



# BURI FUNSTON MUMFORD FURLONG

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January 15, 2021

Deena Garza, CPA  
Team Bellingham Local Audit Manager  
Statewide Program Manager for Ports, IDCs, AS-BHOs, and AAAs  
Office of the Washington State Auditor  
Insurance Building  
Capitol Campus  
302 Sid Snyder Ave. SW  
Olympia, WA 98504-0021

## **RE: Response to Accountability Audit – Closeout Payments**

Dear Ms. Garza:

I represent North Sound Behavioral Health Organization (BHO) and its successor, North Sound Behavioral Health Administrative Services Organization (ASO). We appreciate the opportunity to respond to the State Auditor's accountability audit for the BHO's closeout.

The audit faults the BHO for: (1) making incentive payments under pre-existing contracts to employees who remained with the ASO after closeout; and (2) prepaying rent for the second half of 2019 and all of 2020 on the BHO's 10-year lease to avoid default and penalties. The audit concludes that the BHO paid \$396,997.00 in retention payments and \$359,969.00 in rent, in violation of Article II § 25 of the Washington Constitution and Health Care Authority (HCA) guidelines.

North Sound respectfully disagrees with the audit's findings for three reasons. First, long-standing Washington Supreme Court precedent approves incentive contracts for State employees. Second, the BHO appropriately avoiding default and penalties on its lease – subject to reimbursement by the ASO. And third, throughout this unprecedented transition to managed care for behavioral health services, the HCA gave North Sound and other BHOs intermittent, inconstant, and inaccurate guidance.

North Sound has and will integrate the Auditor's recommendations into its operations. North Sound urges the Health Care Authority to make similar improvements.

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**I. The BHO Appropriately Contracted With Employees To Retain Them Through Closeout.**

North Sound's transition from a BHO to an ASO meant that close to 30 employees would lose their jobs at closeout. This created a dilemma for the organization: how could it retain essential employees during the six-month transition with no guarantee of employment afterwards? The most valuable administrators, technical experts, and managers would predictably find steady work elsewhere rather than work for North Sound with an uncertain future. North Sound adopted a solution used by countless organizations during restructuring, mergers, and consolidations – incentive payments. Workers who remained employed with North Sound BHO through its transition to an ASO would receive compensation for their loyalty. This would partially counterbalance the significant risk that they would either lose their jobs after transition or have different responsibilities in the new organization.

To launch the program, in February 2019, North Sound offered its employees a written Retention Incentive Agreement. A redacted copy of the Agreement is enclosed. This was not a discretionary bonus for past work but rather an incentive payment for future employment at the BHO. Two provisions establish that employees earned the deferred compensation by remaining with the BHO until the end. First, the term of the Agreement was from the date of signing until June 30, 2019, when the BHO became an ASO.

The term of this Agreement will begin when you sign and return this letter and will end on June 30, 2019, unless your employment ends prior to that for any reason. Nothing in this Agreement alters the nature of your at-will employment with NS BHO, your employment with subsequent related organizations, nor does it alter any of the terms of your employment described in the organization's Personnel Policy and Procedure Manual.

(Retention Incentive Agreement ¶ 1).

Second, the Agreement provided a retention payment if the employee remained with the BHO until June 30, 2019.

You will be eligible for a retention incentive of three (3) month salary, subject to the terms described below.

The incentive will be paid to you on the last regular payroll that includes June 2019, but only if you are still employed (and have been continuously employed) by NS BHO on June 30, 2019.

(Retention Incentive Agreement ¶ 4). The Agreement created a form of deferred compensation that did not vest until the employee worked through June 30,

2019. And it gave key employees an incentive to stay with the BHO until then, despite the risk of no or lesser employment afterwards.

The Retention Incentive Agreement does not violate Article II § 25 of the Washington Constitution. Under that section,

*the legislature shall never grant any extra compensation to any public officer, agent, employee, servant, or contractor, after the services shall have been rendered, or the contract entered into, nor shall the compensation of any public officer be increased or diminished during his term of office. Nothing in this section shall be deemed to prevent increases in pensions after such pensions shall have been granted.*

WA. Const. Art. II, § 25 (emphasis added). The italicized portion is at issue here. The Constitution forbids (1) extra compensation (2) after the services have been rendered. As Washington courts have repeatedly held, the section does not forbid incentive programs, deferred compensation, or contracts that reward *future work*.

