

ATTACHMENT B
STAFF'S ARGUMENT

STAFF'S ARGUMENT TO ADOPT THE PROPOSED DECISION

In the consolidated cases of Respondent Howard M. Skopec (Respondent Skopec), Respondent Danilo V. Lucila (Respondent Lucila), Respondent Robert P. Paxton (Respondent Paxton) and California Department of Social Services (CDSS), CalPERS determined that the Medical Consultant Bonus Plan (MC Bonus Plan) payments failed to qualify as "compensation earnable" and should not be used in the calculation of retirement benefits. Respondent Skopec, Respondent Lucila, and Respondent Paxton appealed that determination.

Respondent Skopec, Respondent Lucila and Respondent Paxton worked as Medical Consultants (Psychiatrist) for CDSS processing Social Security Disability claims in a 100% federally funded program. Respondent Skopec and Respondent Paxton worked in CDSS' San Diego office and Respondent Lucila worked in the Oakland office.

Respondent Lucila and Respondent Skopec have retired. During the compensation review process, CalPERS staff determined CDSS had improperly reported payments under the MC Bonus Plan as "special compensation," even after CalPERS instructed CDSS not to report it.

Respondent Paxton's appeal arose a little differently. Respondent Paxton submitted a Request for Service Credit Cost Information – Additional Retirement Service Credit (ARSC). CalPERS provided Respondent Paxton an ARSC costing packet that was calculated using payrate of only \$11,712 per month¹; no income reported as special compensation was used. Respondent Paxton asked to appeal this determination that the MC Bonus Plan payments did not qualify as "compensation earnable" to be used in the calculation of retirement benefits.

The amount of a member's service retirement allowance is calculated by applying a percentage figure, based upon the member's age on the date of retirement, to the member's years of service and the member's "final compensation." Final compensation is a function of the member's highest "compensation earnable," which consists of the member's "payrate" and "special compensation." (Gov. Code § 20636.)

CalPERS determined that the MC Bonus Plan payments did not qualify as "compensation earnable" because, as implemented, the payments violate the provisions of Government Code section 20636, as described below:

1. The payments do not meet qualifications for "special compensation".
2. The payments do not meet requirements to qualify as a "bonus."
3. The payments are a form of overtime pay. They can be manipulated and can result in spiking.

¹ Respondent Paxton earned \$39,501 in one month under the MC Bonus Plan. His highest earnings were approximately \$459,000 a year.

4. The payments are not equally available to all Medical Consultants.

In addition, CalPERS found the payments did not qualify for the following reasons:

1. The payments do not qualify as “compensation” under Government Code section 20630 because the Social Security Administration controlled when the payments were available and not the employer.
2. The Union of Physicians and Dentists (UAPD) agreement does not state the payments are to be included in retirement calculations and therefore, California Department of Human Resources (CalHR) or UAPD, should have received CalPERS Board’s approval for these payments to be included as “compensation earnable.” (Gov. Code §20636, subd. (g)(5).)

Another important concern driving CalPERS’ determination is that allowing such payments to be considered compensation earnable will create an unfunded liability not only for CalPERS, but for the state, as benefits will need to be paid through the Replacement Benefit Fund for those with benefits over \$210,000 per year.

If any of the above reasons for determining the MC Bonus Plan payments are not “compensation earnable” are upheld, then these payments are not to be used in calculating retirement benefits.

Respondent Paxton was represented by counsel at the hearing. Prior to the hearing, CalPERS explained the hearing process to Respondent Skopec and Respondent Lucila and the need to support their cases with witnesses and documents. CalPERS provided all Respondents with a copy of the administrative hearing process pamphlet. CalPERS answered Respondents’ questions and clarified how to obtain further information on the process.

The Administrative Law Judge (ALJ) heard the evidence on April 13 through April 16, 2015, in Sacramento. Witnesses in San Diego and Oakland appeared by teleconferencing. Eighteen witnesses testified and a large volume of documents were exchanged and admitted. In addition, the deposition of Pamela Scheel was taken on December 10, 2014, because she was likely to be unavailable for the hearing. The issues were fully briefed by all parties.

As explained at the hearing and in the deposition of Pamela Scheel, the Department of Personnel Administration (DPA) ² negotiated with the UAPD a payment based on the number of case closures per week to replace overtime pay formerly paid to Medical

² DPA is now Department of Human Resources commonly referred to as CalHR.

