

ATTACHMENT B

STAFF'S ARGUMENT

STAFF'S ARGUMENT TO REMAND THE PROPOSED DECISION FOR THE TAKING OF EVIDENCE

Background

CalPERS' Office of Audit Services (OFAS) conducted an audit of the County of Glenn (Respondent County) to determine whether increases to member payrates were reported to CalPERS in compliance with the Public Employees' Retirement Law (PERL) and the California Public Employees' Pension Reform Act of 2013 (PEPRA). The review was limited to the examination of a sample of active and/or retired employee records from July 1, 2012 through June 30, 2017.

On December 6, 2018, OFAS issued its final public agency review audit report (Audit) of the Respondent County. The Audit found that Respondent County was overreporting payrate to CalPERS by including items of special compensation in payrate and that Respondent County reported pay increases during incorrect reporting periods, both of which caused overreporting of payrate.

Respondent County's reporting errors caused the overpayment of retirement benefits to 56 retirees. CalPERS sought collection of the overpayments from the retirees for the most recent three years of retirement benefits overpayments. Eighteen retired members appealed CalPERS' determination, and those appeals are proceeding separately with the Office of Administrative Hearings (OAH).

CalPERS then invoiced Respondent County for the remainder of the overpayments (referred to as the Employer Liability) made earlier than the most recent three years. Respondent County protested CalPERS' collection attempts and filed an appeal. Following the filing of the Statement of Issues (SOI), Respondent County filed a Motion to Dismiss with OAH.

In its Motion, Respondent County contended that the Administrative Law Judge (ALJ) had the authority to issue a Proposed Decision without the taking of any evidence. Respondent County then argued CalPERS' claim for the Employer Liability is barred by the three-year statute of limitation found in Government Code¹ section 20164(b).

CalPERS filed an Opposition to the Motion to Dismiss objecting to and disputing the ALJ's authority to grant a Motion to Dismiss or to issue a Proposed Decision without the taking of evidence. CalPERS argued that it had the authority to collect the Employer Liability from Respondent County as permitted by CalPERS' contract with Respondent County and PERL Sections 20164 and 20532, and that collection was required to maintain CalPERS' tax-qualified status.

¹ All statutory references are to the Government Code unless otherwise noted.

Prior to issuing his Proposed Decision, the ALJ issued an order bifurcating the proceedings. The ALJ ordered the member appeals, involving the special compensation audit and resulting overpayments, to proceed as a matter separate from the Motion. The ALJ then issued a Proposed Decision granting Respondent County's Motion to Dismiss without taking any evidence.

The Proposed Decision reasons that although the Administrative Procedure Act (APA) never mentions an ALJ's power to refuse to hear any evidence, the power of an ALJ to dismiss a case and refuse to hear any evidence is implied. Then, the ALJ reasons that Section 20164(b) completely bars CalPERS from collecting any overpayments made more than three years past.

The ALJ Lacks the Authority to Dismiss or Issue a Proposed Decision Without Hearing Any Evidence

In the Proposed Decision, the ALJ rules that he has implied authority to dismiss a matter without hearing any evidence.

Contrary to the Proposed Decision, case law indicates that "motions may not be entertained and passed on to the agency boards, at least in proceedings where a hearing officer alone is taking the evidence." (*Frost v. State Personnel Board* (1961) 190 Cal.App.2d 1, 6.) Here, the ALJ is the hearing officer, and is the sole entity taking evidence. Under *Frost*, the ALJ improperly entertained and ruled on the County's motion to dismiss.

Moreover, the ALJ exceeded the authority this Board had delegated to him when he refused to hear any evidence. Section 11425.10 of the Administrative Procedure Act (APA) requires that a matter proceed to an evidentiary hearing. APA Section 11425.25 requires a proposed decision include the "*factual* and legal basis for the decision." (emphasis added). There can be no factual basis for a proposed decision without the taking of evidence. Although the APA does provide for alternative hearing processes, those procedures require acquiescence by all parties to the case. CalPERS did not agree to an alternate process here.

The APA specifically provides for several types of motions which may be brought before an ALJ: 1) motions for joint or consolidated hearings (section 11507.3); motions to compel discovery (section 11507.6); motions for change of venue (section 11508); and motions for a prehearing conference or intervention (section 11511.5). By contrast, the APA does not authorize a motion to dismiss.

In fact, the APA is completely silent regarding the ALJ's ability to dismiss a case, and to refuse to hear evidence. That silence indicates that such motions were intentionally omitted from the APA, showing that the ALJ lacks authority to refuse to take any evidence in a matter.

