

ATTACHMENT A
THE PROPOSED DECISION

BEFORE THE
BOARD OF ADMINISTRATION
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATE OF CALIFORNIA

In the Matter of the Appeal of:

NELEEN FREGOSO,

Respondent,

and

HUMBOLDT TRANSIT AUTHORITY,

Respondent.

CalPERS Case No. 2012-0994

OAH No. 2014040759

PROPOSED DECISION

This matter was heard before Administrative Law Judge Dian M. Vorters, State of California, Office of Administrative Hearings (OAH), on July 8, 2014, in Sacramento, California.

John Mikita, Senior Staff Attorney, represented the petitioner California Public Employees' Retirement System (CalPERS).

Neleen Fregoso (respondent), was present and represented herself.

There was no appearance on behalf of respondent Humboldt Transit Authority (HTA).

Evidence was received and the record remained open through July 23, 2014, to allow the agency decision in *CalPERS v. John F. Foley*, Case No. 2010-1214,¹ to become final. The record closed on July 23, 2014.

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¹ The Decision in *CalPERS v. John F. Foley*, Case No. 2010-1214, was submitted at hearing and marked as Exhibit 20. The decision became effective on July 23, 2014. It was admitted and considered pursuant to Government Code section 11515 and Evidence Code section 452, subdivision (c).

ISSUE

Whether CalPERS correctly excluded a 20 percent salary increase received by respondent in January 2011, as non-compliant with the Public Employees' Retirement Law (PERL), for the purpose of calculating her final compensation and retirement allowance?

FACTUAL FINDINGS

1. The Statement of Issues was made and filed on April 14, 2014, by Karen DeFrank, Chief, Customer Account Services Division, CalPERS, in her official capacity.
2. HTA is a public agency contracting with CalPERS for retirement benefits for its eligible employees. The provisions for local public agencies contracting with CalPERS are set forth in the PERL. (Gov. Code, § 20460 et seq.)
3. Respondent is a retired member of CalPERS. She has over 24 years of service credit. On September 28, 2011, respondent signed her Service Retirement Election Application (Application). She retired from service from HTA as its General Manager (GM) effective October 15, 2011. By virtue of her employment respondent was a miscellaneous member of CalPERS subject to the provisions of the PERL.
4. CalPERS' Compensation Review Unit reviewed the compensation reported by HTA on behalf of respondent. CalPERS determined that some of the compensation paid to respondent during her last year of employment reflected a 20 percent salary increase that was disallowed. CalPERS sent notice of this determination to HTA and respondent by letters dated July 12, 2012. The letters explained that compensation reported to CalPERS must meet the criteria for "compensation earnable" as outlined in Government Code sections 20630 and 20636, and California Code of Regulations, title 2, sections 570 and 571. Respondent timely appealed CalPERS' determination by letter dated July 30, 2012.

Respondent's Recent Salary Changes

5. Respondent's last position with HTA was as GM. Her salary including wage increases were required to be formally approved by the Humboldt County Board of Supervisors (HCBS). The HTA reported the following payrate for respondent during her final years of employment, as follows:

- 1) \$5,427.07 (through July 2008)
- 2) \$5,600.40 (July 2008-July 2009)
- 3) \$5,687.07 (July 2009-March 2010)
- 4) \$5,860.40 (March 2010-July 2010)
- 5) \$5,947.07 (July 2010-January 2011)
- 6) \$7,136.13 (January 2011-July 2011)
- 7) \$7,266.13 (July 2011-November 2011)

6. During the 2009 through 2010 time period, Board minutes show that the HCBS generally approved hourly wage increases of \$0.50 to \$1.50 per hour for HTA employees. For example, on August 19, 2009, the HCBS approved a \$0.50 pay increase for all employees. On February 22, 2010, the HCBS approved respondent's request for a \$1.00 per hour pay increase to compensate for additional responsibilities. The HCBS subsequently approved an operating budget on August 18, 2010, granting respondent a \$1.50 per hour pay increase.