Consultants, which DPA would no longer allow.³

As the witnesses explained, the payments were periodic and available when certain triggers occurred, such as a backlog at a specific branch or statewide as specified in the contract language. The payments varied from \$35 per case over a threshold of 47 cases per week for a period of two months to \$27 per case over a threshold of 90 cases per week for most of the period, if a full-time employee. The threshold numbers were reduced for such occurrences as holidays, vacation or time base reduction.

Likewise, the amount of payments under the plan varied widely from zero for some Medical Consultants to over \$1,200,000 for Respondent Paxton and others during the 2006 to 2011 timeframe. Some Medical Consultants were not allowed to participate in the plan because they worked in the State Programs Office which did not have the 100% federal funding program.

Additionally, the program was generally available to (Psychiatrist) Medical Consultants and rarely available to (non-Psychiatrist) Medical Consultants. The payments were only available once a trigger had occurred and the office asked for the plan to be implemented, and federal funds were available. These circumstances varied by branch as to when the plan was implemented.

The UAPD agreements do not state the payments were to be used in the calculation of retirement benefits. The current agreement explains if the MC Bonus Plan is activated again, it will not be used in the calculation of retirement benefits.

A statement of law and facts supporting the determination and the ALJ's findings are organized by issue below.

1. Payment does not meet qualifications for "special compensation."

"Special compensation" is generally defined in Gov. Code section 20636(g)(3) for state members.

As CalPERS explained, the payment was simply for case closures and doing more of their regular duties. It is not a payment for special skills, knowledge or ability. These skills and abilities are required to hold the position of a Medical Consultant.

Medical Consultants had the option of participating in the plan or not. Not all Medical Consultants participated. If they did not participate, they did not receive a payment even if they closed over 90 cases in a week.

The ALJ agreed with CalPERS and found that the bonus payments were not "special compensation". (Proposed Decision, Item 40, p.18.)

³ Overtime pay does not qualify as "compensation earnable."

2. Payment did not meet the definition of “bonus.”

CalPERS explained that while it is not applicable to state employees, California Code of Regulations, title 2, section 571 is instructive as to the meaning of the word “bonus”. Section 571 defines “bonus” as follows:

Compensation to employees for superior performance such as an “annual performance bonus” and “merit pay.” If provided only during a member’s final compensation period, it shall be excluded from final compensation as “final settlement” pay. A program or system must be in place to plan and identify performance goals and objectives.

CalPERS explained that a true bonus would be paid to all Medical Consultants and not just some. The MC Bonus Plan did not include such items as individual performance goals or objectives. Thus, it did not meet the criteria for a bonus.

The ALJ found that “the medical consultant bonus payments received by the respondents cannot be properly characterized as a “bonus” for purposes of inclusion as an item of “special compensation” within the meaning of Government Code § 20636.” (p. 19.)

3. The payment is a form of overtime pay.

As numerous witnesses explained, the MC Bonus Plan was designed to replace federally funded overtime pay. The analysts (DEAs) prepare the cases for the Medical Consultants to review, and they receive overtime which is not “compensation earnable.”

While each of the Medical Consultants testified that they did not work overtime, that is consistent with the UAPD agreement, as members of this work classification cannot be paid for “overtime.” The Medical Consultants are expected to work the hours necessary to complete the work. The UAPD agreement is internally inconsistent with the MC Bonus Plan. The only reason to pay Medical Consultants extra for closing cases which is part of their normal duties, is to encourage work beyond normal hours.

CalPERS defines overtime as “the aggregate service performed by an employee as a member for all employers and in all categories of employment in excess of the hours of work considered normal for employees on a full-time basis, and for which monetary compensation is paid.” (Gov. Code § 20635.)

The UAPD agreement also contained language which stated, “No time clock or time keeping shall be implemented.” As a result, it is impossible to track whether the Medical

Consultants worked more than their time base of 20 or 40 hours a week to earn the bonuses.

However, the MC Bonus Plan also presents the same policy issues that resulted in

overtime not being included as “compensation earnable.” As CalPERS explained, “the benefit is based on an amount per case.” There is no limit. There is no cap. Just like paying overtime, it is work performed at any hour. Overtime would be hours in excess of what is considered full-time; and likewise, with these numbers of cases closed, you have no clear idea of what really would be the limit or cap, and it could very well be that cases or work is done outside or in excess of the normal work schedule.