The lead case defining this provision is Christie v. Port of Olympia, 27 Wn.2d 534, 179 P.2d 294 (1947). In Christie, the Port of Olympia sought to avoid a wartime longshoreman strike in 1944 by making the following promise:

[Port Manager] Gribble, with full knowledge of the contract between the International and the Waterfront Employers' Association as to the undetermined scale of wages to be paid by the members of the association for work done after October 1, 1944, agreed that, if the members of the local union would continue to work for the Port of Olympia, the port would conform to the conditions of the International-Waterfront Employers' Association contract, as it had done during the preceding ten years.

Christie v. Port of Olympia, 27 Wn.2d at 543. In 1946, the Port paid the longshoreman additional compensation, overtime, and vacation pay based on the International contract.

A taxpayer sued arguing this was unconstitutional extra compensation paid after the fact. The Washington Supreme Court upheld the payments.

The payments contemplated are neither gifts nor 'extra compensation.' Assuming for the present that the contract was legally made, the payments represent compensation which accrued in strict pursuance to a contract made before the work was done. It is true that the resolution providing for the payments is unhappily worded. It speaks of 'retroactive compensation,' but, plainly, it is

*merely deferred compensation that was provided for in the contract.*

Christie, 27 Wn.2d at 543–44 (emphasis added). The same conclusion is appropriate here. By agreeing to remain at the BHO through June 30, 2019 – and then performing that agreement – employees earned the deferred compensation equal to three months' salary. This was not a discretionary bonus, and the BHO would have faced legal liability if it refused to pay.

Washington courts have repeatedly upheld deferred compensation programs like North Sound's. Aldrich v. State Employees' Ret. Sys., 49 Wn.2d 831, 833, 307 P.2d 270 (1957) (“a pension granted to a public employee is not a gratuity but is deferred compensation for services rendered”); Johnson v. City of Aberdeen, 14 Wn. App. 545, 547, 544 P.2d 93 (1975) (“Ordinance did not grant any termination pay to an employee unless at termination he also was eligible to, and did, retire. Thus, the ordinance provided for deferred compensation if an employee met the specified conditions upon retirement”).

Next, the Auditor has cited Attorney General's Office (AGO) opinion 1995 No. 13 as support for its concerns. In fact, the opinion expressly approves incentive programs for public entities.

[C]harter cities, code cities, and charter counties need not have express statutory authority to adopt employee incentive programs. Instead, such entities may adopt such programs so long as they would not be contrary to any constitutional provision or statute. We have located no statute or constitutional provision that prohibits these local governments from establishing employee incentive programs, as defined in this opinion. Accordingly, we conclude that charter cities, code cities, and charter counties have authority to establish such programs.

AGO 1995 No. 13. The Attorney General offers this guidance on constructing an incentive program to satisfy constitutional requirements.

To ensure that employee incentive programs are consistent with these constitutional restrictions, incentives and awards should be provided only for meeting established performance standards or goals that exceed normal employment requirements. Such incentives and awards also should be structured as a component of the compensation in return for which city or county employees provide their services, in such a way that the employees have an expectation of earning the incentives or awards when they are performing their work. This would preclude purely retroactive increases in compensation, including bonuses where the employer decides “after the fact” that one or more employees should receive extra compensation for past services.

AGO 1995 No. 13.

North Sound has complied fully with this advice. Remaining with the BHO until June 30, 2019 – even though the Agency will terminate, far exceeds normal employment requirements. Valuable employees leave as soon as they find new jobs and do not wait to see whether the new Agency will rehire them or provide similar responsibilities. Furthermore, BHO employees knew in advance that they would forfeit the incentive pay if they left before June 30, 2019. If they remained with the BHO until the end, the employees had a contractual right to the incentive pay. North Sound had no discretion after the fact to pay or withhold incentive payments.

