

ATTACHMENT B
STAFF'S ARGUMENT

STAFF'S ARGUMENT TO DECLINE TO ADOPT THE PROPOSED DECISION

Overview

CalPERS staff argues that the Board should decline to adopt the Proposed Decision, in favor of its own decision, after conducting a full Board Hearing in accordance with its policies. Staff's argument is based on the following:

- I. The Proposed Decision erroneously limits the Board's discretion to determine payrate in the absence of publicly available pay schedules. (California Code of Regulations, title 2, section 570.5(b).)
- II. The Proposed Decision interferes with CalPERS' efforts to exclude overtime compensation from the payrate of management employees. (Government Code sections 20635, 20636(b)(1).)
- III. The Proposed Decision does not address an important statute of limitations issue. (Government Code sections 20164, subs. (b), (d) and (e).)

Legal and Factual Background

Bruce Malkenhorst was employed by the City of Vernon (City) from 1977 to June 30, 2005. For most of that period, Malkenhorst served as Vernon's City Administrator/City Clerk. At various points in time, however, Malkenhorst took on other City positions as well, including Treasurer, Municipal Employee Relations Representative, Chief Executive Officer of the Electrical Department (later named the Light and Power Department), Executive Director and Secretary of the Redevelopment Agency, CEO of the Gas Municipal Utility Department, Executive Director of the Industrial Development Authority, and Executive Director of the Vernon Historic Preservation Society.

Malkenhorst's City Administrator/City Clerk position was listed on a pay schedule with a specified monthly salary for a 40-hour position. Malkenhorst's other City positions were not listed on the City's pay schedules.

In 1994, Malkenhorst submitted a retirement application to CalPERS that required evaluation of his final compensation. In connection with its review, CalPERS observed that Malkenhorst held several City positions. CalPERS suspected Malkenhorst was working overtime to complete the work in these other positions and requested, twice, that the City track Malkenhorst's time in each position. Neither the City nor Malkenhorst complied.

Malkenhorst subsequently deferred his retirement until 2005. At that time, the City was reporting Malkenhorst's monthly pay as \$44,128: a monthly base payrate of \$35,302 (corresponding with the City's pay schedule for the City Administrator/City Clerk position) plus an additional 25% longevity pay.

Upon Malkenhorst's retirement, the City did not hire another City Administrator/City Clerk. The City, instead, created full-time Acting City Clerk and Acting City Treasurer positions, each of which was listed on a City pay schedule with a base monthly salary of \$7,875.

On July 18, 2005, CalPERS informed the City that Malkenhorst's longevity pay could not be considered an item of special compensation because he was the only City employee to whom the 25% longevity pay was available. The City appealed, and CalPERS ultimately relented. Administrative proceedings were never initiated.

Beginning in 2011, CalPERS audited the City. Noting that Malkenhorst held positions apart from City Administrator/City Clerk, CalPERS sought City records of the time Malkenhorst spent in these positions, as well as publicly available pay schedules for each. CalPERS ultimately determined these records did not exist.

Based upon the records it was able to obtain from the City, CalPERS concluded: 1) Malkenhorst's monthly base salary of \$35,302 could not be considered his payrate because it reflected pay for positions not listed on publicly available pay schedules, and reflected pay for working overtime hours; and 2) Malkenhorst's 25% longevity pay could not be considered special compensation because it was greater than the 20% longevity pay received by others in City management positions.

CalPERS staff then exercised its discretion to select an alternative payrate for Malkenhorst. It selected a payrate of \$7,875, corresponding with the Acting City Clerk position created at the time of Malkenhorst's retirement. CalPERS then added 20% longevity pay as an item of special compensation and determined Malkenhorst's final compensation to be \$9,450. Malkenhorst appealed this determination.

In his appeal, Malkenhorst denied that he was working in multiple City positions and that he was paid for working overtime hours. In addition, Malkenhorst challenged CalPERS' power to redetermine his final compensation following the 2011 audit. Three arguments were paramount. First, Malkenhorst argued that CalPERS' redetermination of his final compensation was barred by the doctrines of res judicata and collateral estoppel. Second, Malkenhorst argued that CalPERS' redetermination of his final compensation violated the City's autonomy as a charter city. Third, Malkenhorst argued that CalPERS' redetermination of his final compensation and any subsequent effort by CalPERS to recoup overpayment of his retirement benefit was or would be legally or equitably time-barred.

The Proposed Decision

After an administrative hearing, the ALJ issued his Proposed Decision in June 2015. The Proposed Decision affirms CalPERS' redetermination in two respects.

First, the Proposed Decision finds that Malkenhorst's monthly base salary of \$35,302 could not be considered his payrate because it reflected pay for multiple positions not

listed on publicly available pay schedules. The City had effectively used City Administrator/City Clerk “as a catch-all payrate category,” which “concealed from public view” the connection between Malkenhorst taking on new job titles and receiving payrate increases.