7. In February 2010, respondent announced her intent to retire before the end of the year. In the fall of 2010, the HTA attempted to recruit a new GM to replace respondent. Their efforts were unsuccessful and the HCBS determined that the current salary being offered was not high enough to attract qualified GM's from other transit agencies in the State. As such, the HTA conducted a statewide salary survey for the GM position that revealed an average salary range of \$77,000 to \$98,000. On December 15, 2010, the HCBS approved an increased wage range for the GM position consistent with the survey. The HCBS also asked respondent to remain in the position while a second round of recruitments took place. Respondent agreed. However, now respondent was earning below the newly approved salary range for a GM.² To address this salary discrepancy, the HCBS conducted a performance evaluation of respondent's work, which was deemed to be excellent, and on January 19, 2011, approved a salary increase of 20 percent for the remainder of her tenure as GM.³ On August 17, 2011 respondent received one additional increase of \$0.75 per hour as approved by the HCBS for all employees.⁴

8. Respondent's last physical day on the job was September 30, 2011. She retired from the HTA effective October 15, 2011, at an annual salary of \$87,193.56.

CalPERS' Final Compensation Determination

9. Samuel Camacho is a CalPERS Retirement Program Specialist. He has worked for CalPERS for over eight years, and for the last two and one-half years in the Employer and Compensation Review Unit. This unit is responsible to look at agency reporting practices to CalPERS on behalf of members and to communicate with individual members. Mr. Camacho reviewed respondent's case in March 2012, and testified about CalPERS' final compensation determination.

10. Mr. Camacho explained that the review process entailed going back 36 months from the final pay reported by the member's employer. In respondent's case, he found that

² Respondent's annual salary in December 2010 was \$71,365 (\$5,947.07 x 12).

³ As of January 2011, the 20 percent salary adjustment resulted in an annual salary of \$85,633.56 (\$7,136.13 x 12).

⁴ Respondent's salary in August 2011 increased from \$41.17 per hour (\$85,633.56 per year), to \$41.92 (\$87,193.60 per year), a difference of \$0.75 per hour (based on a work schedule of 2080 hours per year).

in the last nine months to one year, there were pay rates that were not in compliance with the PERL. (Gov. Code, § 20636; Cal. Code Regs., tit. 2, § 570.) Mr. Camacho testified that the documents provided by the HTA showed that respondent received final settlement pay in anticipation of retirement. He defined “final settlement pay” as a pay increase or conversion of some type of employee benefit granted or awarded in anticipation of a member’s separation or retirement. (Cal. Code Regs., tit. 2, § 570.) Final settlement pay is excluded from reportable income upon which benefit calculations can be made. (Cal. Code Regs., tit. 2, § 571, subs. (b)(8) & (d).)

11. Respondent disputes CalPERS’ presumption that the 20 percent salary increase was approved in order to provide her with a “golden handshake” or final settlement pay in anticipation of retirement. She contends that the increase was the result of a salary survey and was supported by a positive employment evaluation. However, Mr. Camacho testified that his analysis would not change if the pay increase was the result of a salary survey or responsive to performance. He also stated that it does not matter whether the increase was the result of the conversion of a pre-existing benefit or given as a straight increase. It was disallowed as not in compliance with the PERL. (Cal. Code Regs., tit.2, § 570.)

12. Mr. Camacho explained that after excluding the 20 percent salary adjustment from respondent’s monthly compensation, CalPERS allowed all other salary increases that were approved by the Board. As such, the final compensation used by CalPERS to calculate respondent’s retirement benefit was \$6,077.07 per month (\$35.06 hourly rate, \$72,924.84 annual rate).

13. Compensation must be reported in accordance with section 20636 and must not exceed compensation earnable. (Gov. Code, § 20630, subd. (b).) Compensation earnable is composed of payrate and special compensation. (Gov. Code, § 20636.) Items of special compensation are allowed under specific provisions and exceptions, such as: the pay must be contained in an approved labor agreement, be available to all members in the group or class, be part of normal duties, during normal hours of employment, be paid as earned, be historically consistent with prior payments for the job classification, not be paid exclusively in the final compensation period, not be final settlement pay, and not create an unfunded liability over and above CalPERS’ actuarial assumptions. (Cal Code Regs., tit. 2, § 571, subd. (b).)

14. Addressing these provisions, Mr. Camacho testified that he requested employment contracts for the GM position, but HTA provided only HCBS minutes and resolutions. He reviewed publicly available salary schedules and confirmed that the 20 percent pay increase was not given to any other employee.⁵ Also, the 20 percent increase

⁵ Mr. Camacho noted that interim GM, Greg Pratt, received a 10 percent salary increase. According to the HTA Board minutes for September 30, 2011, Mr. Pratt, who was the HTA Operations Manager, was appointed to take on “additional undefined responsibilities during this interim period.” In his temporary assignment, he was to receive “additional compensation of 10%.”

