REGISTRY'S SUMMARY[1]: ***Elkjaer et al. (No. 2), Applicants v. International Monetary Fund, Respondent***, IMFAT Judgment No. 2023-1 (January 30, 2023)

DIRECT CHALLENGE TO "REGULATORY DECISION" – "RULES-BASED" STAFF COMPENSATION SYSTEM – "FUNDAMENTAL AND ESSENTIAL" CONDITIONS OF EMPLOYMENT – DISCRETIONARY AUTHORITY OF MANAGEMENT AND THE EXECUTIVE BOARD – ORAL PROCEEDINGS – REMEDIES – LEGAL FEES

Applicants, five staff members of the Fund, all principals or former principals of the Staff Association Committee ("SAC"), challenged the FY2022 staff compensation decision, approved by the Fund's Executive Board ("Board") on April 21, 2021, with effect from May 1, 2021. Applicants brought their case pursuant to Article VI (2) of the Tribunal's Statute, which provides for direct challenges to "regulatory decisions," that is, rules of the Fund concerning terms and conditions of staff employment.

The Tribunal decided on its own initiative, after seeking the views of the parties, to hold oral proceedings in the case, limited to the oral arguments of counsel. The proceedings were "open to all interested persons" (Statute, Article XII; Tribunal's Rules of Procedure, Rule XIII) via video link accessible to all Fund staff. Additionally, on an exceptional basis and after seeking the views of the parties, the Tribunal decided to grant staff access to the written pleadings in the case, in the context of a challenge to a regulatory decision affecting the staff generally.

Applicants' challenge focused on the Fund's implementation, in relation to the FY2022 staff compensation decision, of the "safeguard mechanism" adopted by the Board in 2019 as part of the Comprehensive Compensation and Benefits Review ("CCBR") decision. The CCBR decision, which was the first major revision to the staff compensation system since 2006, decoupled annual adjustments to the Fund's payline from total salary increases. The safeguard mechanism is designed to ensure competitiveness of Fund salaries by first determining whether, on average, staff salaries remain within a range of 98-102 percent of the market-adjusted pay-grade midpoints. This determination is made by calculating the "comparatio," which is the average of salaries for each pay grade relative to its midpoint, weighted by the number of staff members at each pay grade. If average salaries fall below the 98 percent threshold (or above the 102 percent ceiling), the Fund is to undertake a four-factor analysis of whether salaries remain competitive in the market. Based on that assessment, the Fund may adjust the total annual salary increase.

Applicants alleged that the Fund misapplied the safeguard mechanism rules for the FY2022 compensation round by: (a) utilizing salary data that terminated prior to the end of the Fund's financial year, so that it did not reflect annual wage erosion for the full financial year;

[1] This summary is provided by the Registry to assist in understanding the Tribunal's Judgment. It does not form part of the Judgment. The full Judgment of the Tribunal is the only authoritative text. The Tribunal's Judgments are available at: www.imf.org/tribunal.

and (b) applying a 2.8 percent average total salary increase, which was the salary increase applicable to Grades A1-B3 staff members but did not take account of the 1.8 percent salary increase applicable to Grades B4-B5 staff members. Applicants submitted that these alleged errors likely had a material effect on the outcome of the comparatio calculation, leading to a lower total salary increase than that to which staff members were entitled.

The Fund, for its part, maintained that the FY2022 staff compensation decision was taken fully in accordance with the safeguard mechanism rules, and that the decision represented a lawful exercise of the Board's discretionary authority. That decision, asserted the Fund, was based on an appropriate consideration of all relevant facts, reasonably related to the objectives it was intended to achieve, and not improperly motivated.

The Tribunal noted at the outset that its '"deference is at its height when the Tribunal reviews regulatory decisions (as contrasted with individual decisions), especially policy decisions taken by the Fund's Executive Board.'" (Para. 80.) The Tribunal further observed that the challenged FY2022 staff compensation decision was proposed by Management and adopted by the Executive Board, following a multi-step decision-making process.

