ATTACHMENT E

THE PROPOSED DECISION

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

In the Matters of the Calculation of the Final Compensation of: ROBERT B. PAXTON, M.D., HOWARD M. SKOPEC, M.D., and DANILO V. LUCILA, M.D., Respondents, and CALIFORNIA DEPARTMENT OF SOCIAL SERVICES, Respondent.	Paxton: Case No. 2014-0336 OAH No. 2014080002 Skopec: Case No. 2013-1120 OAH No. 2014050198 Lucila: Case No. 2014-0335 OAH No. 2014050199

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PROPOSED DECISION

These consolidated matters were heard before Administrative Law Judge Jonathan Lew, Office of Administrative Hearings, on April 13 through 16, 2015, in Sacramento, California.

Jeanlaurie Ainsworth, Senior Staff Counsel, represented the California Public Employees' Retirement System (CalPERS).

Richard A. Schulman, Attorney at Law, Hecht Solberg Robinson Goldberg & Bagley LLP, represented Robert Paxton, M.D. Respondents Howard M. Skopec, M.D., and Danilo V. Lucila, M.D., appeared on their own behalf.

Janine LaMar, Senior Assistant Chief Counsel, represented the California Department of Social Services.

The separate appeals were consolidated for hearing. Evidence was received in the form of documents and testimony. Submission of the matters was then deferred pending

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FILED July 24 20 15

receipt of written closing arguments.[1] Following the filing of closing arguments and other documents, the record was closed and the cases were submitted for decision on July 1, 2015.

FACTUAL FINDINGS

Background

1. The California Department of Social Services (DSS) employed Dr. Paxton, Dr. Skopec and Dr. Lucila as medical consultants. During their employment, DSS offered all medical consultants the opportunity to participate in bonus programs. Respondent doctors participated in the bonus programs, and by completing more cases in a normal workweek than a baseline productivity standard that was set forth in a union agreement, each of them received compensation in addition to their standard payrate. They did not work overtime to earn the bonus payments. DSS deducted CalPERS retirement contributions from the bonuses that were paid to respondent doctors.

When Dr. Skopec and Dr. Lucila retired from state service, they believed CalPERS was required to treat the bonus payments as "special compensation" when calculating their final retirement allowance. Characterizing the bonus payments as "special compensation" would increase each retiree's monthly retirement allowance. Dr. Paxton is in a different position because he is not retired, and continues in his employment as a DSS medical consultant. On November 27, 2012, Dr. Paxton submitted a Request for Service Credit Cost Information and was advised by CalPERS that the special compensation reported as Medical Consultant Bonus Pay could not be included in the calculation of his final compensation when he retires. Because common questions of fact and law are presented, and to promote judicial economy and efficiency, the three matters were consolidated for hearing.

Respondent doctors all filed timely appeals.

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[1] CalPERS filed a Request for Official Notice on June 4, 2015, that was marked as Exhibit 29 for identification. CalPERS filed a Closing Brief on June 5, 2015, that was marked as Exhibit 30 for identification. On June 26, 2015, CalPERS filed a Reply to Respondent Robert B. Paxton's Trial Brief, and Reply to Dr. Lucila's Closing Brief, which were marked respectively as Exhibits 31 and 32 for identification. Respondent Paxton filed a Trial Brief on June 5, 2015, that was marked as Exhibit GG for identification. On June 26, 2015, respondent Paxton filed a Reply Trial Brief, Opposition to CalPERS Request for Official Notice, and Objections to Use of Scheel Deposition, which were marked collectively as Exhibit HH for identification. Respondent Lucila filed an Opening Brief and Reply Brief that were marked respectively as Exhibits II and JJ for identification. Respondent Skopec filed a Joinder in Trial Brief of Respondent Robert B. Paxton that was marked as Exhibit KK for identification. CalPERS was afforded five days from June 26, 2015, to file a reply to objections raised by respondents to Pamela Scheel's deposition. No objections were filed, and the matter was deemed submitted for decision on July 1, 2015.

2. CalPERS contends that the Legislature granted its Board broad authority to determine "compensation earnable," and that where items of "compensation earnable" are to be included as "special compensation" the parties to such agreement are required to obtain CalPERS Board approval, something that was not done here. CalPERS also believes that the bonus payments received by DSS medical consultants cannot be treated as "special compensation" because the payments did not qualify as a "bonus." Rather, CalPERS believes the payments were more in the nature of compensation for "overtime" services, something the retirement law specifically excludes from being treated as "special compensation." In addition, CalPERS claims that not all medical consultants were allowed to participate in the bonus program, which nullified the bonus payments from being treated as "special compensation." CalPERS further contends that the payments do not qualify as "compensation" under the Public Employees Retirement Law (PERL) because the federal government controlled the payments, and not the employer. Finally, CalPERS claims that characterizing the productivity payments as "special compensation" will result in unfunded liabilities and establish a bad precedent.

Respondents urge that the plain language of the statute requires that the bonus payments count toward each employee's pension. Respondents agree that "compensation earnable" excludes overtime pay, but that it does include extra pay for special skills or certifications. They contend that they did not work more than 40 hours per week to earn bonus payments, that all demonstrated special skills by exceeding the threshold baseline productivity ("bonus") standard, that all performed their normally required duties more efficiently, that the bonus program was available to all similarly situated medical consultants, and that other contentions raised by CalPERS are without merit.

CalPERS Retirement Plan

3. CalPERS manages a defined benefit retirement plan for California state employees and employees of contracting public agencies. Retirement benefits are funded by member and employer contributions and by interest and other earnings on the contributions. The CalPERS Board of Administration sets employer contribution rates on an annual basis using actuarial assumptions.

A member's service retirement allowance is calculated using the member's years of service credit, age at retirement, and final compensation. Final compensation is a function of the member's highest "compensation earnable," which consists of the member's "payrate" and any "special compensation." In computing a member's retirement allowance, CalPERS staff may review the salary reported by the employer for the member to ensure that only those items allowed under the PERL will be included in the member's "final compensation" for purposes of calculating the retirement allowance.

The California Department of Social Services

4. Respondent DSS is a state agency that serves needy and vulnerable adults and children through the administration of various regulatory, health and financial programs.

DSS's Disability Determination Service Division (DDSD) determines the medical eligibility of disabled Californians who are seeking federal Social Security disability and supplemental security income benefits, and MediCal. The two federal programs are 100 percent federally funded. The MediCal eligibility determinations are performed by DSS employees for the Department of Health Care Services, and the program is funded 50 percent from the State General Fund, and 50 percent from federal funds. DDSD employs analysts and doctors, both psychiatrists and non-psychiatrists, to reach eligibility determinations. DDSD currently maintains 12 branch offices dedicated to federal Social Security disability and supplemental security income benefit determinations, and one branch office responsible for MediCal determinations. They are referred to within DDSD, respectively, as the federal and state programs.

5. By reason of their employment, respondent doctors are state miscellaneous members of the Public Employees' Retirement System under Government Code section 20380.

History of the Medical Consultant Bonus Program

6. In December 1993, DSS applied for and received an exemption from the Department of Personnel Administration (DPA) that authorized DSS to pay medical consultants overtime pay. DSS made that request to close a backlog of Social Security eligibility cases. DPA granted the exemption with the understanding that DSS would eliminate current formal and informal recognition of overtime pay to salaried employees such as medical consultants and would implement alternatives to the payment of overtime because the payment of overtime violated the Fair Labor Standards Act.