Finally, the Auditor has faulted North Sound for making incentive payments only to BHO employees who transitioned to the ASO. For employees not rehired, the BHO, according to the Auditor, appropriately provided the incentive payment. This does not make sense. North Sound contracted with BHO employees to remain until June 30, 2019, and if they did, they were entitled to the deferred compensation. It did not matter whether or not the ASO chose to hire them. The purpose of the program was to maintain a steady workforce at the BHO through June 30<sup>th</sup>. And the employees who stayed had a vested right to the incentive payment.

The Auditor has assumed that “employment terms did not substantially change for those who accepted positions after the transition.” This is incorrect factually and legally. As the Auditor notes, the ASO’s functions are significantly different from those of the BHO. The new BH-ASO covered “only a subset of crisis-related services for Medicaid clients and...limited services to individuals who are not eligible for Medicaid.” ASO employees had substantially different, and less comprehensive, responsibilities than their BHO counterparts. No one kept the same job or the same terms of employment. As a result, valuable employees left the BHO rather than accepting narrower responsibilities with the ASO.

The Auditor is also incorrect on the law. As detailed above, the Constitution bars paying employees discretionary bonuses after the fact for work already performed. It does not forbid incentive programs that pay employees to remain with a public organization through a difficult, and uncertain transition. Because the ASO was a different organization, with different public responsibilities, any employee who transitioned to the ASO necessarily had different terms of employment. Simply put, North Sound’s employee incentive program did not violate the State Constitution.

## **II. Avoiding Penalties For Early Termination Was Appropriate.**

Next, the audit faults the BHO for prepaying rent on its office space for the last half of 2019 and all of 2020. “Under the spend-down guidance from HCA, BHO



reserves must be directly related to support closeout activities and may not be used to pay for services provided beyond the end of the contract period especially start-up or operational costs of the BH-ASO.” There are a number of problems with this conclusion.

The BHO prepaid the rent to avoid more onerous penalties for terminating the lease early. North Sound’s Commercial Lease defined default as “the vacating or abandonment of the Premises by Tenant.” (Commercial Lease ¶ 17.1.4). Default then entitled BHO’s landlord to collect unpaid rent until the premises were re-let, the leasing commission paid by the landlord, reasonable attorneys’ fees, interest, and the costs of collection. (Commercial Lease ¶ 17.2.1).

The BHO’s 10-year lease term expires on January 1, 2026. Default would subject the BHO to open-ended liability for up to five years, or until the landlord could find a new commercial tenant.

The parties negotiated an exception, however, set forth in Exhibit E to the Lease. At the five-year mark, the BHO had a one-time option to terminate the Lease by paying only a \$62,969.00 real estate commission. (Commercial Lease, Exh. E ¶ 2). The BHO could exercise this option during a limited three-month window.

Tenant’s right to terminate this Lease early is a one-time right with notice required to be delivered during the 57<sup>th</sup> month of the Lease Term, measured from the Commencement Date, with such termination being effective on the last day of the month 60 of the Lease term at 11:59 p.m. (“Termination Date”).

(Commercial Lease, Exh. E ¶ 1). To exercise this option, the BHO had to pay rent through December 2020 and give notice of termination in September 2020. The BHO did both, and successfully terminated the Lease without penalty.

By prepaying rent from June 30, 2019 through December 31, 2020, the BHO saved the Health Care Authority a significant penalty. Neither the Constitution nor Washington statutes required the BHO to incur the penalty nonetheless.

In response to the Auditor’s concerns, North Sound has directed that the BHO charge the ASO for 18 months of prepaid rent, from July 2019 through December 2020. The BHO will then turnover the collected funds to the HCA at closeout.

### **III. The HCA Provided Intermittent, Inconsistent, And Inaccurate Guidance.**

Finally, North Sound disagrees that alleged flaws in the BHO’s spenddown plan arose from North Sound’s failure “to adequately consult with HCA and/or its legal counsel to ensure these types of payments were reasonable, supported and allowable.

The closeout audit examines a one-time event in hindsight: the transition from Behavioral Health Organizations to Administrative Service Organizations. Both North Sound and the Health Care Authority were acting in good faith under novel circumstances. It is extremely unlikely these events will ever happen again.

