

ATTACHMENT A

THE PROPOSED DECISION

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

In the Matter of the Calculation of Final Compensation of:

BRUCE MALKENHORST, SR.,

Respondent,

and

CITY OF VERNON,

Respondent.

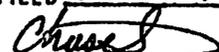
Agency Case No. 2012-0671

OAH No. 2018060607.1

PROPOSED DECISION AFTER REMAND

Howard W. Cohen, Administrative Law Judge, Office of Administrative Hearings (OAH), State of California, heard this matter on remand on November 12, 2019, in Los Angeles.

Jason Levin, Attorney at Law, of Steptoe & Johnson, LLP, represented petitioner Renee Ostrander, Chief, Employer Account Management Division (EAMD), Board of Administration (Board), California Public Employees' Retirement System (CalPERS).

PUBLIC EMPLOYEES RETIREMENT SYSTEM
FILED FEBRUARY 21 2020


Kenneth P. White, Brown White & Osborn, LLP, represented respondent Bruce Malkenhorst, Sr. (respondent or Malkenhorst), who was not present.

Respondent City of Vernon (Vernon) did not appear and was not represented.

Oral and documentary evidence was received. The record was held open to January 21, 2020, to allow the parties to file closing briefs. Briefs were filed and marked.

The record was closed and the matter was submitted on January 21, 2020.

FACTUAL FINDINGS

Jurisdiction and Parties

1. CalPERS is a unit of the Government Operation Agency. (Gov. Code, § 20002.) Under the Public Employees' Retirement Law (PERL), CalPERS administers the retirement system for employees of the State of California and other public entities. The CalPERS Board administers CalPERS's defined benefit retirement plan. Benefits for members are funded by member and employer contributions and by interest and other earnings on those contributions.

2. Vernon is a public agency that contracts with CalPERS for retirement benefits for its eligible employees under Government Code section 20460 et seq. Vernon was incorporated as a general law city; it became a charter city in 1988.

3. Malkenhorst was employed by Vernon from April 1975 until his retirement in 2005. By virtue of his employment with Vernon, Malkenhorst is a local miscellaneous member of CalPERS.

4. On June 12, 2018, CalPERS filed the Statement of Issues in this case.

Factual Background and Procedural History

MALKENHORST'S RETIREMENT ALLOWANCE

5. Vernon hired Malkenhorst in April 1975 as Deputy City Clerk/Deputy Director of Finance. By 1978, Malkenhorst had become City Administrator/City Clerk and City Treasurer. Over the subsequent years, Malkenhorst's job titles and duties changed. While remaining the City Administrator/City Clerk and City Treasurer, Malkenhorst also accrued the titles and duties of Director of Finance and Personnel, Executive Director of Light and Power/Chief Executive Officer of Electrical Department, Executive Director of the Redevelopment Agency, Secretary of the Redevelopment Agency, CEO of the Gas Municipal Utility Department, Executive Director of the Industrial Development Authority, Secretary of the Industrial Development Authority, Treasurer of the Industrial Development Authority, and Executive Director of the Vernon Historic Preservation Society.

6. In June 2005, Malkenhorst submitted an application for service retirement, requesting that his pension be calculated on the basis of his highest City Administrator payrate, including longevity pay. On that basis, CalPERS calculated Malkenhorst's final compensation in the amount of \$44,128 per month, which was then used to calculate his retirement allowance in the amount of \$40,022.66 per month. Malkenhorst retired from service effective July 1, 2005, with just over forty years of service credit. Shortly afterward, CalPERS proposed recalculating Malkenhorst's payrate and revising his retirement allowance downward; Malkenhorst and CalPERS entered into informal discussions and, without proceeding to an administrative hearing, the matter was resolved in favor of no change.