In a variety of contexts, the Fund constrains its discretionary authority by adopting rules governing the particular exercise of discretion. "In the context of a challenge to a regulatory decision affecting staff compensation," the Tribunal considered that "the Fund's obligation to adhere to its written rules will be heightened. This is so because a 'fundamental and essential' condition of staff employment is that the compensation system will be 'rules-based' and 'comparator-based.'" (Para. 82.) "The Board's annual decisions setting staff salaries are therefore closely cabined by the rules-based and comparator-based character of the compensation system." (*Id.*) Accordingly, in deciding Applicants' challenge to the FY2022 staff compensation decision, the Tribunal would "scrutinize closely the Fund's adherence to the governing rules," as found in the compensation system's current iteration, the 2019 CCBR decision, including the safeguard mechanism. (Para. 84.)

The Tribunal additionally observed that "[t]he Fund's staff compensation system recognizes that there is 'scope for management and the Executive Board to exercise judgement, within defined parameters, in setting salary levels.' (Board Paper, p. 3.)" (Para. 85.) The parties disputed how much discretion is afforded by the safeguard mechanism and how that discretion is allocated between Management and the Board.

With these principles in mind, the Tribunal first addressed Applicants' allegation that Management's implementation of the safeguard mechanism was flawed insofar as the comparatio had been calculated using salary data running only through March 1, 2021, when the text of the safeguard mechanism rule called for data through the "end of the financial year." The Fund argued that it was within Management's discretion to use "latest available data" in preparing the proposed staff compensation decision.

The Tribunal concluded that both the text and the purpose of the safeguard mechanism left no room for Management to depart from the definition of financial year given by the Fund's Rules and Regulations, for the following reasons: "First, Rule J-9 of the Fund's Rules and Regulations specifies that the Fund's financial year runs from May 1 through April 30. Second, the purpose of the safeguard mechanism is to take account of a full year of wage erosion and to compare it to the previous year in setting the annual staff compensation. Third, applying the safeguard mechanism rules in an imprecise and variable manner is inconsistent with the principles of 'predictability, consistency, and transparency' (CCBR Overview Paper, p. 8) that the Fund itself acknowledges inhere in a rules-based staff compensation system." (Para. 93.) "[T]he failure of the Fund to follow the 'end of the financial year' rule as written undermines these principles, and, along with them, the trust of the staff in the process." (Para. 92.) The Tribunal accordingly concluded that Management, in recommending to the Board the FY2022 staff compensation decision, exceeded its discretionary authority when it interpreted the safeguard mechanism rules to permit it to utilize salary data that terminated prior to the end of the Fund's financial year, that is, April 30, 2021.

The Tribunal next addressed Applicants' second allegation, that Management failed to follow the safeguard mechanism rules by applying a 2.8 percent average total salary increase in calculating the comparatio. That was the salary increase applicable to Grades A1-B3 staff members, but it did not take account of the 1.8 percent salary increase applicable to Grades B4-B5 staff members. Applicants contended that the comparatio was to assess whether "actual" Fund salaries were aligned with the pay-grade midpoints. The Fund countered that the text of the safeguard mechanism required calculation of the comparatio on the basis of the indexation formula, that is, before application of a discretionary lower salary increase for Grades B4-B5 staff.

The Tribunal concluded that the terms of the safeguard mechanism did not compel the interpretation that Applicants urged. Unlike with regard to the "end of the financial year" requirement, Applicants had not brought to the Tribunal's attention any higher norm, such as is found in the Fund's J-Rules, that would constrain Management's authority. The Tribunal accordingly concluded that it was within Management's discretion to calculate the comparatio by using the 2.8 percent salary increase applicable to the vast majority of Fund staff, even while those at Grades B4-B5 were to receive an increase of 1.8 percent. The Tribunal acknowledged that there may be other approaches that would better align the safeguard mechanism's purpose of ensuring the market competitiveness of Fund salaries with its methodology in relation to a segment of Fund staff that is not subject to market-based increases. However, the Tribunal could not say that it was unreasonable of the Fund to have made the choice that it did. "This decision fell within the 'scope for management and the Executive Board to exercise judgement, within defined parameters, in setting salary levels.' (Board Paper, p. 3.)" (Para. 100.)

Having concluded that Fund Management had (in respect of Applicants' first allegation) failed to comply fully with the safeguard mechanism rules, by calculating the comparatio on the basis of salary data that terminated before the end of the financial year, the Tribunal turned to the ultimate question in the case: Given Management's flawed implementation of the safeguard mechanism, was the Board in a position to exercise properly its discretionary authority in taking the FY2022 staff compensation decision?