7. On May 26, 1996, DSS asked DPA for a second exemption in order to pay the medical consultants overtime, which request was denied. In 1996, the Union of American Physicians and Dentists (UAPD), the bargaining unit representing physicians and dentists employed by the State of California, and DSS signed a side letter under which it was agreed that medical consultants would be paid a case closure fee for each case that was closed that exceeded baseline productivity standards that were set forth in the side letter agreement. Prior to the 1996 negotiation, many UAPD members favored having the doctors in DSS work overtime and simply be paid time and a half. UAPD was told the doctors were statutorily exempt and that the State could not allow overtime pay.

CalPERS did not participate in the negotiations and was not a party to the side letter. The side letter provided for a "temporary medical consultant bonus plan" lasting three months. Under the temporary plan, the baseline productivity standard for full-time medical consultants was 47 cases reviewed for closure per week, with a $35 bonus to be paid for every case that was closed above the baseline standard when the temporary bonus plan was in place. The side letter agreement with UAPD expired on December 31, 1996.

8. In 2002, a side letter was negotiated to continue the bonus program, and it was subsequently amended to extend its term to 2003. In 2003, the new side letter was first presented as part of the UAPD contract.

9. In 2006, the side letter was amended to have two different bonus plans. Under the side letter, a temporary bonus plan was available to DSS medical consultants in late 2006. This was instituted because the Social Security computer system went down for an entire week, resulting in a large backlog. The temporary bonus plan ran from September 18 to December 11, 2006. It lasted a period of weeks for non-psychiatrist medical consultants (physical doctors), and approximately 90 days for psychiatrist medical consultants.

10. In addition to the temporary medical consultant bonus plan, the side letter agreement between the UAPD and DSS provided for a bonus program for periods other than the three-month temporary period. This bonus program was to be available to all medical consultants. Under that part of the side letter agreement, the baseline productivity standard for full-time medical consultants was set at 90 cases reviewed for closure each work week, beyond which individual consultants participating in the program would be eligible to receive a bonus of $27 for each additional case that was closed if the bonus plan was invoked. One trigger available to invoke the bonus plan was "persistent backlog."

11. Under the UAPD/DSS side letter agreement, a second bonus program was triggered in March 2008 as a result of a persistent backlog. The bonus program that was triggered in March 2008 remained in effect until November 2011. The parties to the agreement were DPA, DSS and UAPD. The relevant provisions of the medical consultant bonus plan as set forth in the April 2, 2007 side letter agreement are detailed below:

> 1. Baseline productivity for full-time Medical Consultants will be 90 cases reviewed for closure per week (Monday through Sunday). This is the level beyond which individual MCs would be eligible for bonus pay when the plan is invoked. This 90 case review per week baseline productivity threshold will be prorated within a calendar week (Monday through Sunday) for state holidays and special out-of-office work assignments (e.g., teaching at the RFC Academy). Time off for other leaves such as vacation, sick leave, annual leave, personal holidays, informal time off will not be prorated.
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> 2. Individual Branches will be able to implement the bonus plan, based on the Branch's particular operational situation. To the extent feasible, when invoked by one branch, the bonus plan will be offered to other Bargaining Unit 16 employees who meet the criteria indicated in paragraph A of this Side letter, and who work in the other Disability Determination Services Division (DDSD) branches. Bonus cases must be from the branch invoking the Bonus Plan.

3. A Branch will be able to consider invoking the bonus plan when any one of the following three triggers is met:

- MC full-time Equivalent availability in the Branch falls below 75% of the allocation.

- Workload exceeds 125% of expected workload in a given month (based on federal projected workload estimates for DDSD prorated to the Branch level).

- Persistent backlog, despite appropriate actions, as determined by management.

4. The trigger can be limited to either Medical Consultant I, or Medical Consultant I (Psychiatrist), if conditions warrant.

5. The pay per case above baseline when the bonus plan is invoked is $27.

6. For mixed impairment cases that required both a physical MC and psychiatrist or pediatrician MC review, each MC who signs the case will receive full case credit.

7. MC participation in the bonus plan will be voluntary.

8. Use of the Plan is contingent on availability of funding for this purpose.

12. CalPERS was not a party to the negotiations that resulted in the productivity bonus programs. Nor was CalPERS consulted by UAPD, DSS, or DPA to determine whether bonus payments received by a participating medical consultant under a temporary or other bonus program constituted "special compensation" from which retirement deductions should be taken, or whether those bonus payments could be used in determining the amount of a retirement allowance.

Gary Robinson was formerly UAPD's Executive Director. He has been a consultant to UAPD since 2007. Mr. Robinson testified at hearing. The memorandum of understanding between DSS and UAPD envisioned medical consultants working a 40-hour work week. Many medical consultants were very opposed to working more than a 40-hour work week, which was one reason that overtime pay was not pursued. The baseline case closure rate was a matter that was negotiated between UAPD, DSS and DPA. Mr. Robinson confirmed that in 1996, UAPD was advised that medical consultants were statutorily exempt from overtime, and that the prior overtime agreement had been made in error. When discussions turned to implementing the bonus programs, the threshold number of cases became a subject of

negotiation. The side letter agreements reflect the outcome of these discussions. Mr. Robinson further confirmed that "pensionability" of the bonus payments was never discussed during the UAPD negotiations.

Implementation of the Bonus Programs

13. Medical Consultant Responsibilities. The job description for medical consultants provides that incumbents evaluate medical evidence to determine its adequacy for making disability decisions as defined by Social Security regulations. Medical consultants assess the severity of physical and mental impairments in relationship to specific guidelines, and "examine all available medical information in order to determine an applicant's physical and/or mental restrictions; and assess residual functional capacities."

Medical consultants, according to the official job description, will spend 50 percent of their time evaluating cases. With administrative and other changes, medical consultants actually spend closer to 80 percent of their time evaluating cases.

Medical consultants are assigned to a team comprised of disability evaluation analysts (DEAs) who are responsible for gathering and reviewing medical paperwork and documentation relating to claims, preparing a summary and forwarding the entire case to the medical consultant for review. DEA IIIs are more experienced. They are expected to process more cases than DEAs, identify and highlight relevant portions of the medical record for the medical consultant, and prepare the file for a more summary review and approval by the medical consultant. Each psychiatrist medical consultant could be supported by as many as 20 analysts' cases, with each analyst assigned approximately 15 cases per week.

14. Medical consultant productivity increased proportionally to the number of cases received that were processed by DEA IIIs, as opposed to less experienced DEAs. Productivity gains also resulted from DDSD's transition from paper filing to a computerized filing system whereby medical documents could be readily accessed and reviewed at the medical consultant's desktop electronically. Computerization began around 2005. It contributed to medical consultants performing their analyses in less time. The 90-case per week threshold, however, was not adjusted to reflect the greater efficiencies resulting from computerization or other changes that occurred over that period.

15. Overtime. DEAs and DEA IIIs who work up the cases and present the files to medical consultants for review, can and do receive overtime. In contrast, under the UAPD labor agreement, medical consultants cannot receive overtime pay. They are not paid in addition to their salary for working over 40 hours per week. They are expected, as members of a professional class of state employees, to work the hours necessary to complete their assigned work. And this will normally require 40 hours per week. Medical consultants are not prohibited from working over 40 hours per week. They are just not paid overtime for doing so.