2014-2015 ADMINISTRATIVE HEARING

7. In 2011-12, CalPERS conducted an audit of Vernon's payroll and retirement-related records for the period July 1, 2002 through June 30, 2010. Following the audit, CalPERS determined that Vernon had over-reported Malkenhorst's compensation on behalf of Malkenhorst due to inclusion of payments that do not meet the definition of "compensation earnable" as set forth in the PERL. CalPERS recalculated Malkenhorst's "final compensation," a term defined in the PERL (Gov. Code, § 20000 et seq.).¹ By letter dated October 22, 2012, CalPERS notified Malkenhorst that his final compensation had been incorrectly calculated, that CalPERS had recalculated his "final compensation," that it would be reduced from \$44,128 to \$9,450 per month, and that a corresponding downward adjustment would be made to Malkenhorst's retirement allowance, from \$40,128 per month to \$9,654.09 per month. CalPERS also advised Malkenhorst and Vernon of their right to appeal the determination.

8. Malkenhorst filed a timely appeal and requested an administrative hearing. CalPERS filed a Statement of Issues on September 27, 2013, in Case No. No. 2012-0671 (OAH No. 2013080917). The hearing took place over six days between August 25, 2014, and February 19, 2015. At issue was (a) whether CalPERS had correctly determined that Malkenhorst's final compensation as previously calculated did not comply with the PERL; (b) whether CalPERS had correctly re-determined Malkenhorst's final compensation; and (c) whether CalPERS was barred by res judicata,

¹ All further statutory references are to the Government Code, except where otherwise stated.

collateral estoppel, or another legal or equitable theory from recalculating Malkenhorst's final compensation after having initially calculated a different figure in 2005. In its Statement of Issues, CalPERS did not pray for a decision allowing it to recoup any overpayment it made to Malkenhorst, and therefore the issue of recoupment was not addressed.

9. Because the evidence at hearing established that Malkenhorst's final compensation had been incorrectly determined and that CalPERS was not barred from recalculating his final compensation, the Administrative Law Judge issued a Proposed Decision dated July 14, 2015, denying, in part, Malkenhorst's appeal from CalPERS's benefits determination and affirming that CalPERS had correctly determined that Malkenhorst's final compensation did not comply with the PERL. The Administrative Law Judge granted the appeal, in part, however, finding that CalPERS's final compensation recalculation was arbitrary and constituted an abuse of discretion.

10. CalPERS issued a Final Decision, dated December 16, 2015, adopting the Proposed Decision in part and rejecting it in part. CalPERS affirmed both that Malkenhorst's final compensation did not comply with the PERL and its recalculation of final compensation. CalPERS also found that it was not time-barred to recoup retirement allowance overpayments made to respondent.

MALKENHORST'S WRIT PETITION

11. Malkenhorst filed a petition for a writ of administrative mandate in the Superior Court of the State of California, County of Los Angeles, Case no. BS15989. Judge Mary H. Strobel issued a decision granting the writ petition in part on December 5, 2016, setting aside CalPERS's recalculation of Malkenhorst's payrate and CalPERS's

determination that it is not time-barred from recouping all overpayments made to Malkenhorst.

12. Judge Strobel found that the reduction of Malkenhorst's payrate to equal that of the Acting City Clerk was arbitrary and capricious, as Malkenhorst argued and as the Administrative Law Judge concluded in his Proposed Decision, "because [Malkenhorst] 'was CACC² for most of his career and the CACC responsibilities greatly exceed the responsibilities he held as City Clerk.'" (Ex. 1000, tab C, p. 18, citation omitted.) "[Malkenhorst]'s responsibilities as CA/CC exceeded his responsibilities as City Clerk, even before other positions were assigned to him." (*Ibid.*) Rejecting CalPERS's argument that correspondence between Malkenhorst and CalPERS "justifies limiting [his] payrate to Acting City Clerk, despite his many duties as City Administrator" (*ibid.*), and noting that CalPERS did not consider "prior and subsequent salary schedules regarding the City Administrator position" (*id.* at pp. 18-19), Judge Strobel ordered the final decision of the CalPERS Board set aside. She suggested that CalPERS give more consideration to Malkenhorst's salary history, as well as projected cost-of-living and merit-based pay increases.

13. Judge Strobel also considered CalPERS's finding, in its final decision, that recoupment is timely. CalPERS found that it was required by Government Code sections 20160 and 20164 to correct errors, giving it the power to recoup overpayments, and determined that a 10-year statute of limitations applied here "because [Malkenhorst] 'participated in the submission of a fraudulent payrate.' The Board also determined that the limitations period did not accrue until April 2012, and was tolled after [Malkenhorst] filed his administrative appeal in December 2012." (Ex.