“stood out” as historically inconsistent with prior increases for the GM. (Factual Finding 6.) Further, the increase was paid “exclusively in the final compensation period.” The increase was effective January 2011 and respondent’s official retirement date was October 15, 2011. As such, the 20 percent increase occurred and was reported by HTA to CalPERS only in the last nine months of respondent’s three-year final compensation period. Finally, allowing the 20 percent pay increase would create an unfunded liability over and above CalPERS’ actuarial assumptions.

15. CalPERS submitted the declaration of David Clement, CalPERS Senior Pension Actuary, pursuant to Government Code section 11514. Accompanying his declaration was a document setting forth “Liability Calculations” for respondent. Mr. Clement’s actuarial calculations show that allowing the higher final compensation would result in an additional liability to the retirement system of \$21,617. Mr. Clement did not appear at hearing to explain the formulas and calculations presented in the document. However, it is clear that the unfunded retirement system liability would be greater if higher earnings during the final compensation period were allowed.

16. Based on all of the evidence presented at hearing, respondent’s 20 percent salary increase applied in the final nine months of her employment with HTA is disallowed under the PERL. It is irrelevant whether the salary increase reflected HCBS’s desire to reconcile respondent’s salary to the new GM wage scale or to support a higher retirement benefit. The increase occurred in the final compensation period and conflicts with several provisions of the PERL. (Factual Findings 13 & 14.) Agencies are free to compensate their employees as they deem fit, constrained by applicable law and their own fiduciary duty to its citizens, but, compensation earnable, upon which retirement benefits are calculated, is strictly governed by retirement law.

LEGAL CONCLUSIONS

Applicable Statutes and Regulations

1. CalPERS is a “prefunded, defined benefit” retirement plan. (*Oden v. Board of Administration* (1994) 23 Cal.App.4th 194, 198). The formula for determining a member’s retirement benefit takes into account: (1) years of service; (2) a percentage figure based on the age on the date of retirement; and (3) final compensation. (Gov. Code, §§ 20037, 21350, 21352, 21354; *City of Sacramento v. Public Employees Retirement System* (1991) 229 Cal.App.3d 1470, 1479.)

2. Government Code section 20630 defines “compensation” as the remuneration paid out of funds controlled by the employer in payment for the member’s services performed during normal working hours or for time during which the member is excused from work because of holidays, sick leave, industrial disability leave, vacation, compensatory time off, and leave of absence. Compensation shall be reported in accordance with section 20636 and shall not exceed compensation earnable, as defined in section 20636. (Gov. Code, § 20630, subs. (a) & (b).)

3. "Compensation earnable" is composed of (1) pay rate, and (2) special compensation, as defined in Government Code section 20636.

4. "Pay rate" means the normal monthly rate of pay or base pay of the member paid in cash to similarly situated members of the same group or class of employment for services rendered on a full-time basis during normal working hours. "Pay rate" for a "member who is not in a group or class, means the monthly rate of pay or base pay of the member, paid in cash and pursuant to publicly available schedules, for services rendered on a full-time basis during normal working hours, subject to the limitations of paragraph (2) of subdivision (e)." (Gov. Code, § 20636, subd. (b)(1).)

5. "Special compensation" of a member includes a payment received for special skills, knowledge, abilities, work assignment, workdays or hours, or other work conditions." (Gov. Code, § 20636, subd. (c)(1).)

"Special compensation shall be limited to that which is received by a member pursuant to a labor policy or agreement or as otherwise required by state or federal law, to similarly situated members of a group or class of employment that is in addition to payrate. If an individual is not part of a group or class, special compensation shall be limited to that which the board determines is received by similarly situated members in the closest related group or class that is in addition to payrate, subject to the limitations of paragraph (2) of subdivision (e)." (Gov. Code, § 20636, subd. (c)(2).)

6. Special compensation does not include: "(A) Final settlement pay, (B) Payments made for additional services rendered outside of normal working hours, whether paid in lump sum or otherwise, or (C) Other payments the board has not affirmatively determined to be special compensation." (Gov. Code, § 20636, subd. (c)(7).)

7. A "group or class of employment" means a number of employees considered together because they share similarities in job duties, work location, collective bargaining unit, or other logical work related grouping. One employee may not be considered a group or class. (Gov. Code, § 20636, subd. (e)(1).)

"Increases in compensation earnable granted to an employee who is not in a group or class shall be limited during the final compensation period applicable to the employees, as well as the two years immediately preceding the final compensation period, to the average increase in compensation earnable during the same period reported by the employer for all employees who are in the same membership classification..." (Gov. Code, § 20636, subd. (e)(2).)