16. Medical consultant hours were flexible and not set. Thus, medical consultants can work 30 hours one week, and 50 hours the next. The union agreements specify: "No time clock or timekeeping shall be implemented." They may "flex" their hours and work any time the office is open. They cannot perform their responsibilities outside the office as access to medical and other documentation is restricted to one's desktop computer. DDSD's system did not allow remote access to their work from home. All DDSD employees are required to be in the office between the hours of 9:00 a.m. and 2:30 p.m. They may work earlier and leave earlier, or come in later and leave late. Medical consultants could work as many hours as they wanted during open office hours (6:00 a.m. to 6:00 p.m.), Monday through Friday, and anytime a supervisor was present on weekends. It was therefore possible for medical consultants to work more than 40 hours under the bonus plan. No one monitored the number of hours a medical consultant was physically present at the work site.

17. Respondent doctors were unanimous that they did not work more than their scheduled 40 hours per week. In the case of Dr. Paxton, he had a second job, working from 4:00 p.m. to midnight, up to two nights per week. Dr. Skopec worked on an Indian reservation one or two days each week, and he was also employed part-time with San Diego County. Dr. Lucila also had other demands on his time. All three were under the impression that the law prohibited them from working more than 40 hours per week, and each testified credibly to the hours he worked on average each week at DSS.

18. Earning the Bonuses. Dr. Paxton explained how exceeding the 90-case per week threshold was very doable. He characterized the review process as repetitious work, "something you had to do but wasn't really interesting, but you had to mentally focus on every case to the best of your ability, as quick as you could, and give a coherent, correct decision for every case you had." He estimates spending 80 percent of his time evaluating cases, averaging five minutes per case file. Working at that pace, he would exceed the bonus threshold of 90 cases by Tuesday morning, and if he reviewed cases only 50 percent of his time he would exceed the threshold by Tuesday afternoon.[2] He noted that the shift to electronic review and computerized access to records has increased his efficiency over time. In 2005, for example, he had to unload boxes of hard copy case files for review, whereas today only one in fifty cases involve paper review. Also, in past years he had to contact physicians by telephone and wait for their call back. This is no longer necessary. Dr. Paxton indicated that the threshold was never adjusted to account for the increased efficiencies occasioned by computerization.

When the Office of Inspector General (OIG), Social Security Administration, performed an audit of DDSD, Dr. Paxton was timed on how he went about performing case evaluations. He averaged five to ten minutes per case. Kelly Loomis, M.D., has worked ten years as a psychiatrist medical consultant in DSS's La Jolla office. He testified at hearing.

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[2] A rate of one case every five minutes equals 12 cases per hour. When calculated over eight hours/day at 80 percent work time, this equates to 76 cases per day; and when calculated at 50 percent work time, this equates to 48 cases per day.

Dr. Loomis was also timed as part of an OIG "exercise" and was asked to review three cases on his computer. He completed the review in 15 to 20 minutes, consistent with the pace described by Dr. Paxton. Dr. Loomis further indicated that he spent 85 to 90 percent of his time engaged in evaluating claims.

19. Availability. As noted in Finding 4, DDSD currently maintains 12 branch offices dedicated to federal Social Security disability and supplemental security income benefit determinations, and one branch office for MediCal determinations. They are referred to within DDSD, respectively, as the federal and state programs. The bonus program was never available to medical consultants employed by DSS in its state program. This is because the state MediCal program is not 100 percent federally funded.

The bonus program was not available at all times. It was typically triggered when there were backlogs. It was generally available to psychiatrist medical consultants, and rarely available to non-psychiatrist medical consultants, reflecting both the backlog of mental impairment cases for psychiatric review, and the relatively fewer number of psychiatrist medical consultants available to perform case reviews. The bonus program could be implemented statewide, or in a single DDSD branch office. By 2010, a medical consultant in any given DDSD branch office could access files electronically from any other branch office. Even prior to 2010, paper files could be transferred between offices for review by psychiatrist medical consultants.

20. Control. The bonus program was dependent upon the availability of federal funding. Thus the April 2, 2007 side letter agreement specified: "Use of the Plan is contingent on availability of funding for this purpose." It was 100 percent federally funded. Each year DSS put together a spending plan which included an estimate of medical consultant bonuses, which was then subject to Social Security Administration (SSA) approval. DSS then sent periodic reports on spending which SSA monitored, and occasionally audited. For example, SSA audited the program in 2007 and 2013.

21. Debra Peel is the Assistant Deputy Director of DSS field operations. She testified to the process by which the bonus program was federally funded and controlled. Prior to December 2011, Ms. Peel was the central support services branch chief, providing all administrative support in the areas of contracts, equipment, supplies, computer support systems, and personnel. This included the DDSD disability hearings operations. Ms. Peel confirmed that there was an annual spending plan submitted by DSS to SSA for approval, and that this accounted for both medical consultant salaries and bonus payments. The approved funding was for a given amount, as opposed to an ongoing draw. It was pursuant to a state contract with SSA. She noted that while in California doctors are salaried, in other states the doctors are not salaried and may be contracted independently. DSS had no alternative funding source from which to pay the bonus payments to its medical consultants.

22. DSS withheld retirement contributions from the bonus checks to medical consultants, and these amounts were paid to CalPERS via the State Controller's Office. These withheld amounts were 100 percent federally funded. As detailed below, CalPERS

repeatedly advised DSS to stop reporting the bonus checks as special compensation, and has indicated to DSS that any retirement contributions on bonus payments were paid in error. It is prepared to correct this by returning any amounts withheld. For example, CalPERS has done so to a number of similarly situated DSS employees who did not appeal CalPERS's determination regarding medical consultant bonus payments.

Respondents' Hours and Compensation

23. There was no issue regarding the highest monthly payrates reported as $11,712 for Dr. Paxton, $12,280 for Dr. Skopec, and $12,894 for Dr. Lucila. The amounts of "special compensation" in the form of bonus payments reported on their behalf by DSS to CalPERS are summarized as follows:

a. Dr. Paxton. Dr. Paxton has not retired so his highest year of "final compensation" cannot yet be determined. For purposes of analysis here, he is claiming approximately $459,000 a year as "final compensation." He received over $1.2 million in bonus payments. In 2010, Dr. Paxton received more in bonus payments than his salary. His monthly bonus payments alone that year ranged from a low of $16,821 for November, 2010, to a high of $39,501 for August 2010. The total number of extra cases credited to Dr. Paxton above the threshold for August 2010, was 1,463.[3]

Dr. Paxton testified credibly to not working overtime to earn bonus payments, and to not working more on average than 40 hours per week.

b. Dr. Skopec. Dr. Skopec retired in August 2012. As a psychiatric medical consultant he consistently reviewed between 90 and 120 cases per week. His highest reported annual special compensation totaled $48,690 for fiscal year 2006-2007. His highest documented monthly bonus of $15,365 was received in November 2006. Dr. Skopec closed 439 cases that month above the threshold.[4] There were at least three months in fiscal year 2006-2007 when Dr. Skopec did not exceed the threshold at all. His highest three months were October through December 2006. Over that three-month period he worked "as hard and as fast" as he could, and then returned to a "normal pace." He believes his monthly bonus payments generally averaged between $4,000 and $5,000.

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[3] August 2010 included five weeks, including the week ending August 1, 2010. The total number of cases Dr. Paxton closed that month, minus the base number, equaled 1,463. When multiplied by $27, his gross bonus payment was $39,501, or more than three times his monthly payrate of $11,712.

[4] In November 2006, Dr. Skopec was paid $35 per case review for each case beyond the established baseline of 47 psychiatric cases per week.