Despite the unique circumstances, the Audit addresses only one side of this transition, criticizing North Sound for not adequately consulting with HCA and its legal counsel. There is another side to this story.

North Sound submitted its 57-page closeout plan to HCA on June 8, 2018. The only substantive comments North Sound received from HCA was a one-page email on July 18, 2018, enclosed with this letter. A bullet point in the email advised North Sound that, "staff retention can be used for the purpose of fulfilling the requirements of the contract through 12/31/18 and to complete necessary closeout activities in 2019. Please revise" (7/18/18 HCA email). North Sound revised the closeout plan to clarify and direct that employee retention incentives were solely for completing the BHO's contacts and necessary closeout activities.

North Sound submitted its revised closeout plan on January 4, 2019. Other than receiving an email acknowledging receipt, North Sound received no other substantive guidance or review of the revised closeout plan. HCA provided intermittent help at best, leaving North Sound to interpret a cryptic email in response to a complex document.

Furthermore, the HCA offered inconsistent and inaccurate guidance. The audit notes that North Sound and other BHO's could offer "severance packages" to its departing employees. Under the Auditor's analysis, these packages would be unconstitutional – providing additional compensation after the work is completed. North Sound consulted with HCA at every step and revised its closeout plan to comply with HCA's comments. It received minimal assistance from the HCA. The guidance it did receive was ambiguous and at times, incorrect.

It is both inaccurate and unfair to blame only North Sound for a failure to communicate during the transition. North Sound welcomed help from HCA but received little.

## **CONCLUSION**

Once again, North Sound appreciates the opportunity to respond to the closeout audit. As a public Limited Liability Company of Whatcom, Skagit, Island, San Juan, and Snohomish Counties, North Sound continues to provide critical behavioral health administrative services to the most vulnerable populations.

North Sound shares the Auditor's mission to ensure public funds for this purpose are used wisely and lawfully.

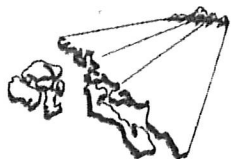
Sincerely,

BURI FUNSTON MUMFORD & FURLONG, PLLC

A handwritten signature in blue ink, appearing to be 'PB', with a long horizontal stroke extending to the right.

Philip Buri  
enclosures





# **North Sound Behavioral Health Organization, LLC**

301 Valley Mall Way, Suite 110, Mount Vernon, WA 98273  
<http://northsoundbho.org> • 360.416.7013 • 800.684.3555 • F 360.416.7017

## **RETENTION INCENTIVE AGREEMENT**

### **1. Duration**

The term of this Agreement will begin when you sign and return this letter and will end on June 30, 2019, unless your employment ends prior to that for any reason. Nothing in this Agreement alters the nature of your at-will employment with NS BHO, your employment with subsequent related organizations, nor does it alter any of the terms of your employment described in the organization's Personnel Policy and Procedure Manual.

### **2. Position**

You will be employed in your current position, devoting your best professional efforts, time and skill to the performance of the duties originally undertaken under your current job description. You will continue to report to your current Supervisor unless circumstances make reassignment necessary. NS BHO retains the full discretion to change or reassign you as it sees fit for the duration of your employment.

### **3. Compensation**

Your compensation will remain the same, and you will be paid in accordance with NS BHO's normal payroll procedures.

### **4. Retention Incentive**

You will be eligible for a retention incentive of three (3) month salary, subject to the terms described below.

The incentive will be paid to you on the last regular payroll that includes June 2019, but only if you are still employed (and have been continuously employed) by NS BHO on June 30, 2019.

You will be responsible for all taxes on the retention incentive just as you are for any other compensation.

### **5. Governing Law**

This Agreement shall be interpreted in accordance with and governed by the laws of the State of Washington.

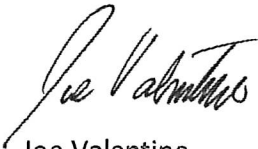
### **6. Modification**

This Agreement may be modified, amended, or superseded only by written agreement between NS BHO and you.

Please contact Margaret Rojas if you have any questions or wish to discuss this offer. If you accept the terms of this Agreement, please sign below in the space provided.

Thank you again for your continued service to NS BHO and for your commitment to our mission.