CalPERS’ payroll transcripts were reviewed by a CalPERS actuarial staff member, who saw it fluctuated and appeared to be easily manipulated as is true with overtime pay. The MC Bonus payments, like overtime, were not available to all Medical Consultants as will be addressed below. It was easily manipulated in that a Medical Consultant could hold cases and close more in one week to earn the larger bonus payments or take vacation and then work extra hours on one day to have a lower threshold and greater bonus payments. In some cases, Medical Consultants earned double or triple their “payrate” in bonuses in some months.

The ALJ opined “this is clearly more akin to overtime, and not a bonus in recognition of superior performance.” In support of this finding, the ALJ summarized the testimony of the CalPERS actuary, who had stated that, “the periodic increases occasioned by the bonus payments are ‘very unique’ and not in line with typical salary increases or bonuses that are usually in the eight to ten percent range.” The ALJ pointed out that the CalPERS actuary emphasized that the Medical Consultants’ bonus payments, up to triple the amount of their base pay, was not a pattern seen anywhere else. (Proposed Decision, Item 40, p.18.)

4. Payment was not equally available to all Medical Consultants.

“Compensation earnable” for state members must be equally available to other members in the “same group or class of employment and at the **same rate of pay.**” (Gov. Code, §20636, subd. (g) (1).) (Emphasis added.)

The policy reason behind this requirement is to prevent the spiking of income and retirement for a few individuals as explained in the Legislative History of the statute. Both the physical doctors and psychiatrists in the state and federal branches hold the position of Medical Consultants, so they are in the same group or class.

Respondent Paxton argued that psychiatrists are in a different group or class than physical doctors. Even if that interpretation is used, the fact remains that the bonus payments were never available to psychiatrists employed by CDSS in the State Program Branches or to permanent intermittent employees, as confirmed by witnesses.

CDSS Manager Mr. Poole explained that the physical doctors rarely had the opportunity to earn the case closure fees under the permanent plan in the UAPD contract. He also explained that in his branch, the cases were put into two specific doctors’ caseloads. If others wanted extra cases, they asked, and the cases were transferred within the branch.

During 2006 to 2008, some branches were authorized to have bonus payments and others were not. For example, another CDSS Manager, Ms. Peel, testified that the bonus payments were rarely used in the Roseville Branch when she managed it. Mr. Poole testified the bonus payments were occurring frequently in the San Diego and La Jolla branches when he managed them.

The MC Bonus Plan was not equally available to all Medical Consultants in CDSS in all branches; and thus, does not meet this statutory requirement and should be excluded on that basis alone.

The ALJ found that the bonus was available at times in some branches, and not in others. It was available at times to psychiatrist Medical Consultants and not to non-psychiatrist Medical Consultants. It was never available to Medical Consultants in CDSS State Program branches. For these reasons, the ALJ found that the MC Bonus Plan did not meet the statutory requirement that compensation earnable for state members be "equally available to other members in the same group or class of employment and at the same rate of pay." (Proposed Decision, Item 44, p. 20.)

5. Federal Government controlled the funds, so not "compensation."

CalPERS also argued that the MC Bonus Plan payments do not qualify as "compensation" because the funds are paid and controlled by the federal Social Security Administration (SSA) and thus are not "controlled by the employer" (CDSS), per Government Code section 20630. 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 . . ."

The SSA controls the funding and ultimately when bonuses are being paid and when they are not. The employer, CDSS, has little control over the bonus payments. This fact is supported by Sideletter 2 DSS Disability and Adult Program's Division - Medical Consultant Bonus Plan which reads "**8. Use of the Plan is contingent on the availability of funding**" and by the testimony of witnesses at hearing or through deposition.

As written, the MC Bonus Plan explains that bonus payments are triggered in three different manners, **if the funds are available**. Each manager testified that the MC Bonus Plan was 100% federally funded. Ms. Scheel confirmed that if the federal government said they did not want to fund the bonus for a period, the bonus payments would not continue.