Dr. Skopec testified credibly to not working overtime to earn bonus payments, and to not working more on average than 40 hours per week.

c. Dr. Lucila. Dr. Lucila retired in May 2014. He served as a psychiatric medical consultant out of DSS's Oakland branch. Dr. Lucila's highest reported annual special compensation totaled $35,802 for fiscal year 2008-2009. His highest documented monthly bonus of $11,880 was received in May 2009. Dr. Lucila closed 440 cases that month above the threshold.[5] He otherwise received on average just over $2,000 per month in bonus payments for fiscal year 2008-2009.

Dr. Lucila testified credibly to not working overtime to earn bonus payments, and to not working more on average than 40 hours per week.

CalPERS Compensation Review Unit/Notice to Parties

24. Tomi Jimenez is the Assistant Chief Manager of CalPERS' Customer Account Services Division. She was previously the Manager of CalPERS' Compensation Review Unit, and testified to the process by which CalPERS determines whether an item falls within "compensation earnable." Compensation review is the process by which CalPERS determines if the amount of compensation reported by an employer complies with the Public Employees Retirement Law. Where a Memorandum of Understanding (MOU) is silent as to whether an item of special compensation is reportable, it comes to the Compensation Review Unit for evaluation. Ms. Jimenez explained that for a special compensation to be eligible and accepted as compliant, it would need to specifically state in the MOU that it was to be used for retirement purposes and then approved through the proper channels, or the parties are required to seek CalPERS Board approval.

25. Ms. Jimenez indicated that the issue in this case first arose in about 2007, and CalPERS subsequently gave notice to DSS that the medical bonus payments were not reportable as special compensation by letters dated July 15, 2009, November 3, 2009, November 10, 2010, February 8, 2011, October 6, 2011, September 20, 2013, and July 8, 2014. The letters were sent to individual members, with a copy to DSS, and also directly to a DSS contact person, Susan Bonham. For example, on July 15, 2009, the CalPERS Compensation & Employer Review Unit manager advised Ms. Bonham that it would be excluding the medical consultant bonus payments from a member's retirement benefit calculation and that "CalPERS requests that the CDSS reverse this compensation out of our payroll system in order to recover contributions paid on this benefit."

26. CalPERS analysts began the compensation review by examining the agreement between UAPD, DPA and DSS, the side letters, case review bonus certifications,

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[5] In May 2009, Dr. Lucila was paid $27 per case review for each case beyond the established baseline of 90 psychiatric cases per week.

and other documentation. CalPERS analysts did not contact respondents in reaching their determination that the bonus payments were not recognized as "special compensation" under the retirement law.

Unfunded Liability

27. Jean Fannjiang is a Senior Pension Actuary with CalPERS. She testified that retirement pensions are prefunded and that the calculation of funding needs is based upon actuarial assumptions such as the member's age and salary increases over time. When 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. Here, Ms. Fannjiang noted that the periodic increases occasioned by the bonus payments were "very unique" and not in line with typical salary increases that are usually in the eight to ten percent range. Where a member's earnings increase by two or three times above the base salary, as in the case of Dr. Paxton, the bonus payment will result in an unfunded liability and the employer's contribution must increase dramatically to account for this. Ms. Fannjiang emphasized that the medical consultant bonus payments, up to triple the amount of one's base pay, were not a pattern seen anywhere else.

28. Ms. Fannjiang further explained that under Internal Revenue Code section 415, subdivision (b), CalPERS can only pay $210,000 a year in benefits to a retiree and still qualify as tax exempt. In cases such as Dr. Paxton's, the requested final compensation will result in a retirement benefit that exceeds this amount. Dr. Paxton is claiming final compensation of approximately $459,000. If approved the State would need to make payments to Dr. Paxton from a replacement benefit program (RBP), with benefits paid out of the State's General Fund. The RBP would be funded by the member's former employer, DSS in this case, independent from CalPERS. Payments into the RBP would be on a pay-as-you-go basis for any excess benefit received by the member above $210,000.

Discussion

29. Per the consolidated Statement of Issues, the appeals are "limited to the issue of whether CalPERS properly determined that the Medical Consultant Bonus Pay did not qualify as compensation earnable under the PERL." Respondent doctors established that they received payments above their standard payrate for services rendered during normal working hours, and that DSS reported the payments in the pay period in which the bonus payments were earned.

CalPERS has made a number of contentions. It believes that each of these contentions, if sustained, will support its determination. Discussion here will separately consider these contentions. In its Closing Brief, CalPERS contends that the payments do not qualify as "compensation" under the PERL because the federal government controlled the payments, and not the employer. CalPERS next contends that the Legislature granted its Board the authority to determine "compensation earnable," and that where the UAPD side letter does not state that the bonus payments are to be included in retirement calculations the

parties to such agreement were required to obtain CalPERS Board approval. CalPERS further contends that the productivity payments received by respondents cannot be treated as "special compensation" because the payments did not qualify as a "bonus," and that not all medical consultants were allowed to participate in the program. Rather, CalPERS believes the payments were more in the nature of compensation for "overtime" services that can easily be manipulated and result in spiking. Finally, CalPERS contends that characterizing the productivity payments as "special compensation" will result in unfunded liabilities and establish a bad precedent.

Respondents strongly disagree, urging that the plain language of the statute requires that the bonus payments count toward each employee's pension. Respondents believe they all demonstrated special skills by exceeding the threshold baseline productivity standard, that all performed their normally required duties more efficiently within normal working hours, that the bonus program was available to all similarly situated medical consultants, and that other contentions raised by CalPERS are without merit. The above matters are discussed in order below.

Federal Control

30. CalPERS believes the medical consultant bonus payments do not qualify as "compensation" because the funds are paid and controlled by the federal government or SSA. 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..." CalPERS notes that SSA controls the funding and ultimately when bonus payments are made and when they are not. CalPERS suggests that the employer, DSS, has little control over the bonus payments, and cites language in the side letter to the effect that "[u]se of the Plan is contingent on the availability of funding." Thus, the medical consultant bonus payments are triggered only if the funds are available in a program that is 100 percent federally funded. For example, medical consultants in the state program, while technically covered by the bonus plan, were not offered bonuses because the payments were federally funded and there was a lack of funding for that purpose for medical consultants performing similar work in the MediCal eligibility determinations branch office.

Respondents contend that the fact that monies originated from the federal government does not mean that the funds are not controlled by the employer. Particular guidance can be found in PERL language defining "employee" and which specifies: "'Funds directly controlled by the state' includes funds deposited in and disbursed from the State Treasury in payment of compensation, regardless of their source." (Gov. Code, § 20028, subd. (a).) 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 base payrate. For this reason respondents' arguments are more persuasive that the term "controlled by" must have a meaning no less broad than "paid by." Such is entirely consistent with the section 20028 language relating to

funds "controlled by" the state being inclusive of disbursements to state employees "regardless of their source." Other arguments raised by CalPERS relating to control by SSA were unavailing and not persuasive otherwise.