Sincerely,



Joe Valentine  
Executive Director

I understand that my employment is at-will and that this offer does not change my at-will status. By signing below I represent that I intend to continue employment with NS BHO at least through June 30, 2019. I understand that NS BHO is offering this retention incentive in reliance upon my representation and I agree to the terms and conditions.

Signature:  Date: <sup>APR</sup> March 4, 2019

Printed Name: 

## Philip Buri

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**From:** Claycamp, Teresa L (HCA) <teresa.claycamp@hca.wa.gov>  
**Sent:** Wednesday, July 18, 2018 5:58 PM  
**To:** Bill Whitlock; Joe Valentine  
**Cc:** Vijay, Kirti (HCA)  
**Subject:** FW: Spend Down Plan  
**Attachments:** NorthSoundBHOSpendDownPlan2019.docx

Thank you for submitting your draft spenddown plan. The review team has met and reviewed the draft plan.

Below are areas where we are requesting more information or revisions.

1. Narrative Spenddown Plan:

- Record retention section – Please review CFR § 438.3 (u), as some retention requirements have recently increased to ten years. Please revise accordingly.
- Staff wages section for necessary closeout staff – Please list out the staffing plan for personnel that you plan to have on staff post closeout. List out position title and FTE amount. If the position title is not clear (such as fiscal or data staff), indicate what close out activities this individual will be doing. Please list out costs or reference the line item title for expenditures on your attached budget.
- Staff retention bonus section – States that staff retention is for the purpose of “ASO transition”. This is not an allowable expense. Staff retention can be for the purpose of fulfilling the requirements of the contract through 12/31/18 and to complete necessary closeout activities in 2019. Please revise.
- Severance pay – what are the requirements for this? Staying on until what date? Which staff?
- Annual audit costs – please provide more detail on what this entails.
- Overall, more detail would be helpful. If we have limited information, it will make it difficult to come to a mutually agreed upon plan.....and our goal is to approve a plan by end of August.

2. Budget

We will need the budgets broken down between Medicaid and non-Medicaid, mimicking the structure of the R&E's. Kirti will be sending a template in the next few days to assist with this request.

3. MH Inpatient Costs – Please provide projection of costs using historical data. Please provide details on the methodology used on projecting IP costs and tail liability.

Hospital Bills Post Closeout:

The BHO is responsible for all active inpatient stays up until the closeout date (i.e. through the end of the contract). The Managed Care Entities (MCEs) will be responsible for any services authorized post closeout date.

Inpatient risk reserves (both non-Medicaid and Medicaid) need to be able to cover projected inpatient costs during 2018 and after the closeout of the BHO. These reserves need to cover any inpatient stays authorized by the BHO prior to closeout, as well as cover any outstanding inpatient bills. Keep in mind that hospitals have up to a year to bill.

The BHO will need to provide a projection of inpatient costs that will be outstanding post closeout.

Let us know what questions you have. Once we get an updated version, we will either schedule a phone call to discuss any lingering questions/concerns or we'll be ready to approve.

Thank you for your diligence in this matter!

Teresa

**Teresa Claycamp, LMHC**

Medical Program Specialist 3

Division of Medicaid Program Operations and Integrity

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[Teresa.Claycamp@hca.wa.gov](mailto:Teresa.Claycamp@hca.wa.gov)

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Health Care Authority

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**From:** Bill Whitlock <[bill\\_whitlock@northsoundbho.org](mailto:bill_whitlock@northsoundbho.org)>

**Sent:** Friday, June 8, 2018 11:47 AM

**To:** Leppa, Justin (DSHS/BHA) <[leppaj@dsht.wa.gov](mailto:leppaj@dsht.wa.gov)>

**Cc:** Joe Valentine <[joe\\_valentine@northsoundbho.org](mailto:joe_valentine@northsoundbho.org)>

**Subject:** Spend Down Plan

Attached is the North Sound BHO spend down plan. These are for the funds to be spent after the normal operating of the BHO 12/31/18. The problem is we are having state funding short falls due to the IMD issues.

Let us know if you have any questions or comments.

Bill Whitlock

***Fiscal Officer***

North Sound BHO

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