Bd. of Educ. Borough of Somerville*, 811 A.2d 962, 967-68 (N.J. Super. Ct. Law Div. 2002) (emphasis added).

The broad disqualification coverage causes a particular problem where a school board votes on a merit pay system which may benefit a member, a member's family or close friends. The safest method is to choose members who have no connections to the schools, similar to how businesses choose non-interested officers for their boards of directors to avoid potential claims of a conflicted board and obtain the benefit of the business judgment rule.<sup>135</sup> At a minimum, school board members, as public officials, should recuse themselves from the deliberations and decision if there is any indirect benefit to the member, his family, or close friends, or if the member's judgment is affected by participation in an organization or a desire to help that organization. Any connection to the member should make a board's decisions suspect regarding merit pay.

*c. Tainted Contracts*

A board's decision involving conflicted members taints the validity of the decision, including the choice to enter a contractual relationship. Conflicts of interest affect the enforceability of contracts entered by a conflicted body. A contract made in violation of conflict of interest rules may be *ultra vires*, or outside the board's authority, and found void or voidable depending on the circumstances.<sup>136</sup> A contract entered by a conflicted Board may also be void by common law conflict of interest in violation of public policy or by a conflict of interest statute if the Board member benefits, even if there is no injury to the school district.<sup>137</sup> A contract is void if anything of value is given to a board member to influence the board member's decision or

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<sup>135</sup> McMullin v. Beran, 765 A.2d 910, 923 (Del. 2000).

<sup>136</sup> 1 RAPP, *supra* note 105 § 4.02[3][c].

<sup>137</sup> Sch. Dist. v. Pomponi, 247 P. 1056, 1057-58 (Colo. 1926) (ordering contract annulled under Colorado statute or alternatively as violative of public policy where school board entered into contract which benefited two of the three board members by private access to district sewer line; no financial injury to the district was required); *see also* Indep. Sch. Dist. v. Collins, 98 P. 857, 859 (Idaho 1908) (remanding for determination whether contract was entered into while individual was a board of trustees member and consequentially void because the benefit conveyed to the member).

to inure a personal benefit to the member.<sup>138</sup> Under the right set of circumstances, a conflict of interest violation could void an employment contract for a public school teacher.<sup>139</sup>

Removal from office may be required if a contract is entered in an official capacity which benefits the member's private employer, even if the member only indirectly benefits because the member is not a shareholder, director or officer; the fact there are limited alternative suppliers available is no defense.<sup>140</sup> Conflicted board members may also be monetarily penalized for violating a conflict of interest statute.<sup>141</sup>

A school board member is presumably a public officer who is subject to both common law and statutory conflict of interest rules. A school board member violates the common law conflict of interest rules when the member votes on merit pay which could benefit anyone in a close relationship with the board member. If the board member fails to recuse himself, the member should be removed from office for violating the public trust. Any contracts entered by the conflicted board should be evaluated for avoidance.

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<sup>138</sup> *Honaker v. Bd. of Educ.*, 24 S.E. 544, 546 (W. Va. 1896) (affirming injunction preventing collection of debt from school board due to improper compensation paid to board member who signed contract for school charts).

<sup>139</sup> *State v. Bd. of Educ. of Dependent Sch. Dist.*, 389 P.2d 356, 360 (Okla. 1964) (granting writ of mandamus to compel Board of Education to pay contractual salary of individual who entered public school teacher employment contract while a member of the legislature; the contract would have been "void and unenforceable" but for the passage of a law during the legislator's term which made the contract enforceable although "subsequent appropriations for state aid by the Legislature, of which he is a member, will, for reasons set forth in this opinion invalidate any subsequent school teaching contract of his which depends upon state aid for its validity").

<sup>140</sup> *Summers County Citizens League, Inc. v. Tassos*, 367 S.E.2d 209, 216-17 (W.Va. 1988) (remanding with orders to remove officers from board of education for authorizing payments to their private employers notwithstanding a lack of "any immoral act, wrongdoing or moral turpitude" and notwithstanding that there were no alternative suppliers in the county).