CalPERS Board Approval

31. In 1993, the Legislature, through Senate Bill 53, crafted the definition of "compensation earnable" in an effort to address the widely used practice of "spiking" or the intentional inflation of one's final compensation upon which retirement benefits are based. The Legislature intended to produce a comprehensive pension accountability program that provides: 1) full funding of all member benefits; 2) reduces the ability to manipulate benefits; 3) provides the CalPERS Board with "clear oversight of benefits"; and 4) provides CalPERS with "greater statutory authority to combat pension abuse."[6] (See LH, pp. 0088, 0131, and 0145.) The reported spiking mainly concerned local governments and contracting public agencies, and as a result Senate Bill 53 was amended on July 2, 1993, to apply different criteria for state employees. Under these amendments, CalPERS Board of Administration was granted broad discretion to determine what qualified as "compensation earnable" and the specific items to be used in retirement benefits. At the time, the definition of "compensation earnable" was codified as Government Code section 20023, and it was later re-codified to the current section 20636.

32. Under Government Code section 20636, subdivision (g)(1), "compensation earnable" for state members is defined to be:

> [T]he average monthly compensation, *as determined by the board*, upon the basis of the average time put in by members in the same group or class of employment and at the same rate of pay, and is composed of the payrate and special compensation of the member.

[Italics added.]

33. Government Code section 20636, subdivision (g), proceeds to detail specific items to be included in "payrate" and "special compensation," and further specifies that CalPERS Board has authority to determine "other payments" that may be included within "payrate" or "special compensation." (Gov. Code, § 20636, subds. (g)(2)(F) & (3)(D).) It also vests in CalPERS Board the authority to determine other payments that "*are not* 'payrate' or 'special compensation.'" (Italics added. Gov. Code, § 20636, subd. (g)(4)(L).)

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[6] Official notice was taken of the Legislative Intent History filed by CalPERS pertaining to Government Code section 20636. References to the Legislative History of Senate Bill 53 are to "LH, page number."

Regarding items of compensation earnable that are included in MOUs, section 20636, subdivision (g)(5) provides in pertinent part:

> If 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.

[Italics added.]

34. CalPERS contends that the cited legislative history and the language of Government Code section 20636 demonstrate that CalPERS has broad authority and discretion to determine "compensation earnable" for state employees so that the pensions cannot be manipulated, pay is fully disclosed, and unfunded liabilities would not occur. It believes that the medical consultant bonus payments can easily be manipulated by members, were periodic in payment, and thus "make it a prime tool for pension spiking."

CalPERS points more specifically to the UAPD contract side letter in effect for the periods in question, and notes that it is silent on whether the bonus payments were meant by the parties to be included in the calculation of retirement benefits.[7] Gary Robinson, UAPD's former executive director, confirmed that "pensionability" of the bonus payments was never discussed during the negotiations. CalPERS was not a party to the negotiations. Neither CalHR nor UAPD sought or received CalPERS' approval for the bonus payments to be included as special compensation. When provided notice of the contract side letter, CalPERS told UAPD, CalHR and DSS that the payments did not qualify as special compensation and directed DSS to correct its payroll and stop reporting it. In short, the medical consultant bonus plan was never presented to the CalPERS Board for approval as contemplated under Government Code section 20636, subdivision (g)(5).

35. Respondents contend that CalPERS' argument under section 20636, subdivision (g)(5) is flawed because CalPERS approval would be needed only if an MOU explicitly conflicts with the legislative definitions of "payrate" or "special compensation." Respondents believe the side letter, because "payrate" and "special compensation" are not explicitly addressed, presents no conflict. Respondents rely upon the following language in subdivision (g)(5):

> If the provisions of this subdivision, including the board's determinations pursuant to subparagraph (F) of paragraph (2)

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[7] In contrast, the side letter to the current MOU specifically states: "Medical Consultant Plan Bonus payments issued during the term of this MOU shall be specifically excluded from being reported as pensionable compensation to the CalPERS and therefore will not be considered 'compensation' for purposes of calculating retirement benefits."

> and subparagraph (D) of paragraph (3), are in conflict with the provisions of a memorandum of understanding reached pursuant to Section 3517.5 or 3560, the memorandum of understanding shall be controlling without further legislative action, except that if the provisions of a memorandum of understanding require the expenditure of funds, those provisions may not become effective unless approved by the Legislature in the annual Budget Act.

The above language merely dictates which provisions control when there is a conflict between the board's determinations and an MOU.[8] It is not a condition precedent to seeking board approval when items of compensation earnable are included in an MOU as "special compensation" as suggested by respondents. The separate provisions within subdivision (g)(5) operate independently of each other.

36. Whether the side letter contained express language regarding the medical consultant bonus payments being considered "special compensation" for retirement purposes, and it did not, the side letter was interpreted over a number of years by DSS as including the bonus payments as an item of special compensation without affording CalPERS an opportunity to determine whether it should be included as an item of special compensation.[9] However, this 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

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[8] Nor does this language suggest that more deference should generally be accorded to MOUs, than determinations by CalPERS. The references to "board's determinations pursuant to subparagraph (F) of paragraph (2) and subparagraph (D) of paragraph (3)" refer to other items of payment that the board may determine to be *within* "payrate" or "special compensation." As such, any conflict with the MOU would contemplate the MOU being more conservative in its treatment of a particular item, perhaps not even including it within "payrate" or "special compensation" and thus the language making the MOU provisions controlling where a conflict exists. It is noted that there is no reference to conflicts with the board's determinations pursuant to subparagraph (L) of paragraph (4), which confirms that compensation earnable does not include: "Other payments the board may determine are *not* "payrate" or "special compensation." (Italics added. Gov. Code, § 20636, subd. (g)(4)(L).) Applying the same reasoning, if the MOU provisions were controlling in the case of conflicts with this section, then parties to such agreements could easily trump any CalPERS determination that a particular item should not be included as special compensation, without more, and there would be no purpose in seeking CalPERS approval. It cannot be found that the Legislature intended such an absurd result.

[9] The facts that the parties to the MOU never discussed "pensionability" of the bonus payments during the negotiations, and that CalPERS was neither a party to the negotiations nor consulted about the bonus payments could also be interpreted as the parties never intending the bonus payments to be an item of special compensation.

remedy for which is full consideration of the substantive issues set forth in the consolidated Statement of Issues as part of these administrative proceedings.

Characterization as Bonus

37. "Special compensation" is generally defined as a payment received by a member "for special skills, knowledge, abilities, work assignment, workdays or hours, or other work conditions." (Gov. Code, § 20636, subd. (c)(1).) It includes "[c]ompensation for performing normally required duties, such as . . . bonuses (for duties performed on regular work shift)." (Gov. Code, § 20636, subd. (g)(3)(B).) As additional guidance, the parties cite to a CalPERS regulation specific to local governments that defines bonus. Although not applicable to state employees, it is nevertheless instructive. Rule 571 defines bonus as follows:

> Bonus - Compensation to employees for superior performance such as "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.

(Cal. Code Regs., tit. 2, § 571, subd. (a)(1).)

38. CalPERS characterizes the bonus payments as simply a payment for case closures above a certain number, and not a "bonus" tied to particular performance goals and objectives in advance of payments. Preliminarily, CalPERS contends that the bonus payments do not even meet the definition of "special compensation" which requires that payment be "for special skills, knowledge, abilities, work assignment, workdays or hours or other work conditions." Such contemplates the medical consultants doing more than simply performing their normal work duties. CalPERS characterizes the bonus as being payment for normal work, only for extra work. It did not require any special skills or knowledge separate from those required for their regular duties as medical consultants. The payments were for closing more cases at times when there were backlogs. CalPERS notes that a true bonus would not be paid only to some employees who performed the same tasks and not to others. Thus, under the medical consultant bonus program, if a medical consultant did not sign up for the program, and closed in excess of 90 cases in a given week, he or she would not have received the bonus payments.

