

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 concluded that payments made by Respondent City of San Bernardino (Respondent City or City) in settlement of an employment discrimination lawsuit brought against it by Respondent Richard Lewis (Respondent Lewis) qualified as an item of special compensation (temporary upgrade pay or TUP) to be included in Respondent Lewis' final compensation for purposes of calculating his retirement allowance. (California Code of Regulations, title 2, section 571 (a)(3).)
- II. The Proposed Decision concludes in *dicta* that the settlement payments may qualify as "payrate" notwithstanding the fact that this was not an issue before the Administrative Law Judge. (Government Code sections 20636(a)(b); California Code of Regulations section 570.5.) Contrary to controlling case law, the Proposed Decision improperly defers to and relies upon the anecdotal intention of Respondent City and Respondent Lewis as the bases for qualification of settlement payments as Battalion Chief payrate. The Proposed Decision also erroneously concludes that because the settlement payments Respondent Lewis received as a separate item on his pay warrant, were based on the difference between the base salary of his actual position as a Fire Captain and that of a Battalion Chief, the salary schedule for the higher position constituted his "publicly available pay schedule," notwithstanding the fact that he was never actually promoted to such position.
- III. The Proposed Decision acknowledges CalPERS' duty to correct errors under Government Code section 20160 but fails to apply it in this case to permit correction of the City's erroneous reporting of Respondent Lewis' settlement payments.
- IV. The Proposed Decision improperly applies the doctrine of equitable estoppel.
- V. The Proposed Decision misconstrues the fact that allowing settlement payments will result in an unanticipated actuarial loss proscribed under the California Public Employees' Retirement Law (PERL).

Legal and Factual Background

The case involves claims that amounts paid in settlement of a lawsuit are temporary upgrade pay or TUP. CalPERS disagrees, and therefore disallowed the claimed special compensation as TUP for Respondent Lewis. TUP for classic members is defined as

compensation to employees who are required by their employer or governing board to work in an upgraded position/classification of limited duration. (Cal. Code Regs, Title 2, § 571(a)(3).) The employee entering into the temporary position must give up his or her previous duties and completely work in the upgraded position. TUP cannot be awarded for taking on duties in addition to the member's own job duties, as this would be considered "overtime" which is not reportable to CalPERS. The "limited duration" requirement means there has to be a finite period for the assignment. Respondent Lewis sued the City for discrimination in failing to promote him to a Battalion Chief over other candidates for that position. In settlement of a cause of action against the Fire Chief, the parties entered into an agreement that would pay Respondent Lewis backpay, as if he had been promoted when he claimed he should have been, and to pay him prospectively, by adding a separate supplemental amount to his monthly pay calculated on the difference between Respondent Lewis' actual base salary as a Fire Captain and that of a Battalion Chief. Respondent Lewis was specifically never promoted to the higher position and would receive the settlement proceeds regardless of the performance of any duties of the higher position. The agreement requires the settlement payments to be paid indefinitely.

When contacted by the City, after the settlement agreement was fully executed, as to how the City might report the settlement payments, the City was initially informed by CalPERS that since the payments did not qualify as payrate, the payments could initially be reported only as special compensation, possibly TUP. However, on further review by CalPERS staff, it was determined that the payment did not qualify as TUP. Therefore Respondent Lewis' additional pay did not meet the definitional requirements described above to be classified as TUP.

The Proposed Decision

After an administrative hearing, the Administrative Law Judge (ALJ) issued her Proposed Decision on July 15, 2015. The issue before the ALJ was whether the settlement payments reported to CalPERS qualified as TUP. The Proposed Decision concludes that CalPERS shall include "Temporary Upgrade Pay / Special Compensation" and the related value of Employer Paid Member Contributions (EPMC) in Respondent Lewis's final compensation.

Why the Proposed Decision Should Be Rejected

I. The Proposed Decision Erroneously Concludes that the Proceeds from the Settlement Agreement Qualify as TUP.

1. The PERL defines "final compensation", in this particular case, as the highest average consecutive 12 months of compensation earnable (Gov. Code section 20042.) The PERL defines "compensation earnable" as the compensation paid by the employer as "payrate" and "special compensation." (Gov. Code section 20636(b).) "Payrate" is defined as 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, pursuant to publicly available pay schedules. (Gov. Code section 20036(b).) A similar definition applies to members who are not considered in a group or class. "Special compensation" is generally defined as payments received by a member for special skills, knowledge, abilities, work assignment, workdays, or other work conditions. Special compensation must be paid pursuant to a written labor policy or agreement or as otherwise required by state or federal law, to similarly situated members of a group or class of employment, in addition to payrate. (Gov. Code section 20636(c).) The Board, pursuant to statutory mandate, has specifically and exclusively identified what constitutes special compensation and under what conditions payments to a member may qualify as special compensation. (See, 20636(c)(6); Cal. Code Regs., Title 2, section 571).