Regardless, the ALJ here considered some, but refused to consider other, evidence. Both parties submitted requests for official notice, which allows an ALJ to consider

facts and documents generally not subject to dispute. Respondent County submitted one of the invoices issued by CalPERS to recover the Employer Liability, and the ALJ took official notice of that invoice. But the ALJ refused to consider any of the evidence that CalPERS submitted (as well as additional evidence the County submitted).

CalPERS requested official notice of its agency contract with Respondent County, which gives CalPERS authority to directly invoice Respondent County for system costs following CalPERS' periodic investigations like the subject audit. Although the agency contract is a public document not reasonably subject to dispute, the ALJ refused to consider the contract and its relevant provisions.

In addition to his refusal to receive documentary evidence, the ALJ also refused to hear testimony on any of the issues. Without any evidence, there is no record other than the Motion papers and CalPERS' Opposition. This refusal to take evidence violates the APA. Accordingly, the Board should remand the case for a full evidentiary hearing.

IRS and Tax Implications

Moreover, the Proposed Decision ignores the matter's serious tax implications. The ALJ incorrectly concludes that the Internal Revenue Service (IRS) correction procedures for overpayments from a tax-qualified plan set forth in Revenue Procedure 2019-19 (Correction Procedures),² do not require CalPERS to collect the Employer Liability from the Respondent County. In reaching his conclusion, the ALJ states that the IRS Correction Procedures are permissive and provide other options to CalPERS when taking corrective action for the Public Employees' Retirement System (the Plan or System). However, what the ALJ fails to consider is that to the extent CalPERS cannot recoup the full overpayment from the member due to the statute of limitations set forth in the Public Employees' Retirement Law (PERL) Section 20164(b), the IRS Correction Procedures *require* that the Plan Sponsor or another person contribute the difference to the Plan. Accordingly, the Respondent County must pay the Employer Liability.

The CalPERS Plan is a tax-qualified Plan under Section 401(a) of the Internal Revenue Code (IRC) and in order to maintain its tax-qualified status, CalPERS must comply with all requirements of Section 401(a). (Title 2, California Code of Regulations § 553.1.) In addition, consistent with the duties imposed by Article XVI, Section 17 of the California Constitution, CalPERS must prudently administer the Plan in a manner that maintains its federal tax-qualification for the benefit of its current members and beneficiaries.³ State law thus mandates that CalPERS take all actions necessary to maintain its tax-qualified status.

One such requirement is that the Plan operate in accordance with its Plan terms. The PERL sets forth, among other things, the amount of the benefit payable to participants and their beneficiaries. To the extent benefit payments exceed the amount payable

² The Employee Plans Compliance Resolution System (EPCRS or Correction Procedures),

³ California courts have enforced retirement board decisions that were made in order to address federal tax-qualification considerations. See, e.g., *San Diego City Firefighters Local 145 v. Board of Admin. of San Diego City Employees' Retirement System* (2012) 206 Cal.App.4th 594, 620.

under the terms of the Plan, including overpayments like the ones here, the IRS Correction Procedures provide specific guidance for how Plan administrators like CalPERS may correct operational failures. (i.e. Rev. Proc. 2019-19; https://www.irs.gov/irb/2019-19_IRB#REV-PROC-2019-19.)

Under the IRS Correction Procedures, overpayments are benefit payments exceeding “the amount payable to the participant or beneficiary under the terms of the plan.” (Rev. Proc. 2019-19 §5.01(3)(c).) “Overpayments **must** be corrected in accordance with section 6.06(3) for defined benefit plans.” (*Id.*; emphasis added.) It is appropriate to have “the employer or another person contribute the amount of the Overpayment (with appropriate interest) to the plan instead of seeking recoupment from a plan participant or beneficiary.” (Rev. Proc. 2019-19 §6.06(3).) In short, the overpayment must be corrected, and if the overpaid amount cannot be recouped from the members, an appropriate correction includes having the employer or Plan sponsor contribute the amount of the overpayment (with appropriate interest) to the Plan instead.⁴ Consequently, because the Respondent County is both the employer and Plan sponsor, as a practical matter, the IRS Correction Procedures require Respondent County to contribute the remaining uncollected overpayments to the Plan. CalPERS, as the Plan administrator, is neither the employer nor the Plan sponsor and, as such, it is not responsible for making such repayments. The ALJ states that CalPERS has other alternatives, such as the Plan sponsor, from which to recoup the overpayments. However, since Respondent County, not CalPERS, is both the employer *and* Plan sponsor, CalPERS must recoup the payments from Respondent County.