Respondents contend it was a bonus because they reviewed more cases than the defined threshold. They believe such constitutes "superior performance" and that it was pursuant to a program that defined performance goals and objectives. Respondents note that compensation earnable "includes extra pay for special skills and certifications" and that they demonstrated special skills by exceeding the threshold. (*Stillman v. Board of Retirement* (2011) 198 Cal.App.4th 1355, 1362.) Respondent Paxton contends at the most basic level

that his bonuses were earned during normal working hours, he earned them for performing his normally required duties more efficiently, his bonuses were PERSable, "and that's all that this case is about."

39. Dr. Paxton, in fact, received over $1.2 million in bonus payments. In 2010, he received more in bonus payments than his salary. His monthly bonus payment alone for August 2010 was $39,501. He closed 1,463 cases above the threshold that month. He did this while averaging a 40-hour work week. What this case really "is about" is whether such extra payments to medical consultants such as Dr. Paxton were for special skills, knowledge and abilities (i.e. superior performance), or merely for extra work. For the reasons explained below, it was the latter. The medical consultant bonus payments should therefore not be characterized as a "bonus" for purposes of inclusion as "special compensation." (Gov. Code, § 20636, subd. (g)(3)(B).)

40. Consideration of the history of the bonus program is critical to a proper understanding and characterization of the bonus payments. (See Findings 6 through 17.) The bonus program was implemented to encourage DSS medical consultants to work more hours to address substantial case backlogs. In 1993 they were paid overtime to do so. In 1996, DSS was denied its request for a second exemption to pay medical consultants overtime. DSS and UAPD understood that medical consultants were part of a professional class of employees that could no longer be paid overtime. The medical consultant bonus program was then devised in lieu of, and as an alternative to overtime pay. That is not to say that bonus payments are overtime pay and must therefore be disallowed. Bonus payments are not overtime pay because medical consultants, regardless of the hours worked, cannot receive overtime.[10] The history of the program does, however, provide important context. And because it was established as an alternative to overtime pay, based upon a fixed dollar amount per case above a threshold, it cannot fairly be characterized as a "bonus" for purposes of inclusion as an item of "special compensation" within the meaning of Government Code section 20636.

The bonus payments were not paid for special skills, knowledge and abilities beyond those possessed by all medical consultants. The payments, though not overtime, were

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[10] Medical consultants are in a work group that is excluded from the Fair Labor Standards Act. They are exempt employees and do not receive overtime pay for working more than 40 hours per week. They are in work group SE and the State's policy for employees within this work group provides as follows:

> Unit 16 employees are expected to work hours necessary to accomplish their assignments or fulfill responsibilities, and must respond to directions from management to complete work assignments by specific deadlines. Their normal workload will require 40 hours per week to accomplish. However, inherent in their job is the responsibility and expectation that work weeks of longer duration may be necessary.

certainly more akin to overtime. In fact, medical consultants were not precluded from working additional hours above 40 if they worked full time, or above 20 if they worked half time. They could choose or not choose to close additional cases. They could work 6:00 a.m. to 6:00 p.m., Monday through Friday if they chose. They could work Saturdays. It was extra work made available to them if they desired it. It was the same type of work. It required no special skills, knowledge and abilities beyond which they already possessed to perform this work.

The program was designed to provide federally funded overtime pay. It was used this way for DEAs working overtime to address the backlog. It was initially used this way to pay overtime to medical consultants until the second request for an exemption by DSS was denied in 1996. After 1996, the program transmuted from one based on overtime into one that afforded extra pay for extra work above a threshold. Such could be earned whether one worked less than or greater than 40 hours per week. The fact that respondents believed that they were precluded from working in excess of 40 hours per week is irrelevant. A medical consultant could have worked any or all hours that his or her branch office was opened, just as DEAs who worked overtime did. Like paying overtime, the bonus payments were not limited. There was no cap. Bonus payments fluctuated. They could easily be controlled, even manipulated by the employee. For example, a medical consultant working half time could work a full week, easily exceeding the half-week threshold and receiving a bonus payment for every case closed. Or a medical consultant could take a state holiday resulting in a lower threshold, and then work extra hours on the remaining days and receive greater bonus payments. This is clearly more akin to overtime, and not a bonus in recognition of "superior performance." As Ms. Fannjiang noted, the periodic increases occasioned by the bonus payments were "very unique" and not in line with typical salary increases or bonuses that are usually in the eight to ten percent range. She emphasized that the medical consultant bonus payments, up to triple the amount of one's base pay, were not a pattern seen anywhere else.

41. For all the above reasons, the medical consultant bonus payments received by respondents cannot properly be characterized as a "bonus" for purposes of inclusion as an item of "special compensation" within the meaning of Government Code section 20636.

Availability

42. "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).) The CalPERS system contemplates equality of benefits between members of the same group or class and there is an intent not to treat members within the same class and at the same pay dissimilarly. (*City of Sacramento v. Public Employees Retirement System* (1991) 229 Cal.App.3d 1470, 1492.) CalPERS notes that both the non-psychiatrist medical consultants and psychiatrist medical consultants are in the same group or class, as were medical consultants within the DSS federal program and state program branch offices. Yet the bonus payments were never made available to medical consultants in the state program branches, and rarely to the non-psychiatrist medical

consultants. It was also the case during 2006 to 2008 that some branch offices were authorized to have bonus payments and others were not. Thus, while the bonus payments were frequently available in the San Diego and La Jolla branches, the payments were rarely used in the Roseville Branch. It does appear that the medical consultant bonus program, though generally available, was not equally available to all DSS medical consultants in all branches at all times. Demand was such that it was triggered in some branches, and not in others. Medical consultants could only earn bonus payments when the plan was triggered. The triggers for the bonus could be by branch, or statewide. When it was by branch, one's opportunity to earn bonus payments was not equally available statewide. There was also inequality within a branch office if the bonus payments were only available to psychiatrist medical consultants. As noted earlier, the bonus payments were never available to DSS medical consultants assigned to the state program branch offices.

43. Respondents contend that psychiatrist medical consultants were in a different class than non-psychiatrist medical consultants, and were therefore not similarly situated. They further suggest that psychiatrist medical consultants in DSS state program branch offices are not similarly situated to their counterparts in DSS federal program branches. Respondents contend that medical consultants in the state and federal programs have different "job duties," "work locations" and other "logical grouping" because they are in different branches, work under different titles of law with different funding, and work on behalf of different state departments.[11] Respondents further argue that because the Legislature specifically defined bonuses as an item of "special compensation," it did so without regard for individual variation. And that by their very nature bonuses are not earned by everyone. For these reason respondents suggest that the availability requirement under section 20636, subdivision (g)(1) is not one that is imposed on "bonuses."

44. Respondents are mistaken. Bonus payments are not an exception to the requirement that items of special compensation must be equally available to other members in the same group or class of employment. Whether an individual member qualifies for or takes advantage of a particular item is a separate matter. Here, DSS medical consultants in different branch offices had unequal access to the bonus program. It was available at times in some branch offices, and not in others. Thus, the UAPD/DSS side letter agreement specified that "Individual Branches will be able to implement the bonus plan, based on the Branch's particular operational situation." It was available at times to psychiatrist medical consultants and not to non-psychiatrist medical consultants. It was never available to medical consultants in DSS state program branches. As a result, members within the same group or class of medical consultants employed by DSS at the same rate of pay were treated dissimilarly. For these reasons the medical bonus program 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." (Gov. Code, § 20636, subd. ((g)(1).)