Second, the Proposed Decision affirms CalPERS’ decision to provide Malkenhorst only 20% longevity pay as an item of special compensation.

In sum, the ALJ agreed with CalPERS that Malkenhorst’s final compensation was subject to redetermination. The ALJ rejected Malkenhorst’s argument that the redetermination of his final compensation was barred by res judicata, collateral estoppel, city charter, statute of limitations, or any other legal or equitable doctrine.

In two other respects, the Proposed Decision disagrees with CalPERS’ conclusions. First, the Proposed Decision finds that CalPERS failed to establish that Malkenhorst’s monthly base salary of \$35,302 included pay for working overtime hours. The ALJ credited Malkenhorst’s hearing testimony that he accomplished all his work, in all positions, in 40 to 45 hours per week. Second, the Proposed Decision rejects CalPERS’ selection of \$7,875 as Malkenhorst’s payrate. The ALJ ruled that the process by which CalPERS selected this payrate was arbitrary.

One issue was not resolved by the Proposed Decision: Malkenhorst’s argument that CalPERS will be time-barred from recouping some or all of its past overpayment of benefits. The ALJ ruled that issue would not be ripe until such time that CalPERS seeks recoupment.

Why the Proposed Decision Should Be Rejected

- I. The Proposed Decision erroneously limits the Board’s discretion to determine payrate in the absence of publicly available pay schedules. (California Code of Regulations, title 2, section 570.5(b).)

The PERL defines payrate to exclude any part of an employee’s salary attributable to positions not described on a “publicly available pay schedule.” (20636(b)(1).) By regulation, a pay schedule is proper only if it “[i]dentifies the position title for every employee position” and “[s]hows the payrate for each” (Cal. Code Regs., tit. 2, § 570.5(a)(2) and (a)(3), emphasis added.)

The Proposed Decision correctly found that the City lacked a publicly available pay schedule that would substantiate Malkenhorst’s payrate. The City’s pay schedules listed a base salary for the position of City Administrator/City Clerk, but no base salaries were listed for the various other positions held by Malkenhorst. Moreover, the City lacked time records by which CalPERS could determine the hours Malkenhorst worked in his various positions.

When a member's payrate does not meet the regulatory criteria, "the Board, in its sole discretion, may determine an amount that will be considered to be payrate, taking into consideration all information it deems relevant..." (Cal. Code Regs., tit. 2, §570.5(b).) Here, CalPERS properly exercised that discretion. Looking to City records, CalPERS noted that the City eliminated the single City Administrator/City Clerk position and created two full-time positions related to Malkenhorst's job duties: Acting City Clerk and Acting City Treasurer. Both full-time positions were listed on a City pay schedule with a base monthly salary of \$7,875, so CalPERS selected that amount for Malkenhorst's payrate.

Malkenhorst had not argued that some other figure was more appropriate for his payrate. Nor did Malkenhorst argue that CalPERS' selection of a \$7,875 payrate was arbitrary. Nonetheless, the ALJ so ruled.

The Proposed Decision finds that CalPERS acted arbitrarily because it failed to consider additional data that might provide a payrate for Malkenhorst that better corresponds with his City duties. The Proposed Decision does not, however, specify the relevant data that was overlooked or describe an objective process by which CalPERS might have better weighed that data. Thus, although it may be the ALJ's impression that a "better" payrate for Malkenhorst exists, the evidence does not establish that CalPERS acted arbitrarily. The Board should conduct a hearing to affirm CalPERS' discretion in cases such as this to weigh the relevant evidence as it sees fit.

II. The Proposed Decision interferes with CalPERS' efforts to exclude overtime compensation from the payrate of supervisory employees. (Government Code sections 20635, 20636(b)(1).)

Final Compensation excludes overtime pay, which is pay for work hours "in excess of the hours of work considered normal for employees." (Gov. Code § 20635.) Similarly, payrate is defined to include only what a member is paid for work during "normal working hours." (Section 20636(b)(1).) "Normal hours" for all full-time positions at the City (outside of the Fire Department) meant working 40-hour weeks.

The City Administrator/City Clerk position held by Malkenhorst was a 40-hour per week position. Therefore, when CalPERS learned in 1994 that Malkenhorst held several positions at the City in addition to City Administrator/City Clerk, CalPERS suspected Malkenhorst must be working overtime hours. To address the concern, CalPERS twice wrote the City asking Malkenhorst to track the time he spent in each of his positions.

As the City's chief administrative officer, it was Malkenhorst's statutory duty to provide the information CalPERS requested. (Gov. Code § 20221(b), making the "chief administrative officer of a contracting agency" responsible for furnishing CalPERS with "additional information concerning any member that the board may require in the administration of this system.") Malkenhorst ignored CalPERS' letters and did not track his hours.