As a tax-qualified Plan CalPERS is subject to the IRS requirements that overpayments must be recouped in instances where the Plan did not operate in accordance with the Plan terms. Accordingly, CalPERS must require full return of the overpaid amounts to the Plan. Because the terms of the Plan limit recoupment from members beyond three years, the Correction Procedures require Respondent County to pay the difference. As discussed below, the Correction Procedures do not conflict with the three-year statute of limitations under PERL Section 20164(b)(1) since that limitation applies solely to the collection of overpayments from members, not employers or Plan sponsors. Therefore, the ALJ incorrectly concluded that CalPERS is limited from recouping the overpaid amounts beyond three years. As such, the matter should be remanded for the taking of evidence regarding the IRS Correction Procedures and their application to the Employer Liability at issue.

CalPERS’ Authority to Collect Under Section 20164

In the Proposed Decision, the ALJ determined that CalPERS is prohibited from collecting the Employer Liability under Section 20164(b). Under Section 20164(b)(1), CalPERS’ right to collect overpayments expires three years from the date of payment. Although the Employer Liability resulted from an audit of Respondent County’s reporting

⁴ Under the EPCRS, the Plan Sponsor is the “employer that establishes or maintains a Qualified Plan for its employees.” Rev. Proc. 2019-19 §5.01(6).

practices, the ALJ erroneously rejected CalPERS' contentions that the overpayments resulted from a periodic investigation subject to Section 20532. Under Section 20532:

The contracting agency shall make the contribution for its employees in this system, as recommended by the actuary and approved by the board and certified by it to the contracting agency.

The contribution may consist of fixed sums, percentages of compensation of contract members, or both, and shall be paid to this system as provided in the contract.

The actual contribution is subject to adjustment by the board as may be necessary on account of any additional prior service credits that the contracting agency may desire to provide for its employees in this system or on account of experience under this system as determined by periodical investigation, valuation and determination required to be made by the board, including adjustments determined as necessary by the board, even after the total contributions determined, plus subsequent adjustments, if any, have been completely paid. (Emphasis added.)

Respondent County's agency contract provides that Respondent County shall pay:

A reasonable amount, as fixed by the Board, payable in one installment as the occasions arise, to cover the costs of special valuations on account of employees of Public Agency, and costs of the periodic investigation and valuations required by law.

The contract also states:

Contributions required of Public Agency and its employees shall be subject to adjustment by Board on account of amendments to the Public Employees' Retirement Law, and on account of the experience under the Retirement System as determined by the periodic investigation and valuation required by said Retirement Law.

Although Section 20532 allows CalPERS to assess fixed sums to agencies "on account of experience under this system as determined by periodical investigation," the ALJ concluded that the Employer Liability, which was discovered and assessed following a periodic investigation of Respondent County's reporting practices, did not result from a periodic investigation. Instead of hearing evidence as to what adjustments result from "experience under this system as determined by periodical investigation," the ALJ declined to hear any evidence on the issue. Instead, the ALJ applied Section 20164(b)(1) in a vacuum, without regard to the Correction Procedures, and incorrectly concluded that because Section 20164(b)(1) limits CalPERS collection of overpayments *from members* made more than three years past, any action to collect the remainder of

the overpayment *from the employer* is barred in all circumstances even when, like here, the employer's erroneous reporting was the cause of the overpayments.

The ALJ's analysis ignores the relevant contract language and the language of Section 20532 that specifically allow CalPERS to assess costs of periodic investigations to Respondent County. Prohibiting CalPERS from assessing the Employer Liability, a cost following the periodic investigation and experience of the system, would render the relevant parts of the agency contract and Section 20532 meaningless surplusage.

Other than through periodic investigations like the audit at issue, CalPERS has no way of knowing if an agency is correctly reporting employee compensation. And the erroneous reporting, coupled with attendant retirement overpayments, may not be detected for an extended period of time. Under the ALJ's analysis, CalPERS would be precluded in all situations from collecting the Employer Liability, even if the errors had occurred for more than ten years and caused substantial overpayments. If the Proposed Decision is adopted, CalPERS members and member agencies would become responsible for repaying errors made by other, unrelated agencies. The responsible agency would not be held accountable for payment of its Employer Liability created as a result of its own errors.

The Matter Should be Remanded for The Taking of Evidence

The Proposed Decision is flawed because the ALJ refused to take any evidence, in violation of the APA, and erroneously dismissed CalPERS' claim for the Employer Liability against Respondent County. The Board should remand the matter for the taking of evidence regarding CalPERS' ability to collect the Employer Liability from Respondent County. Such evidence should include, but not be limited to, the agency contract, testimony from witnesses regarding investigations and resultant costs to the system, the IRS guidelines and their application to the Employer Liability at issue, and other relevant evidence.

For all the above reasons, staff argues that the Proposed Decision be rejected by the Board and remanded for the taking of evidence as described above.

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