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[11] Although all medical consultants are DSS employees, respondents note that DSS medical consultants who are assigned to the state program work pursuant to an interagency agreement between DSS and the Department of Health Care Services.

CalPERS Authority to Determine Special Compensation

45. Respondents failed to establish that the medical consultant bonus payments constituted "bonuses" or special compensation within the meaning of Government Code section 20636. CalPERS may still independently determine that a particular item may be included or excluded as special compensation. As noted earlier, the Legislature vested in CalPERS the authority to determine what other payments may be included or excluded as items of compensation earnable. Thus, Government Code section 20636, subdivision (g), specifies that CalPERS Board has authority to determine "other payments" that may be included within "payrate" or "special compensation." (Gov. Code, § 20636, subds. (g)(2)(F) & (3)(D).) The Legislature also vested in the CalPERS Board the authority and discretion to determine other payments that "*are not* 'payrate' or 'special compensation.'" (Italics added. Gov. Code, § 20636, subd. (g)(4)(L).) CalPERS has exercised this authority here in determining that the medical consultant bonus payments are not special compensation. Its determination has been well explained, is supported by the record, and is not unreasonable.

46. CalPERS notes that the "pensionability" of the medical consultant bonus program was never discussed during the contract negotiations and the MOU contains no language regarding its inclusion or exclusion as an item of compensation earnable. CalPERS was never consulted or informed that the bonus was to be included in retirement calculations. It had no opportunity to calculate the funding needed based upon actuarial assumptions. No costing was ever requested. CalPERS indicated that the issue arose only after DSS mistakenly and improperly reported the bonus payments as an item of "special compensation." It now seeks to correct this by exercising its authority under Government Code section 20636, subdivision (g)(4)(L), to prevent this type of unfunded liability.

47. 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). The testimony of CalPERS Senior Pension Actuary Jean Fannjiang was most persuasive on this point. Retirement pensions are prefunded and based upon actuarial assumptions. 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 Dr. 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.

48. Ms. Fannjiang further explained that under the Internal Revenue Code, CalPERS can only pay $210,000 a year in benefits to a retiree and still qualify as tax exempt. In cases such as Dr. Paxton's, the requested final compensation will result in a retirement benefit that exceeds this amount. The State would need to make separate payments to Dr. Paxton and to any other medical consultant whose benefit exceeds the limit from the RBP, with all benefits paid out of the State's General Fund. The RBP would be funded by DSS, independent from CalPERS. Payments into the RBP would be on a pay-as-you-go basis for any excess benefit above $210,000. To summarize, if medical consultant bonus payments are included as "special compensation," the result will be significant unfunded liabilities and non-budgeted expenses for the State to cover.

49. Respondents believe any unfunded liability resulting from CalPERS' failure to investigate the bonuses conscientiously so that its actuaries could plan properly, and to understand the psychiatrist medical consultants' work pace and bonus system "is CalPERS' problem." Respondents contend that this case concerns a vested contractual right to pension benefits, and that any withholding of statutorily mandated sums to fund these benefits is an impairment of contract." (*Teachers' Retirement Board v. Genest* (2007) 154 Cal.App.4th 1012, 1036.) They believe any failure by CalPERS staff to engage in actuarial planning does not override their rights to such pension benefits.

Respondents' arguments are not persuasive. That respondents have vested pension rights is undisputed. However, the amount of the pension may not always be ascertained until the last contingency has occurred, or may even be lost upon the occurrence of a condition subsequent such as a lawful termination from employment. (*Dickey v. Retirement Board of the City and County of San Francisco* (1976) 16 Cal.3d 745, 749-750.) In Dr. Paxton's case, he has not retired and he has no vested right to any given amount of pension benefit. The calculation of the *amount* of respondents' pension remains the issue in this case.

50. CalPERS reasonably exercised its authority and discretion in determining that the medical consultant bonus payments are not items of special compensation. Its reasoning has been well-articulated. The medical consultant bonus payments do not meet the statutory requirements for special compensation, and more specifically for bonuses. When exercising its independent authority under Government Code section 20636 to determine other items of special compensation, CalPERS reasonably determined that the medical consultant bonus payments will result in substantial unfunded liabilities occasioned by large fluctuations, inconsistency of payments and other unpredictable elements inherent in the program.

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.

LEGAL CONCLUSIONS

The Burden and Standard of Proof

1. As in ordinary civil actions, the party asserting the affirmative at an administrative hearing has the burden of proof, including both the initial burden of going forward and the burden of persuasion by a preponderance of the evidence. (*McCoy v. Board of Retirement* (1986) 183 Cal.App.3d 1044, 1051, at fn. 5.)

With regard to pension legislation, pension provisions shall be liberally construed and all ambiguities must be resolved in favor of the pensioner. This rule of liberal construction is applied for the purpose of effectuating obvious legislative intent and should not blindly be followed so as to eradicate the clear language and purpose of a statute. (*In re Retirement Cases* (2003) 110 Cal.App.4th 426, 473.)

The Public Employees' Retirement Law

2. Pension programs for public employees serve two objectives: to induce persons to enter and continue in public service, and to provide subsistence for disabled or retired employees and their dependents. The express statutory purpose underlying the state retirement system is to effect economy and efficiency in the public service by providing a means whereby employees who become superannuated or otherwise incapacitated may, without hardship or prejudice, be replaced by more capable employees. (*Wheeler v. Board of Administration* (1979) 25 Cal.3d 600, 605; *Lazan v. County of Riverside* (2006) 140 Cal.App.4th 453, 459.)

Members of CalPERS, once vested, participate in a defined benefit retirement plan that supplies a monthly retirement allowance under a formula comprising factors such as final compensation, service credit (i.e., the credited years of employment), and a per-service-year multiplier. The retirement allowance consists of an annuity (funded by member contributions deducted from the member's paycheck and interest thereon) and a pension (funded by employer contributions and which must be sufficient, when added to the annuity, to satisfy the amount specified in the benefit formula). (*In re Marriage of Sonne* (2010) 48 Cal.4th 118, 121, citing Gov. Code, §§ 21350, 21362.2, subd. (a), and 21363.1, subd. (a).)

The determination of what benefits and items of pay constitute compensation is crucial to the computation of an employee's ultimate pension benefits. (*City of Sacramento v. Public Employees Retirement System* (1991) 229 Cal.App.3d 1470, 1478.)

Final Compensation

3. Final compensation is a function of an employee's highest "compensation earnable," which consists of "payrate" and "special compensation." An employee's "payrate" is the monthly amount of cash compensation received "pursuant to publicly available pay schedules." "Special compensation" is payment received for an employee's

special skills, knowledge, abilities, work assignment, workdays or hours, or other work conditions," but is "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. (*Molina v. Board of Admin., California Public Employees' Retirement System* (2011) 200 Cal.App.4th 53, 65-66.)

4. Premium pay earned for performing normally required duties is "special compensation" under retirement statutes defining "compensation."[12] Although certain premiums are not specifically mentioned by statute, the list of goods and services that may be included within the meaning of the term "compensation" when computing benefits is not exhaustive. The key to coming within the meaning of "compensation" is that the compensation be "special" and earned for nothing more than the performance of normally required duties. (*City of Sacramento v. Public Employees Retirement System* (1991) 229 Cal.App.3d 1470, 1484.)