8. California Code of Regulations, title 2, section 570 defines "Final Settlement Pay" to mean any pay or cash conversions of employer benefits in excess of compensation earnable, that are granted or awarded to a member in connection with or in anticipation of a separation from employment. (Gov. Code, § 20636, subd. (f); Cal. Code Regs, tit. 2, § 570.)

Final settlement pay may take the form of any item of special compensation not listed in Section 571. It may also take the form of a bonus, retroactive adjustment to payrate, conversion of special compensation to payrate, or any other method of payroll reported to PERS. (Cal. Code Regs, tit. 2, § 570.)

9. California Code of Regulations, title 2, section 571, exclusively identifies and defines special compensation items for members employed by contracting agency that must be reported to CalPERS if they are contained in a written labor policy or agreement. (Cal. Code Regs., tit. 2, § 571, subd. (a).) The Board has determined that all items of special compensation listed in subsection (a) are:

- (1) Contained in a written labor policy or agreement as defined at Government Code section 20049, provided that the document:
 - (A) Has been duly approved and adopted by the employer's governing body in accordance with requirements of applicable public meeting laws;

[¶]...[¶]
- (2) Available to all members in the group or class;
- (3) Part of normally required duties;
- (4) Performed during normal hours of employment;
- (5) Paid periodically as earned;
- (6) Historically consistent with prior payments for the job classification;
- (7) Not paid exclusively in the final compensation period;
- (8) Not final settlement pay; and
- (9) Not creating an unfunded liability over and above PERS' actuarial assumptions.

[¶]...[¶]

(Cal. Code Regs., tit. 2, § 571, subd. (b).)

- (c) "Only items listed in subsection (a) have been affirmatively determined to be special compensation. All items of special compensation reported to PERS will be subject to review for continued conformity with all of the standards listed in subsection (b)." (Cal. Code Regs., tit. 2, § 571, subd. (c).)
- (d) "If an item of special compensation is not listed in subsection (a), or is out of compliance with any of the standards in subsection (b) as reported for an individual, then it shall not be used to calculate final compensation for that individual." (Cal. Code Regs., tit. 2, § 571, subd. (d).)

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Legal Cause

10. An applicant for retirement benefits has the burden of proof to establish a right to the entitlement, absent a statutory provision to the contrary. (*Greatorex v. Board of Administration* (1979) 91 Cal.App.3d 54, 57.)

11. Respondent did not meet her burden to establish that her 20 percent pay increase is properly included as compensation earnable for the purpose of calculating her retirement benefits. The historically inconsistent increase in pay during the final year of her employment is specifically excluded by the PERL. (Gov. Code, § 20636, subd. (e).)

Legal Analysis

12. Respondent argued that her pay increase was tied to a salary survey conducted for recruitment purposes and not motivated by a desire to spike her income for retirement calculations. CalPERS contends that the genesis for respondent's 20 percent pay raise is of no consequence to their determination.

13. Case law supports a finding that the pay raise at issue here cannot be included as compensation earnable for the purpose of calculating retirement benefits. "An employee's compensation is not simply the cash remuneration received, but is exactly defined to include or exclude various employment benefits and items of pay." (*Oden v. Bd. of Admin. Of the Public Employees' Retirement System* (1994) 23 Cal.App.4th 194, 198.) Respondent's 20 percent pay raise was not granted to any other employee in the same membership classification, was not historically consistent with prior pay increases, was paid exclusively in her final compensation period, and created an unfunded liability above PERS' actuarial assumptions. As such, it constitutes an impermissible salary increase under the PERL. (Gov. Code, § 20636, subs. (c)(2) & (e); Cal. Code Regs., tit. 2, § 571, subs. (b) & (d).)

Conclusion

14. CalPERS correctly determined that respondent's compensation earnable for purposes of calculating her retirement benefits cannot include the 20 percent salary increase applied during her last year of employment with HTA. CalPERS' adjustment to respondent's compensation earnable is supported by the PERL and is upheld. (Gov. Code, § 20636; Cal. Code Regs., tit. 2, §§ 571, 570.)

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ORDER

The appeal of respondent Neleen Fregoso and respondent Humbolt Transit Authority to include the 20 percent salary increase into respondent Fregoso's compensation earnable for purposes of calculating her service retirement allowance is DENIED.

DATED: August 15, 2014



DIAN M. VORTERS
Administrative Law Judge
Office of Administrative Hearings