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October 22, 2012

John Jensen
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Dear Mr. Jensen

The California Public Employees' Retirement System (CalPERS) is in receipt of your letter dated July 24, 2012 and accompanying documents. The information you have provided in response to CalPERS May 25, 2012 preliminary determination letter to Mr. Malkenhorst, Sr. has been reviewed. However, the information has not altered the determination that Mr. Malkenhorst's retirement allowance will require a downward adjustment.

By way of background, CalPERS undertook a Public Agency Review (Review) of the City of Vernon (City) and the final report was released April 2012. CalPERS audit staff reviewed payroll and other relevant records and compensation reported to CalPERS for individuals included in a test sample over service periods of July 1, 2002, through June 30, 2010. CalPERS has also completed a review of the compensation reported by the City on Mr. Malkenhorst's behalf, and determined portions of the compensation reported to CalPERS does not comply with the California Public Employees' Retirement Law (PERL) and does not meet the definition of "compensation earnable".

CalPERS informed Mr. Malkenhorst of its preliminary decision by way of letter dated May 25, 2012 and provided 30 days to present any additional documentation, information or argument he felt would alter CalPERS' decision to decrease his retirement allowance. Mr. Malkenhorst hired you, Mr. John Jensen, to represent him in this matter and requested an extension in providing documentation. On June 7, 2012, an extension was granted to July 25, 2012. On July 27, 2012, CalPERS received your responsive documents, and have reviewed all documents provided which included the following: *Bruce V. Malkenhorst, Sr. Cover Letter, Initial Response to CalPERS Audit Request, Declaration with 83 Exhibits, Arguments with Exhibits 84-88*; and three (3) binders containing exhibits 1-83.

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Final Determination

CalPERS originally calculated Mr. Malkenhorst's final compensation at the time of retirement effective July 1, 2005 in the amount of \$44,128 per month based upon payment amounts reported by the City. This final compensation amount was then used to calculate his original retirement allowance of \$40,022.93 per month. As a result of the Review an investigation of all relevant information provided by the City as well as payroll records was initiated. CalPERS investigated Mr. Malkenhorst's final compensation amount and has concluded that it appears to have been erroneously calculated at the time of retirement due to the inclusion of payments that are not authorized by the PERL.

Under the PERL, the amount of compensation earnable that an employer reports to CalPERS is used to determine member contributions, final compensation and to calculate retirement benefit allowances. Compensation earnable consists of "payrate" and "special compensation". If CalPERS determines that compensation is, or has been, reported in error because it does not constitute compensation earnable as defined in the PERL, then CalPERS has a duty to correct the error.

As detailed below, not all pay schedules provided appear to have included amounts solely attributable to one position¹. The pay schedules provided by you and the City list the positions of City Administrator/City Clerk. Moreover, the documentation provided confirms that Mr. Malkenhorst served in the capacity of several positions simultaneously. Since more than one position has been identified, each position Mr. Malkenhorst occupied must have the corresponding payrate listed on all publicly available pay schedules.² CalPERS has yet to receive copies of publicly available pay schedules for each of these positions. Also, to discern the amount of service credit attributable to each position and the payrate associated with each position, CalPERS must receive information verifying the proportionate amount of service rendered in each respective position.

Payrate

All payrates or base pay reported must comply with Government Code Section 20636(b)(1)³ which provides in relevant part as follows:

"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,

¹ The City at different times has reported that Mr. Malkenhorst served in a number of capacities simultaneously. For example in 1995, the Chief Deputy City Clerk stated Mr. Malkenhorst served as "City Administrator/City Clerk, City Treasurer, Director of Finance and Personnel, Purchasing Agent, Executive Director of Light & Power and Executive Director of the Redevelopment Agency.

² See California Government Code sections 570.5 and 20636.

³ All further references are the California Government Code unless otherwise specified.

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pursuant to publicly available pay schedules. 'Payrate,' 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 pay schedules, for services rendered on a full-time basis during normal working hours, subject to the limitations of paragraph (2) of subdivision (e)." (Emphasis added)

Additionally, Section 20636(d) provides, "[N]otwithstanding any other provision of law, payrate and special compensation schedules, ordinances, or similar documents shall be public records available for public scrutiny."