Compensation Earnable

5. By statute, "compensation earnable" means the payrate and special compensation. (Gov. Code, § 20636, subd. (a).) The bonus payments that respondents received were not "payrate."

Special Compensation

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

7. Government Code section 20636, subdivision (c)(2), provides in relevant part:

> Special compensation shall be limited to that which is received by a member pursuant to a labor policy or agreement . . . to similarly situated members of a group or class of employment that is in addition to payrate ....

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[12] When *City of Sacramento v. Public Employees Retirement System* was decided, the term "compensation" was defined by Government Code section 20022, subdivision (a), to include "(1) the remuneration paid in cash out of funds controlled by the employer, . . . (8) any special compensation for performing normally required duties such as holiday pay, bonuses (for duties performed on regular work shift), . . . and (12) any other payments the board may determine to be compensation."

8. Government Code section 20636, subdivision (g)(3), provides in part:

> Notwithstanding subdivision (c), "special compensation" for state members shall mean all of the following:
>
> [¶] . . . [¶]
>
> (B) Compensation for performing normally required duties, such as . . . bonuses (for duties performed on regular work shift) . . . .
>
> [¶] . . . [¶]
>
> (D) Other payments the board may determine to be within "special compensation" . . . .

9. Government Code section 20636, subdivision (g)(5) provides in part:

> If items of compensation earnable are included by memorandum of understanding as "payrate" or "special compensation" for retirement purposes for represented . . . employees pursuant to this paragraph, the Department of Human Resources . . . shall obtain approval from the board for that inclusion.

Conclusions

10. The appeal is limited to the issue of whether CalPERS properly determined that medical consultant bonus pay did not qualify as compensation earnable.

11. The matters set forth in Findings 29 through 50 have been considered and are summarized below.

a. Federal Control. Regarding CalPERS' contention that bonus payments do not qualify as compensation because they were paid out of funds not controlled by the employer, respondents were persuasive that the fact that bonus program monies originated from the federal government did not mean that the funds were not controlled by the employer, and that the term "controlled by" must have a meaning no less broad than "paid by." Such is entirely consistent with the section 20028 language relating to funds "controlled by" the state being inclusive of disbursements to state employees "regardless of their source." (Gov. Code, § 20028, subd. (a).)

b. CalPERS Board Approval. The medical consultant bonus plan was never presented to the CalPERS Board for approval as contemplated under Government Code section 20636, subdivision (g)(5). Even though the side letter did not contain express language that the medical consultant bonus payments would be considered "special

compensation" for retirement purposes, the side letter was interpreted over a number of years by DSS as including the bonus payments as an item of special compensation without affording CalPERS an opportunity to determine whether it should be included as such. The failure to "obtain approval from the board for that inclusion" does not, however, give rise to rejection of all respondents' claims, or otherwise exclude the medical consultant bonus payments from the calculation of final compensation. It is merely a procedural error, the remedy for which is full consideration of the substantive issues as part of these administrative proceedings.

c. Characterization as Bonus. Special compensation "includes a payment received for special skills, knowledge, abilities, work assignment, workdays or hours, or other work conditions." (Gov. Code, § 20636, subd. (c)(1).) The bonus payments were not paid for special skills, knowledge and abilities beyond those possessed by all medical consultants. Nor did respondents establish that the medical consultant bonus payments constituted "[c]ompensation for performing normally required duties, such as . . . bonuses (for duties performed on regular work shift)." (Gov. Code, § 20636, subd. (g)(3)(B).) The parties cited, as guidance, to a CalPERS regulation specific to local governments that defines bonus:

> Bonus - Compensation to employees for superior performance such as "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.

(Cal. Code Regs., tit. 2, § 571, subd. (a)(1).)

Thus, bonuses recognize "superior performance," typical examples of which include annual performance bonuses and merit pay.[13] The medical consultant bonus payments constituted neither. It was payment for the same work, only above a threshold. It was extra pay for extra work, or piecework. Piecework is an apt description of the medical consultant bonus program because it simply created an inducement for medical consultants to perform

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[13] The Department of Human Resources, for example, defines "Merit Award" as follows:

> An award for an adopted suggestion that results in an intangible benefit and/or identifiable tangible benefit shall be a certificate of award and a payment of cash. An award for an approved special act, special service, or superior accomplishment shall be a scroll, ribbon, medal, pin, gift, or other appropriate token of esteem, and may include a payment of cash.

(Cal. Code Regs., tit. 2, § 599.655, subd. (i).)

more work, whether they worked additional hours or not. It was never intended to be compensation or an award for "superior performance" and it therefore did not constitute a bonus within the meaning of section 20636.

The program history supports such interpretation. The program was originally designed to provide federally funded overtime pay and it was used in just this way for both medical consultants and DEAs working overtime to address backlogs. It continued to be used to pay overtime to medical consultants until the second request for an exemption by DSS was denied in 1996.

After 1996, the program transmuted from one based on overtime into one that afforded extra pay for extra work above a threshold. Such could be earned whether one worked less than or greater than 40 hours per week. Medical consultants were not precluded from working additional hours above 40 if they worked full time, or above 20 if they worked half time. They could choose whether to close additional cases. It was extra work made available to them if they desired it. It was the same type of work. It required no special skills, knowledge and abilities beyond which they already possessed to perform this work. Like paying overtime, the bonus payments were not limited. There was no cap. Bonus payments fluctuated. They could easily be controlled, even manipulated by the employee. For all these and other reasons detailed in Findings 37 through 41, the medical consultant bonus payments received by respondents cannot properly be characterized as a "bonus" for purposes of inclusion as an item of "special compensation" within the meaning of Government Code section 20636.

d. Availability. "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).) The CalPERS system contemplates equality of benefits between members of the same group or class and there is an intent not to treat members within the same class and at the same pay dissimilarly. Here, DSS medical consultants in different branch offices had unequal access to the bonus program. It was available at times in some branch offices, 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 DSS state program branches. As a result, members within the same group or class of medical consultants employed by DSS at the same rate of pay were treated dissimilarly. (Findings 42 through 44.) For these reasons the medical bonus program 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." (Gov. Code, § 20636, subd. ((g)(1).)

e. CalPERS Determination. CalPERS reasonably exercised its authority and discretion in determining that the medical consultant bonus payments are not items of special compensation. Its reasoning has been well-articulated. (Findings 45 through 50.) When exercising its independent authority under Government Code section 20636 to determine other items of special compensation, CalPERS determined that the medical consultant bonus payments will result in substantial unfunded liabilities occasioned by large fluctuations,

inconsistency of payments and other unpredictable elements of the program. Its determination is supported by the record in this case. The Legislature 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).) CalPERS has done so here in reasonably determining that the medical consultant bonus payments are not special compensation.

12. The above matters having been considered, the medical consultant bonus payments do not meet the statutory requirements under Government Code section 20636 to qualify as "compensation earnable." CalPERS's determination that the bonus payments are not bonuses or other "special compensation" is well supported by the law and facts. Respondents' contentions and arguments to the contrary were not persuasive otherwise. Their appeals should accordingly be denied.

ORDER

The medical consultant bonus payments paid by the Department of Social Services to respondents Robert B. Paxton, M.D., Howard M. Skopec, M.D., and Danilo V. Lucila, M.D., also known as case closure fees, do not constitute special compensation, and cannot be included in calculating compensation earnable under Government Code section 20636. Respondents' appeals are accordingly DENIED.

DATED: July 22, 2015

JONATHAN LEW
Administrative Law Judge
Office of Administrative Hearings