² City Administrator/City Clerk.

1000, tab C, p. 20, citation omitted.) Judge Strobel found that CalPERS had not pled fraud in its Statement of Issues in OAH no. 2013080917. "CalPERS's initiation of an action to correct Petitioner's payrate under section 20160 does not give sufficient notice of a claim of fraud under section 20164(d)." (*Id.*, citation omitted.) Judge Strobel further held:

CalPERS has not cited, and the court has not found, evidence that [Malkenhorst] litigated a charge that he participated in fraud, thus triggering a 10-year statute of limitations. [¶] In the instant case, based on the parties' citation to the record, it appears [Malkenhorst] was prejudiced to the extent the Board determined that he participated in submitting fraudulent reports for compensation. (§ 20164(d).) It appears Petitioner did not receive adequate notice of that charge or opportunity to litigate. [¶] . . . [¶]

Based on the foregoing, the court finds that [Malkenhorst] did not have a fair trial with respect to the Board's determination that recoupment is timely pursuant to the 10-year statute of limitations based on fraud.

(Ex. 1000, tab C, p. 21.) The court held that CalPERS did not establish that its claim for recoupment is timely under a shorter, three-year, statute of limitations, citing *Topanga Assn. for a Scenic Community v. County of Los Angeles* (1974) 11 Cal.3d 506, 515.

14. In conclusion, Judge Strobel ordered as follows:

CalPERS is ordered to reconsider the appropriate payrate for [Malkenhorst] as "City Administrator/City Clerk" *based on the existing administrative record*, including as augmented in this writ proceeding. If CalPERS addresses the statute of limitations issue with respect to recoupment, the Board is ordered to conduct further proceedings to provide a fair hearing with proper notice and to make additional findings on the timeliness of recoupment in accordance with this decision, including on the issues of estoppel and laches.

(Ex. 1000, tab C, p. 22, italics added.)

THE SEPTEMBER 2018 ADMINISTRATIVE PROCEEDING

15. After Judge Strobel issued her order, CalPERS calculated a new payrate for Malkenhorst. It notified respondent in a letter dated June 22, 2017, that it had newly re-determined respondent's payrate, based on an average of the payrate of several director positions at Vernon, that the payrate was lower than that credited to Malkenhorst, and that CalPERS would seek recoupment of overpayments under a 10-year statute of limitations applicable in cases of fraudulent reports for compensation set forth at section 20164, subdivision (d).

16. CalPERS filed the Statement of Issues in this matter. In the superior court, Malkenhorst filed an amended petition appealing CalPERS's redetermination and a notice of intent to appeal the redetermination through the administrative process.

17. On September 13, 2018, the parties filed with OAH a stipulation as to the issues to be decided in the matter. They are:

a. Did CalPERS act arbitrarily in selecting a new payrate for respondent in its June 22, 2017, letter to respondent?

b. Is CalPERS's reliance on Government Code section 20164, subdivision (d), which extends the statute of limitations for recouping overpayments from three years to ten years in instances where a member's payrate is based on "fraudulent reports for compensation," lawful or supported by the evidence?³

A. CALPERS'S RE-DETERMINATION OF MALKENHORST'S PAYRATE AND FINAL COMPENSATION

18. CalPERS's October 2012 letter to Malkenhorst related that his final compensation amount was \$9,450, based on the payrate for Acting City Clerk. Judge Strobel rejected that calculation. In its subsequent recalculation, CalPERS derived a payrate for Malkenhorst by averaging the payrates of five Vernon directors reflected in the pay schedule in effect as of July 1, 2005, the day after Malkenhorst's retirement: Director of Community Services and Water, \$12,974; Acting Director of Light and Power, \$24,000; Fire Chief, \$10,899; Police Chief, \$11,243, and Director of Environmental Health, \$10,986. "The average of these five director payrates was \$14,020.00. CalPERS therefore selected \$14,020.00 for Malkenhorst's payrate." (Ex. 1001, p. 5.) CalPERS used the directors' group as a measure "because it is objective and based on public records in effect at the time of the member's retirement." (*Ibid.*)

19. In its June 2017 letter to Malkenhorst, CalPERS wrote:

³ The stipulation, with its attachments, was marked as exhibit 1002 and made part of the record of this matter.