A "payrate" must also be listed in a publicly available pay schedule which meets all criteria listed in California Code of Regulations (CCR) Section 570.5. The publicly available pay schedules provided by the City in support of Mr. Malkenhorst's pay amounts fail to comply with CCR Section 570.5 subdivision (a)(3)(4)(6) because:

- They fail to show the payrate for each identified position, which may be stated as a single amount or as multiple amounts within a range;
- They fail to indicate the time base, including but not limited to, whether the time base is hourly, daily, bi-weekly, monthly, bi-monthly, or annually; and
- They fail to indicate an effective date and date of any revisions.

Although CCR Section 570.5 was adopted in August 2011, the statute serves as a clarification regulation to Section 20636 which, as stated above, cites a publicly available pay schedule is required to constitute compensation earnable.

CCR Section 570.5 (b) states:

"Whenever an employer fails to meet the requirements of subdivision (a) above, 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 including but not limited to, the following:

- 1) Documents approved by the employer's governing body in accordance with requirements of public meetings laws and maintained by the employer;
- 2) Last payrate listed on a pay schedule that conforms to the requirements of subdivision (a) with the same employer for the position at issue;
- 3) Last payrate for the member that is listed on a pay schedule that conforms to the requirements of subdivision (a) with the same employer for a different position;
- 4) Last payrate for the member in a position that was held by the member and that is listed on a pay schedule that conforms to the requirements of subdivision (a) of a former CalPERS employer.

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Additionally, in order to constitute payrate, pay must be for services rendered on a full-time basis during normal working hours and cannot be for additional duties or services related to other positions.⁴ Pay related to services performed that constitute "overtime", as that term is defined under the PERL, is not reportable for retirement purposes. Section 20635 provides in pertinent part:

"When the compensation of a member is a factor in any computation to be made under this part, there shall be excluded from those computations any compensation based on overtime put in by a member whose service retirement allowance is a fixed percentage of final compensation for each year of credited service.

...

If a member concurrently renders service in two or more positions, one or more of which is full-time, service in the part-time position shall constitute overtime. **If two or more positions are permanent and full-time, the position with the highest payrate or base pay shall be reported to this system.**" (Emphasis added)

The most recent amount of pay represented as payrate and reported by the City is approximated at \$35,302 per month. Based on the documentation available to date, it does not appear that this reported amount meets the definitional requirements of "payrate" under the PERL.

As a result, CalPERS has concluded that the amounts reported to CalPERS by the City for Mr. Malkenhorst's services do not appear to have been paid "pursuant to publicly available pay schedules" under the meaning of that phrase in the statutory and regulatory definitions for payrate. In addition, the amounts failed to meet other definitional requirements of payrate in so far as they were not for the normal duties of one full-time position and were amounts reported for duties or services performed for other simultaneous positions and constitute "overtime" under the PERL.

CalPERS reviewed Mr. Malkenhorst's compensation history to identify any pay that would meet the definition of compensation earnable to be used for the purposes of determining the correct final compensation and retirement benefit amount. The most recent payrate reported by the City that meets the definition of "payrate," appears on a publicly available pay schedule in the amount of \$7,875 per month for the single position of Acting City Clerk, as provided in Resolution 8780, signed June 29, 2005, effective July 1, 2005.

⁴ Section 20636(b) and (c)(7)(B) also provides that special compensation does not include payments made for additional services rendered outside of normal working hours, whether paid in lump sum or otherwise. See also *In re the Matter of the Appeal of the Calculation of Benefits Pursuant to Employer's Report of Final Compensation Related to Roy T. Ramirez, and City of Indio*, (2000) CalPERS Precedential Board Decision No. 00-06, and *Prentice v. Board of Administration* (2007) 157 Cal.App. 4th 983.

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Pay schedules provided by you and the City list Mr. Malkenhorst's position as City Administrator/City Clerk. However, Vernon's City Charter clearly defines each title as a separate position. Pursuant to Section 20635, stated in pertinent part above, the position with the highest payrate shall be reported to CalPERS. In most cases, the position of City Administrator has a higher payrate than that of a City Clerk. Therefore, it appears the City Administrator should have been the payrate reported to CalPERS if the payment was compliant with "compensation earnable" as provided.

The use of the payrate for Acting City Clerk is a result of the lack of information needed to substantiate Mr. Malkenhorst held the single position of City Administrator and CalPERS inability to determine the payrate provided for City Administrator was solely attributable to that position. In addition to the lack of documentation, the position of City Administrator was not immediately filled after Mr. Malkenhorst's retirement to utilize as a reportable payrate nor is there a current payrate associated with that position.