<sup>141</sup> *State v. Ladner*, 512 So.2d 1271, 1276-81 (Miss. 1271) (remanding to determine penalties for each board member for making emergency contract with non-voting board member's private employer in violation of the public interest and dismissing member defense that contract was entered on counsel's advice that conflict of interest statutes would not be violated if the conflicted member abstained from voting).

*d. Allowing an Outside Organization to Control Merit Pay Prevents the Proper Fulfillment of the Public Duty to Provide a Public Education*

The most basic conflict of interest rule which may be violated is *any action which prevents the proper fulfillment of the public office.*<sup>142</sup> A school board which allows an outside organization to determine how the merit pay is awarded violates conflict of interest rules because it has effectively subordinated the school's authority to control its teachers in the fulfillment of the public duty to provide a public education.

The delegation of control of teacher salaries creates a non-actionable conflict in the teacher who must choose between teaching the lessons set by the school district administration to provide a public education, or teaching lessons for the purpose of maximizing student performance in order to be awarded merit pay. Because teachers are public employees and are not public officers, they are not subject to the conflict of interest rules. This does not mean that the public officers who initiate and maintain a merit pay system do not violate conflict of interest rules when a pay system is partly controlled by an outside organization. The delegation of authority to determine pay for the employees under the district's control prevents the proper fulfillment of the public offices responsible to provide a public education because it undermines the authority of the district to control the teachers and staff in providing the public education.

A school district can potentially eliminate this conflict of interest if the district maintains complete control over merit pay authorization. The conflict is eliminated even where the merit pay is privately funded.

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<sup>142</sup> See Gee & Sperry, *supra* note 10 at C-24.

### **C. Summary**

Private funding of merit pay in the public sector raises concerns which have not yet been addressed by the courts. Conflict of interest rules are present in the public employment environments which are not present in the private sector. The use of privately funded merit pay presents conflicts of interest of two types.

First, a conflict of interest is present when a school public officer, or any of the people the officer is close to, receives a personal benefit, either directly or indirectly related to the implementation of a merit system. The conflict of interest rules are broadly interpreted, and include actual and potential conflicts.

Second, a conflict of interest is created where the privately funded merit pay of public teachers is controlled by a private organization. The private control of merit pay awards creates a conflict of duties within the teachers who must decide whether to properly fulfill their duty to the school district in performance of its public duty to provide a public education, or to attempt to maximize the chances of receiving merit pay by meeting the requirements set by the private organization in control of awarding merit pay. This conflict interferes with the public duty to provide a public education, which prevents the proper fulfillment of the public office for those who allowed the privately funded merit pay to undermine their control of the educational process. The interference with the district's authority to determine the educational process prevents the proper fulfillment of the public office and its duty to provide a public education which is an impermissible conflict of interest.

The result of violating either type of conflict of interest is the severe consequences applicable to the conflicted public officers who initiated and administered the privately funded merit pay. The consequences for violating the conflict of interest rules include ouster from

office, disqualification from voting processes, and avoidance of some contracts entered into by the conflicted public body.

## **VI. CONCLUSION**

The use of a privately funded merit pay system for public school teachers is a new area of law with numerous potential pitfalls. School systems are under tremendous pressure to change, aiming to improve education and control large budget deficits. The presence of several groups and their competing interests means it is unlikely to find consensus on how to improve the school system, including the proper use of funding and merit pay.

Merit pay presents significant hazards in the public sector, including the possible rejection of those in need of a public education – students who rely on public education. There is a lack of evidence which shows that merit pay improves performance in both the non-educational and educational settings. Given the lack of evidentiary support, it is difficult to understand why merit pay has so many advocates.

There are many constraints present if a merit pay system is used for public teachers. A merit pay system can not be used to illegally discriminate and must be administered correctly under the NLRA or applicable state employment relations act. There are additional conditions in a privately funded merit pay situation. Merit pay in a public employment setting implicates conflict of interest rules which are broadly interpreted and carry severe consequences for violations. A school district administration would be ill-advised to initiate a merit pay system for public school teachers without significant advice and planning.