We've determined the City Administrator/City Clerk was most closely related to the group of City Directors. The average payrate for this "Director Group" is \$14,020.00. This average takes into consideration the highest step of the range in each compensated Director position listed in Resolution 8780, effective July 1, 2005.

Therefore, we will recalculate your retirement benefit to reflect a final compensation totaling \$16,824.00. This results in a retirement allowance of \$14,822.17, taking into account your 40.195 years of service credit.

(Ex. 1000, tab D, p. 2, footnotes omitted.)

20. At the administrative hearing on September 17, 2018, Brad Hanson, a CalPERS Assistant Division Chief responsible for compensation review, testified that he oversaw the 2017 recalculation of Malkenhorst's final compensation. CalPERS relied on Vernon's July 2005 pay schedule when re-determining Malkenhorst's final pay rate in 2017, choosing Vernon's directors as the positions most comparable to Malkenhorst's. In its post-hearing brief, CalPERS argued that:

CalPERS relies on pay schedules for payrate determinations because they are contemporaneously prepared public records, because they are required by law (§ 20636(b)(1)), and because the use of publicly disseminated records foster the goal of transparency. Other potential sources of information, including Malkenhorst's hearing testimony, do not meet these criteria. [¶] Malkenhorst has suggested that

his payrate should be no lower than \$24,000, the 2005-2006 payrate for Vernon's Acting Director of Light & Power. But *Malkenhorst lacks contemporaneously prepared public records indicating that he spent most (much less all) of his year before retirement working in this or a similar position. CalPERS's averaging methodology was therefore more appropriate and not an abuse of discretion.* (Ex. 1001, p. 7, italics added.)

21. During the audit and payrate review process, CalPERS considered alternative measures for determining Malkenhorst's final compensation, but decided against using them.

22. The Administrative Law Judge issued a Proposed Decision on February 11, 2019, finding that, in its June 2017 recalculation of Malkenhorst's payrate, CalPERS did not comply with Judge Strobel's instructions. It did not consider prior and subsequent salary schedules regarding the City Administrator position, Malkenhorst's salary history, or projected cost-of-living and merit-based pay increases. Neither did CalPERS comply with the suggestions of the Administrative Law Judge in the Proposed Decision along similar lines, that CalPERS (a) reconsider applying some elements of the alternative measures for determining Malkenhorst's final compensation CalPERS had originally considered as a result of its audit of the City of Vernon; or (b) consider the enhanced responsibilities reflected in the 40 percent salary increase Vernon gave Malkenhorst within a year of adding City Administrator to his City Clerk title, such as, for example, the fact that the department heads in whose class it places Malkenhorst reported to him as their supervisor. "Although it may be difficult to identify a payrate for City Administrator, a difficulty created by Vernon's practices and Malkenhorst's

cooperation in obscuring what exactly he was being compensated for, there is a significant amount of data that CalPERS can and should review to ascertain an appropriate payrate for Malkenhorst as City Administrator.” (Ex. 1000, Tab A; p. 11.)

23. The February 2019 Proposed Decision also recited findings that CalPERS did not review the administrative record, according to Hanson, and only considered information Vernon had provided in 2005, before the administrative process. Though placing Malkenhorst in the class of directors for payrate purposes achieves, perhaps, a closer approximation of an appropriate payrate than assigning him the payrate of an Acting City Clerk, CalPERS’s did not adequately justify its decision to deviate from applying the methodology the court ordered. CalPERS did not address how Malkenhorst’s actual responsibilities compared to the responsibilities of the Vernon Directors, how the fact that the directors reported to and were supervised by Malkenhorst should affect the calculation, and other relevant factors, such as subsequent payrate schedules, because, according to Hanson, duties and payrates change over time. Having failed to undertake the work required to establish an acceptable rationale for a recalculation, as Judge Strobel ordered, CalPERS acted arbitrarily and capriciously. (See, e.g., *In re Scott* (2005) 133 Cal.App.4th 573, 596 [administrative failure to consider relevant evidence is arbitrary]; *Douda v. California Coastal Com.* (2008) 159 Cal.App.4th 1181, 1194, as modified on denial of reh’g (Mar. 4, 2008) [it is arbitrary and capricious for agency to simply ignore relevant evidence].)