With the documentation available, Mr. Malkenhorst was first appointed to the position of City Clerk July 1, 1977 and thereafter held that position throughout his tenure with the City. There is a publicly available pay schedule available for duties related to this single position. Therefore, this payrate can be used for compensation earnable purposes in determining the final compensation and retirement benefit amount.

Special Compensation

As stated above, compensation earnable consists of two components "payrate" and "special compensation". In order for special compensation to be included as a basis for retirement benefits, compensation reported to CalPERS must meet the definition as provided in Section 20636, and specifically, in Section 20636(c)(2).

"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)." (Emphasis added)

Section 20636(e)(1) provides in relevant part:

"...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."

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Any compensation paid in addition to base pay must meet the definition of "special compensation" and must be an item of pay that has been expressly approved by the CalPERS Board. The approved list of special compensation items can be found in the CCR Section 571(a). Although, Longevity Pay is listed as an approved item of special compensation, all items listed in CCR Section 571(a) must also meet all criteria listed in CCR Section 571(b).

The City reported longevity pay for Mr. Malkenhorst as City Administrator at the level of 25 percent of base pay upon reaching 25 years of service. However, all other similarly situated City management positions received only 20 percent of base pay for the same 25 years of service. Since the longevity benefit paid to Mr. Malkenhorst was higher than that of the other members of the group or class, it does not meet the requirements of Section 20636 as noted above, nor does it meet all criteria listed in CCR 571(b)(2) which, among other things, requires the amount be available to all members in the group or class.

The City reported payments consisting of a base pay of \$35,302 plus 25 percent longevity payment of \$8,825.50 for a total of \$44,128.00 from July 10, 2004 through his last day on payroll, June 30, 2005. The correct amount of longevity pay should have been 20 percent of base pay, where such base pay met the definition of "payrate."

Authority for Correction of Retirement Allowance for Amounts Erroneously Reported that Do Not Appear to Meet the Definition of Compensation Earnable

CalPERS was established by statute, the PERL, which grants it certain authority. The California Constitution also grants the CalPERS Board of Administration, as the board of a public retirement system, certain powers. CalPERS has no authority other than those granted by the PERL and the Constitution. Therefore, CalPERS only has the authority to pay retirement benefits to a member when authorized and only in amounts authorized.⁶ CalPERS has no authority to use a final compensation amount that is calculated with amounts of pay that do not meet the definition of "compensation earnable" pursuant to the PERL.⁷

Section 20120 states that the management and control of this system is vested in the board. Section 20125 further provides that the board shall determine who are employees and is the sole judge of the conditions under which a person may be admitted to and continue to receive benefits under this system. The PERL includes provisions that address errors made by an employer and/or CalPERS and mandates corrections in certain instances.

⁶ See CalPERS Precedential Decision *In re the Matter of the Appeal of Decreased Level of Retirement Allowance of Harvey H. Henderson* (1998) CalPERS Precedential Board Decision No. 98-02 and California Constitution, Art. XVI, section 17.

⁷ See Section 20636.

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Section 20160 outlines the criteria for correcting errors and omissions and requires the board to correct all actions taken as a result of errors or omissions of any contracting agency or this system. Corrections of errors or omissions made pursuant to section 20160 subsection (a)(3)(e) and subsection (b) shall be such that the status, rights, and obligations of all parties are adjusted to be the same that would have been, if the act that would have been taken, but for the error or omission, was taken at the proper time.

Section 20163(e) provides in pertinent part:

“... Adjustments to correct overpayment of a retirement allowance may also be made by adjusting the retirement allowance so that the retired person or the retired person and his or her beneficiary, as the case may be, will receive the actuarial equivalent of the allowance to which the member is entitled...”

Section 20164 provides in pertinent part:

“(a) The obligations of this system to its members continue throughout their respective memberships, and the obligations of this system to and in respect to retired members continue throughout the lives of the respective retired members, and thereafter until all obligations to their respective beneficiaries under optional settlements have been discharged. The obligations of the state and contracting agencies to this system in respect to members employed by them, respectively, continue until all of the obligations to this system in respect to those retired members, respectively, have been discharged. The obligations of any member to this system continue throughout his or her membership, and thereafter until all of the obligations of this system to or in respect to him or her have been discharged.

(b) For the purposes of payments into or out of the retirement fund for the adjustment of errors or omissions, whether pursuant to section 20160, 20163, or 20532, or otherwise, the period of limitation of actions shall be three years, and shall be applied as follows:

(1) In cases where this system makes an erroneous payment to a member or beneficiary, this system's right to collect shall expire three years from the date of payment...”