TUP is a type of special compensation. (Cal.Code Regs., § 571(a)(3).) TUP is defined as "compensation to employees who are required by their employer or governing board or body to work in an upgraded position/classification for a limited duration."

The Proposed Decision presumes, without any analysis, that the settlement payments were TUP. The Proposed Decision does not acknowledge or discuss other requirements of special compensation including that it be paid pursuant to a labor policy or agreement. Other than a reference in a quoted portion of CalPERS' determination letter, the ALJ never discusses the criteria for TUP and, in fact, makes factual findings that are inconsistent and in conflict with such a conclusion.

The Board should conduct a hearing on the record and affirm CalPERS' determination that the settlement payments paid to Respondent Lewis do not qualify as TUP.

II. The Proposed Decision Erroneously Finds In Dicta That the Settlement Payments Qualify As Payrate.

As previously mentioned, "payrate" is defined under the PERL to be 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 during normal working hours, pursuant to a publicly available pay salary schedule. (Gov. Code section 20636(b).) The Board has defined in regulation what may be considered a publicly available pay schedule (Cal. Code Regs., Title 2, §570.5; see also, CalPERS Precedential Decision *In re Randy Adams*, OAH case No. 10122030095.)

The issue of whether the settlement payments constituted payrate was not before the ALJ. Yet, in *dicta*, the Proposed Decision includes a finding that because the City and Respondent Lewis agreed to settle their lawsuit by paying Respondent Lewis "as if" he had been promoted, the payments were evidence of his "payrate" as a Battalion Chief. However what does and does not qualify as payrate is not a subject of agreement by

or between the employer and employee. (*Oden v. Board of Administration* (1994) 23 Cal.App.4h 194, 201.)

Although there were salary schedules for the position of Battalion Chief, the evidence is undisputed that Respondent Lewis was never promoted to the rank of Battalion Chief. Contrary to the finding in the Proposed Decision, other than anecdotal and inconsistent testimony, there is little to no evidence supporting the ALJ's finding that Respondent Lewis performed the duties of a Battalion Chief. Nor does the evidence indicate that his settlement agreement was, or could, qualify as a salary schedule. The Proposed Decision is inconsistent with statutory, regulatory and precedential civil and administrative case law. Thus, the Board should conduct a hearing on the record to correct this erroneous analysis and conclusion in the Proposed Decision.

III. The Proposed Decision Acknowledges CalPERS' Duty to Correct Errors Under Government Code Section 20160 But Fails To Apply It In This Case to Permit Correction Of The City's Erroneous Reporting of Respondent Lewis' Settlement Payment.

The Proposed Decision recognizes that, pursuant to section 20160, the Board has the right and duty to correct errors of any member, contracting agency or of the system. However, the Proposed Decision refuses to apply this statutory right/duty to CalPERS to correct any possible error by CalPERS staff in permitting the City to initially "report" the settlement payments as TUP. The Proposed Decision further fails to recognize that the mere act of reporting an item of compensation does not preclude CalPERS from correcting such error, at any time.

IV. The Proposed Decision Improperly Applies The Doctrine of Equitable Estoppel.

The Proposed Decision improperly applies the doctrine of equitable estoppel. Estoppel is not available to provide Respondent Lewis a benefit not otherwise available under the express provisions of the PERL. Where estoppel is sought to be asserted against a governmental entity, a fifth element must be met - which the ALJ fails to adequately address - that the interests of the private party must outweigh the effect on the public interest and policies. Here, permitting estoppel would conflict with strong public interest against the spiking of individual compensation by permitting local agencies to artificially increase a preferred employee's retirement benefits (by providing the employee with compensation increases which are not available to other similarly situated employees), in conflict with express provisions of the PERL.

V. The Proposed Decision Misconstrues The Fact That Allowing Settlement Payments Will Result in An Unanticipated Actuarial Loss Proscribed Under The PERL.

The PERL generally prohibits payments made to an individual employee which will result in unfunded liabilities from being included in a member's final compensation. The Proposed Decision acknowledges that the settlement agreement payments payable

only to Respondent Lewis will increase the liability associated with his pension allowance by nearly \$600,000. However, the Proposed Decision erroneously finds that such increase is allowable because the City paid contributions on the payments while they were being paid. Because compensation on which the contributions were paid related to a position that never existed, other than as a result of the settlement agreement, the resulting increase in liability will be inadequately funded.

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.

October 21, 2015



Wesley E. Kennedy
Senior Staff Attorney