B. RECOUPMENT OF OVERPAYMENTS

24. The February 2019 Proposed Decision addressed the issues of CalPERS’s right to recoup overpayments made to Malkenhorst, when that right accrued, what statute of limitations applied to the exercise of that right, when that statute of limitations began running, and whether CalPERS was equitably estopped or barred by

the doctrine of laches to recapture alleged overpayments. Those findings are unchanged and are adopted herein, as CalPERS did not remand for the taking of additional evidence on those issues.

Evidence Taken at this November 2019 Remand Proceeding

25. On May 30, 2019, after considering the February 2019 Proposed Decision, CalPERS remanded the matter to the Administrative Law Judge to take additional evidence regarding the appropriate payrate to apply in calculating Malkenhorst's final compensation.

26. At the administrative remand hearing on November 12, 2019, Lisa Renee Ostrander, Chief, EAMD, testified for CalPERS. From late 2012 to 2014, Ostrander was the Assistant Chief in the Customer Account Services Division, where she oversaw the determination of members' payrates at retirement. That function was transferred to the newly created EAMD in 2014. Ostrander testified that she had supervised Brad Hanson and had overseen the 2017 and 2019 payrate determinations for Malkenhorst.

27. Ostrander testified that when, as in this matter, CalPERS lacks a publicly available pay schedule from which to calculate a payrate, it looks to the average payrate of positions with similar responsibilities. CalPERS calls this method the Toering method, after a member to whom the method was applied. CalPERS used the Toering method for Malkenhorst in 2017, because there was no publicly available pay schedule, and Malkenhorst served in multiple positions. CalPERS simply calculated the average salary for City of Vernon department heads, which was \$14,020.

28. Ostrander testified that CalPERS considered using one of two other methods. Under one method, CalPERS looked at the publicly available pay schedules for City Administrators after Malkenhorst retired. Those administrators also served in

other positions, as did Malkenhorst, so their service as City Administrator was part-time; calculating a full-time payrate for Malkenhorst based on the other employees' part-time service as City Administrator would, Ostrander testified, violate the PERL. CalPERS considered the percentage of time each of them spent performing the duties of City Administrator. Under the other method, CalPERS used the City Administrator payrate from July 1, 1980 as a base payrate, because it appeared to be the last date where multiple positions were not combined under a single payrate. Ostrander directed CalPERS's Actuarial Office to calculate a payrate using the July 1, 1980 payrate and adjusting it for inflation, merit salary increases, and promotions. Using this method, CalPERS calculated a payrate for Malkenhorst at the time of his retirement to be \$13,370.03.

29. Ostrander testified that CalPERS does not regularly use either of these two alternative methods. She noted that, in addition to the Toering method's being commonly used by CalPERS, it yielded, in this matter, the highest payrate for Malkenhorst among the three possible methods for calculating payrate.

30. Ostrander testified that the team working on the Malkenhorst payrate calculation considered only materials CalPERS possessed prior to the administrative hearing and the creation of an administrative record, namely, information provided to CalPERS by the City of Vernon in the audit CalPERS conducted.

31. Ostrander did not review the administrative record when deciding to apply the Toering method. She asserted that CalPERS's decision to use the Toering method was justified because it was based on objective, publicly available data. In using the Toering method, she read the audit report, the pay schedules, and documents regarding employees and the positions they held. She did not review the testimony from the administrative proceedings, and was unfamiliar with which

documents were used and admitted into evidence at those hearings. She knew that Judge Strobel wanted CalPERS to recalculate Malkenhorst's payrate, but did not read Judge Strobel's order.

32. CalPERS complied with Judge Strobel's suggestion in considering a method that adjusted Malkenhorst's salary by projecting cost-of-living and merit-based pay increases. That method yielded a projected payrate of \$13,370.03. Rather than use that projected payrate, CalPERS adopted the Toering method, based on the average payrate of department heads at the time Malkenhorst retired, and yielding a payrate of \$14,020.