Section 20160 requires CalPERS to correct errors made by an employer or by the system. Once an error is discovered, CalPERS is required to take action to correct it and is permitted to pay only those benefits authorized under the PERL. CalPERS is required to correct the amount of Mr. Malkenhorst's retirement allowance for the reasons described above. Moreover, CalPERS is required to collect the overpayments made in error.

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Section 20164(b) states that where the system has made an erroneous payment to a member, the right to collect expires three years from the date of payment except where the payment is a result of fraudulent reports for compensation made.

This letter further serves to confirm that CalPERS will seek to collect back all overpayments authorized by statute.

Conclusion

CalPERS must make a downward adjustment to Mr. Malkenhorst's retirement benefit because the pay amounts reported by the City failed to meet the definition of "compensation earnable" and should not have been used to calculate his final compensation and retirement benefit. This correction is based upon a final compensation amount adjusted from \$44,128 to \$9,450 per month. The corrected final compensation amount is calculated using the most recent pay amount meeting the definition of "payrate" in the amount of \$7,875 in addition to the longevity payment of 20 percent of that base pay which is approximately \$1,575.60. Accordingly, Mr. Malkenhorst's monthly retirement allowance will be reduced to \$9,654.09 minus any authorized deductions.

Should Mr. Malkenhorst, Sr. exercise the right to appeal, CalPERS will continue to pay the current amount of Mr. Malkenhorst's allowance between now and the time of hearing. Should a decision be reached to reduce Mr. Malkenhorst, Sr.'s retirement allowance in the administrative process, CalPERS will seek to recover all overpayments made to Mr. Malkenhorst, Sr. as provided under the PERL.

This letter highlights some of the major concerns identified by CalPERS in its determination. However, the issues identified in this letter are not exhaustive, nor are they intended to reflect all of the legal, technical and administrative issues that CalPERS considered in reaching the determination. In addition, this letter does not repeat all of the issues and facts identified in the Public Agency Review. Thus, it should be read in conjunction with these documents. CalPERS reserves the right to raise additional issues relating to the determinations listed above. If additional issues are raised, you will be notified and granted additional appeal rights as to any new findings.

You have the right to appeal the decision referred to in this letter if you desire to do so, by filing a written appeal with CalPERS, in Sacramento, within **thirty days of the date of the mailing of this letter**, in accordance with Government Code section 20134 and sections 555-555.4, Title 2, California Code of Regulations.

An appeal, if filed, should set forth the factual basis and legal authorities for such appeal. A copy of the applicable statute and Code of Regulations sections are included for your reference. If you file an appeal, the Legal Office will contact you and handle all requests for information.

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Your appeal will be set for hearing with the Office of Administrative Hearings (OAH). The assigned CalPERS attorney will contact you to coordinate a hearing date. Depending on the current caseload of the OAH and the assigned attorney, the hearing date may be set several months after the case is opened. The OAH will typically offer its earliest available hearing date that meets the schedule of both parties. If Mr. Malkenhorst chooses not to be represented by an attorney, the assigned CalPERS lawyer will be in direct communication with Mr. Malkenhorst during the appeal process. However, as of today's date CalPERS has you, Mr. John Michael Jensen, as the attorney of record for Mr. Malkenhorst, Sr. as to the above referenced matter.

Attached is an informational brochure on the General Procedures for Administrative Hearings.

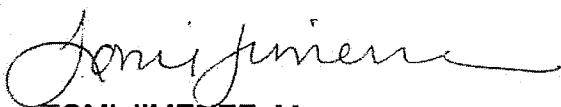
After the hearing is completed, the Administrative Law Judge will issue a Proposed Decision in approximately 30 days. The CalPERS Board of Administration will then make a determination whether to accept or reject that Proposed Decision. If the Board rejects the Proposed Decision, they will hold a Full Board Hearing in order to review the entire hearing record again before finalizing their decision.

Your appeal should be mailed to the following address:

Karen DeFrank, Chief
Customer Account Services Division
P.O. Box 942709
Sacramento, CA 94229-2709

If you have any questions regarding this information, please call me directly at (916) 795-0340.

Sincerely,



TOMI JIMENEZ, Manager
Compensation and Employer Review
Customer Account Services Division

cc: Karen DeFrank
Bruce V. Malkenhorst, Sr.