The ALJ did not agree with this argument of CalPERS. He explained that, "Respondents correctly note that it is irrelevant that the monies for the bonus plan originally came from the federal government, particularly since the federal government pays for the entire disability review program, including the base payrate." (Proposed Decision, Item 30, p.13.)

6. CalHR or the UAPD should have received the CalPERS Board of Administration's approval for MC Bonus Plan payments to be included as "compensation earnable."

The MC Bonus Plan is silent on whether the case payments were meant by the parties to the contract (UAPD and DPA) to be included in the calculation of retirement benefits.

CalPERS was not a party to the negotiations. Therefore, CalHR or UAPD are required to seek and receive CalPERS' approval for any such payments to be included pursuant to statute. Specifically, Government Code section 20636, subdivision (g)(5) provides that:

[I]f items of compensation earnable are included by memorandum of understanding as "payrate" or "special compensation" for retirement purposes for represented and higher education employees pursuant to this paragraph, the Department of Human Resources or the Trustees of the California State University **shall obtain approval from the board for that inclusion.** (Emphasis added.)

Respondents allege that the MC Bonus Plan payments should be included as "special compensation." As a result, CDSS, CalHR or the UAPD were required to seek the Board's approval to include the payment in the calculation of retirement benefits. They did not. No evidence has been presented to even suggest an attempt was made to seek approval.

With regard to this argument, the ALJ explained that the failure to obtain approval from the Board for that inclusion does not alone give rise to rejection of all respondents' claims and/or exclude the Medical Consultant bonus payments from the calculation of final compensation. Rather it is a procedural error, the remedy for which is full consideration of the substantive issues set forth in the consolidated Statement of Issues as part of these administrative proceedings. (Proposed Decision, Item 36, pp.16-17.)

7. CalPERS' authority to determine special compensation.

As the ALJ explained "The record established that the medical consultant bonus program, if determined to be compensation earnable, will result in an unfunded liability and substantial yearly payments by the State into the Replacement Benefit Program (RBP)." (Proposed Decision, Item 47, p. 21.)

The ALJ further explained:

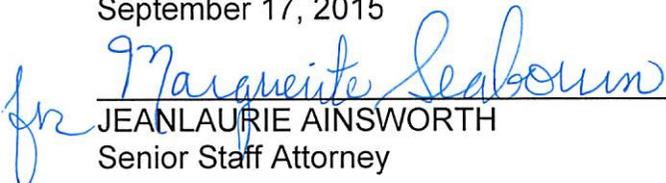
Where there is no accounting for dramatic increases in a member's earnings, and payment of a retirement allowance is greater than expected, the increase in the service retirement results in an unfunded liability. Where a member's earnings increase by two or three times above the base salary, as in the case of Respondent Paxton, the bonus payments will result in an unfunded liability and the employer's contribution must increase dramatically to account for this. The bonus program is way too unpredictable. For example, participation by medical consultants is voluntary and not everyone is covered. For the actuary, it is unclear who will be participating in the program and to what degree in order to estimate future retirement benefits, and because some medical consultants are not allowed to participate or do not sign up, large fluctuations may be spread over a smaller group of medical consultant members. There is no cap on the amount that can be earned by a single medical consultant. And, because the bonus payments were paid out on a periodic basis under the terms of the MOU, there is no consistency of payments into the retirement system by either the members or the employer. (Proposed Decision, Item 47, p. 21.)

As a result, "The medical consultant bonus program is clearly unlike any other type of compensation upon which actuarial assumptions have been made in the past by CalPERS. The variation and disparities in bonus payments to respondents illustrated this. The Legislature has vested in CalPERS the authority and discretion to determine other payments that "are not 'payrate' or 'special compensation.'" (Gov. Code, § 20636, subd. (g)(4)(L).) Here, CalPERS has reasonably exercised that authority in determining that the medical consultant bonus payments are not special compensation. Its determination should be sustained." (Proposed Decision, Item 50, p.22.) Thus, the ALJ concluded that Respondent Paxton, Respondent Skopec and Respondent Lucila's appeals should be denied.

The Proposed Decision is supported by the law and the facts. Staff argues that the Board adopt the Proposed Decision.

Because the Proposed Decision applies the law to the salient facts of this case, the risks of adopting the Proposed Decision are minimal. The members are likely to file a Writ Petition in Superior Court seeking to overturn the Decision of the Board because of the amount of money involved.

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