33. CalPERS also complied, in substance, with Judge Strobel's suggestion that it consider subsequent City Administrator payrates. Though it did not refer to the administrative record, CalPERS used information it obtained in its 2012 audit of the City of Vernon. It found that the three City Administrators who served after Malkenhorst retired, from December 2006 to 2012, worked in that position only part-time, as had Malkenhorst. CalPERS could not calculate a full-time payrate in compliance with the PERL to apply in this case.

34. Judge Strobel ordered CalPERS to examine the administrative record in order to apply a methodology that took into account information including pay schedules, merit increases, and cost-of-living increases. Though CalPERS recalculation was not based on the administrative record, CalPERS did consider materials from the City of Vernon that were, in fact, used as evidence in the administrative proceedings. Most importantly, CalPERS acted in accordance with the express intent of Judge Strobel's order, in that it considered Malkenhorst's salary and projected inflationary, merit, and promotional adjustments and, in the alternative, salaries of persons holding the office of City Administrator subsequent to Malkenhorst's retirement. The

considered decision to use a higher payrate than that yielded by these methods, one derived using the Toering method, cannot be said to be arbitrary and capricious.

LEGAL CONCLUSIONS

1. CalPERS initiated this action, now on remand, by filing a Statement of Issues. (Factual Finding 16.) CalPERS has the burden of proof in this proceeding. The standard of proof is a preponderance of the evidence, meaning that CalPERS is obliged to adduce evidence that has more convincing force than that opposed to it. (Evid. Code, § 115; *Glover Vernon. Bd. of Retirement* (1989) 214 Cal.App.3d 1327, 1332.)

2. CalPERS has the authority and the responsibility to correct errors in the calculation of benefits under section 20160, which provides:

(a) Subject to subdivisions (c) and (d), the board may, in its discretion and upon any terms it deems just, correct the errors or omissions of any active or retired member, or any beneficiary of an active or retired member [¶] . . . [¶]

(b) Subject to subdivisions (c) and (d), the board *shall correct* all actions taken as a result of errors or omissions of . . . any contracting agency . . . or this system.

(c) The duty and power of the board to correct mistakes, as provided in this section, shall terminate upon the expiration of obligations of this system to the party seeking

correction of the error or omission, as those obligations are defined by Section 20164. [¶] . . . [¶] (§ 20160, italics added.)

3. When CalPERS is unable to rely on a publicly available pay schedule for a member, “the [CalPERS] Board, in its sole discretion, may determine an amount that will be considered to be [the] payrate” (Cal. Code Regs., tit. 2, § 570.5, subd. (b)), so long as the determination is not arbitrary or capricious. (*Poncio v. Department of Resources Recycling & Recovery* (2019 34 Cal.App.5th 663, 673.)

4. CalPERS’s re-calculation of Malkenhorst’s final compensation, both to determine future retirement benefits and to recoup alleged overpayments made to him, is not arbitrary and capricious, as set forth in Factual Findings 25 through 34. Judge Strobel ordered CalPERS to follow a methodology that took into account information in the administrative record, including pay schedules, merit increases, and cost-of-living increases. Though CalPERS did not rely on the administrative record, it used materials also used in the administrative process, and did take into account pay schedules, merit increases, and cost-of-living increases. The method finally chosen by CalPERS is not arbitrary and yields a payrate higher than a payrate that would result from looking at merit and cost-of-living increases. There has been no abuse of discretion.⁴

⁴ As set forth in the February 11, 2019, Proposed Decision, the 10-year statute of limitations on actions to recoup overpayments applied, that statute of limitations did not begin to run until October 2012, and has not been tolled, CalPERS is not equitably estopped to seek recoupment, and CalPERS is not barred from seeking recoupment by the doctrine of laches.

ORDER

The appeal of respondent Bruce Malkenhorst, Sr., from CalPERS's reduction of his retirement benefits based on a recalculation of his final compensation and its proposed recoupment of alleged overpayments, is denied.

CalPERS has properly recalculated Malkenhorst's payrate based on the Toering method, after consideration of alternative methods, and has satisfied the terms of the writ issued by Judge Strobel. CalPERS shall calculate recoupment based on the 10-year statute of limitations.

DATE: February 20, 2020

DocuSigned by:
Howard W. Cohen
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HOWARD W. COHEN

Administrative Law Judge

Office of Administrative Hearings