Given the lack of contemporaneously kept time records, the ALJ concluded that CalPERS lacked the evidence to prove that Malkenhorst was in fact working overtime. The ALJ also credited Malkenhorst's hearing testimony that he needed only 40 to 45 hours per week to complete the duties of all his positions. Both rulings are erroneous.

CalPERS' evaluation of Malkenhorst's payrate has at every step been tethered to its analysis of City records. CalPERS' reliance on agency records is typical: CalPERS depends upon the payroll submissions it receives from its contracting agencies, and it may, if necessary, require the agency and/or its chief administrative officer to provide further documentation. (Gov. Code § 20221(b).) This records-based decision-making serves the goal of transparency because the records used by CalPERS for deciding payrate can be obtained and reviewed by the public. Oral statements, whether provided as part of or before litigation, are less reliable than contemporaneously prepared records, are less transparent, and are not in any event gathered or used by CalPERS for calculating final compensation.

Here, the City's own records provided strong circumstantial evidence that Malkenhorst was working overtime. CalPERS sought to supplement that evidence with Malkenhorst's contemporaneously kept time sheets, but Malkenhorst refused to cooperate with CalPERS' request despite his statutory obligation to do so. Malkenhorst should not be permitted to benefit from his own refusal to cooperate.

Malkenhorst argued that as an "exempt" City employee under the Fair Labor Standards Act (FLSA), he had no overtime to record or report. CalPERS, however, has not adopted the FLSA rules for overtime. Unlike FLSA overtime, overtime under the PERL applies equally to high-ranking managers and rank-and-file employees. All compensation for work beyond the City's standard 40-hour week is excluded from pension calculations, whether paid to those at the top or bottom of the organization chart.

CalPERS can readily identify and exclude overtime paid to the rank and file because it is segregated from regular pay in the payroll reports CalPERS receives. That same level of clarity is often missing from payroll reports for FLSA-exempt management employees, whose regular and overtime hours and pay may be lumped together. Thus, CalPERS' ability to compel timekeeping by managerial employees is the only objective tool available to enforce the PERL's overtime standards.

When agencies and their managerial employees fail to comply with CalPERS' directives to keep and provide overtime-related documents, the burden of producing documentary evidence of overtime cannot properly rest upon CalPERS. The Board should conduct a hearing to establish this point and affirm the Staff's determination that Malkenhorst worked and received pay for overtime hours.

III. The Proposed Decision does not address an important statute of limitations issue that was fully briefed by the parties. (Government Code sections 20164, subs. (b) and (e).)

The ALJ declined to address an important statute of limitations issue, even though it was briefed by the parties. That issue pertains to CalPERS' ability to recoup benefit overpayments made to Malkenhorst, and Malkenhorst's argument that such recoupment may, in whole or part, be time-barred. The Board should exercise its statutory authority to decide the issue.

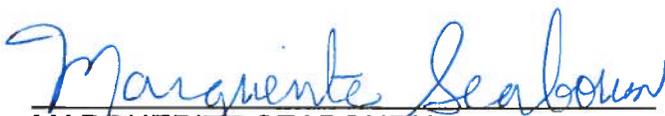
The PERL envisions two methods by which CalPERS may recoup overpayments to members. First, CalPERS may elect to file a civil lawsuit to recover overpayments, subject to a three-year or ten-year limitations period. (Gov. Code § 20164(b), (d).) Second, CalPERS may recover overpayments through the process of administrative adjustment, modifying a member's allowance "so that the retired person ... will receive the actuarial equivalent of the allowance to which the member is entitled." (Gov. Code § 20163(a).) CalPERS is directed to make adjustments so that "the status, rights, and obligations of all parties ... are adjusted to be the same that they would have been if the act that would have been taken, but for the error or omission, was taken at the proper time." (Gov. Code § 20160(e).)

Malkenhorst disagrees with the above analysis of the PERL and has argued, as a matter of law and equity, that CalPERS can no longer recoup overpayments. The dispute centers, in part, on the applicability, accrual and tolling rules for the limitation periods described in Sections 20164(b) and 20164(d). This dispute should be resolved by the Board in the first instance, which it is fully authorized to do under PERL section 20164(e) ("The board shall determinate the applicability of the period of limitations in any case, and its determination with respect to the running of any period of limitation shall be conclusive and binding for purposes of correcting the error or omission.")

Proposed Board Action

Based on the serious flaws of the Proposed Decision, CalPERS staff urges the Board to reject the Proposed Decision and hold a full Board Hearing. Once the Board considers all the evidence and arguments in full context, the Board can then decide for itself whether the ALJ has analyzed the applicable law correctly. In short, the Board should grant a full Board Hearing so that the Board's final decision, whatever it may be, is supported by a correct and reasonable application of law.

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