In answering that question, the Tribunal considered that "[i]n exercising its discretionary authority, the Board was bound by the rules it prescribed for Management to follow as a prerequisite to the Board's taking the ultimate decision on annual staff compensation." (Para. 112.) In its 2019 CCBR decision, the Board had identified what facts would be relevant to assessing whether a particular annual increase will continue to maintain the market competitiveness of staff salaries. Those facts included performing the comparatio calculation utilizing salary data running through the end of the Fund's financial year.

The Tribunal rejected the Fund's argument that the FY2022 staff compensation decision should be upheld because, in taking that decision, the Board had considered and rejected arguments presented by SAC that were the same as those that Applicants raised before the Tribunal. The Tribunal held that the "consultative process does not . . . excuse non-compliance with applicable rules." (Para. 105.) Accordingly, "the fact that the Board was informed of the controversy, and considered it in the decision-making process, [was] not dispositive of the question before the Tribunal." (*Id.*) The Tribunal also rejected the view that by its FY2022 staff compensation decision the Board had amended the 2019 CCBR decision.

Having reviewed the evidence, the Tribunal additionally found that neither Management nor the Board, as part of the decision-making process leading to the FY2022 staff compensation decision, had performed an analysis of the four factors set out in the further provisions of the safeguard mechanism.

The Tribunal concluded: "The safeguard mechanism sets out a sequential process by which, first, Management is to perform the safeguard analysis within prescribed rules and, second, if the comparatio falls outside the safety corridor, the Board, after applying a four-factor test to assess market competitiveness, may exercise its discretion to adjust the salary increase." (Para. 117.) Accordingly, the "Board's lawful exercise of its discretionary authority in taking the FY2022 staff compensation decision is . . . predicated on Management's full compliance with rules that the Board established when it adopted the 2019 CCBR decision. Given Management's flawed implementation of those rules, the Board was not in a position to exercise properly its discretionary authority in taking the FY2022 staff compensation decision." (*Id.*)

Article XIV (3) of the Tribunal's Statute authorizes the Tribunal to annul a regulatory decision, if it concludes that an application challenging the legality of a regulatory decision is well-founded. In the "singular circumstances" presented by this case, the Tribunal concluded that a remedy short of annulment was appropriate. That is because the failure that the Tribunal had found affected but one component of a multi-step decision-making process: "Annulment of the final step in that process, that is, annulment of the FY2022 staff compensation decision, would be premature given: the terms of Applicants' requests for relief; the interests of the staff and the institution; and the deference to be afforded to the Board before it has had the opportunity to make a properly informed decision." (Para. 121.) The Tribunal accordingly concluded that the appropriate remedy was to place the Board in a position to exercise properly its discretionary authority in relation to the FY2022 staff compensation decision, and for the Board to take any further steps as may, in its view, be warranted.

The operative provisions of the Tribunal's Judgment provide as follows:

1. Management failed to comply fully with the rules governing the safeguard mechanism, as prescribed by the 2019 CCBR decision, when it calculated the comparatio using salary data that terminated prior to the "end of the financial year."

2. To correct the effects of that decision, Management shall rerun the safeguard mechanism calculation for the FY2022 compensation decision on the basis of salary data concluding at the end of the Fund's financial year, that is, April 30, 2021.

3. The Tribunal does not sustain Applicants' additional allegation that Management failed to comply with the safeguard mechanism rules in respect of its treatment, for purposes of calculating the comparatio, of the lower salary increase applicable to Grades B4-B5 staff members.

4. In recalculating the comparatio for the FY2022 compensation decision, Management could nonetheless consider whether to take account of the actual salary increase to Grades B4-B5 staff members of 1.8 percent.

5. If the recalculated comparatio falls below the safeguard threshold of 98 percent, then the Board shall consider whether any adjustment to staff salaries, retroactive to FY2022, is warranted, following an analysis of the four factors set out in paragraph 21 of the 2019 CCBR decision.

6. The Fund shall take all measures necessary to implement any such adjustment to staff salaries.

7. The Fund shall notify all staff members that it has taken the above steps and the results thereof, along with the essential elements of the underlying analysis, in accordance with its commitment to transparency in the compensation review process.

8. The Fund shall pay Applicants $28,987.50, which is the total amount of legal fees and costs they have incurred in the case.