ATTACHMENT B

STAFF'S ARGUMENT

STAFF'S ARGUMENT TO DECLINE TO ADOPT THE PROPOSED DECISION

Overview

In the consolidated cases of Respondent Timothy Bacon and Respondent Darryl Hurt (Respondents) and the City of Riverside (City), CalPERS determined that the increase in pay, provided pursuant to a settlement agreement, failed to qualify as "payrate" and should not be used in the calculation of retirement benefits. The Administrative Law Judge (ALJ), however, disagreed with CalPERS.

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

I. The Proposed Decision erroneously concluded that payments made by the City, in settlement of a failure to promote and employment discrimination lawsuit brought against it by Respondents, qualified as payrate to be included in Respondents' Final Compensation for purposes of calculating their retirement allowance. (California Code of Regulations, title 2, section 571 (a)(3))

II. The Proposed Decision acknowledges CalPERS' duty to correct errors under Government Code section 20160; however, fails to apply it in this case to permit correction of the City's erroneous reporting of Respondents' settlement payments.

III. The Proposed Decision improperly applies the doctrine of equitable estoppel.

IV. The Proposed Decision misconstrues the fact that allowing settlement payments will result in an unanticipated actuarial loss proscribed under the California Public Employees' Retirement Law (PERL).

Legal and Factual Background

The case involves claims that amounts paid in settlement of a lawsuit are considered payrate. CalPERS disagreed, and therefore disallowed the claimed amounts as payrate for Respondents.

Respondents, police lieutenants, sued the City for failure to promote them to police captains, and other Civil Code violations. Respondents settled the matter with the City, whereby Respondents agreed to be placed on administrative leave and retire. In return, the City agreed to pay additional money to ensure Respondents receive "at least 12 months of compensation at the top-step captain rate prior to their retirement." Respondents were placed on administrative leave on the date of the settlement until they became eligible for retirement. Respondents were specifically never promoted to the higher position and would receive the settlement proceeds regardless of the performance of any duties of the higher position.

Respondents presented witness testimony claiming the City contacted CalPERS and was informed the increase in pay would be considered in the calculation of final compensation. No other evidence, however, was presented in support of such contentions. Furthermore, CalPERS has no record of such a conversation.

The Proposed Decision

After an administrative hearing, the ALJ issued her Proposed Decision on October 22, 2015. The sole issue before the ALJ was whether the increase in pay pursuant to the settlement agreement which was reported to CalPERS qualified as payrate. The Proposed Decision concludes that CalPERS shall include the increase in the calculation of Respondents' Final Compensation.

Why the Proposed Decision Should Be Rejected

I. The Proposed Decision Erroneously Finds That the Settlement Payments Qualify As Payrate

The PERL defines "compensation earnable" as the compensation paid by the employer as "payrate" and "special compensation." (Government Code § 20636(b).) "Payrate" is defined as normal monthly rate of pay or base pay of the member paid in cash to similarly situated members of the same group or class of employment for services rendered on a full-time basis during normal working hours, pursuant to publicly available pay schedules. (Government Code § 20036(b).) A similar definition applies to members who are not considered in a group or class.

The Board has defined in regulation what may be considered a publicly available pay schedule (California Code of Regulations, Title 2, §570.5; see also, CalPERS Precedential Decision *In re Randy Adams*, OAH case No. 10122030095).

The ALJ held that because the City and Respondents agreed to settle their lawsuit by paying Respondents "as if" they had been promoted, the payments were evidence of their "payrate" as police captains. The ALJ reasoned that upholding CalPERS determination would "forever preclude CalPERS's members from the ability to sue their employers for being wrongfully passed over for promotion." However what does and does not qualify as payrate is not a subject of agreement by or between the employer and employee (*Oden v. Board of Administration* (1994) 23 Cal.App.4th 194, 201).

Although there were salary schedules for the position of police captains, the evidence is undisputed that Respondents were never promoted to the rank of police captains. Contrary to the finding in the Proposed Decision, other than anecdotal and inconsistent testimony, there is little to no evidence that Respondents even performed the duties of police captain. Rather, pursuant to the settlement agreements, Respondents agreed to be placed on administrative leave and retire in return for the pay increase. Furthermore, the evidence does not indicate that their confidential settlement agreement was, or could, qualify as a salary schedule.

The Proposed Decision is not only inconsistent with statutory, regulatory and precedential civil and administrative case law but completely ignores the provisions of the PERL. Thus, the Board should conduct a hearing on the record to correct the erroneous analysis and conclusion in the Proposed Decision.

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

The Proposed Decision recognizes that, pursuant to Government Code section 20160, the Board has the right and duty to correct errors of any member, contracting agency or of the system. However, the Proposed Decision refuses to apply this statutory right and duty to CalPERS to correct any possible error by CalPERS staff in permitting the City to initially "report" the settlement payments as payrate. The Proposed Decision further fails to recognize that the mere act of reporting an item of compensation does not preclude CalPERS from correcting such error, at any time. In *City of Pleasanton v. Board of Administration of the California Public Employees' Retirement System* (2012) 211 Cal.App.4th 522, 544, the respondent argued that CalPERS must pay him the higher retirement benefits because CalPERS permitted his employer to report the excess contributions. The court; however, disagreed and held that "PERS's fiduciary duty to its members does not make it an insurer of every retirement promise contracting agencies make to their employees. PERS has a duty to follow the law." *Id.*

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

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

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

The PERL generally prohibits payments made to an individual employee which will result in unfunded liabilities from being included in a member's final compensation. The

Proposed Decision acknowledges that basing the payrate on the pay increases for Respondents will increase the liability associated with their pension. However, the Proposed Decision erroneously finds that such increase is allowable because the City paid contributions on the payments while they were being paid. Because compensation on which the contributions were paid related to a position that never existed, other than as a result of the settlement agreement, the resulting increase in liability will be inadequately funded.

Proposed Board Action

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

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