

ATTACHMENT B

STAFF'S ARGUMENT

STAFF'S ARGUMENT TO ADOPT THE PROPOSED DECISION AS MODIFIED

Respondent California Military Department (Respondent CMD) is a state agency, comprised of state active duty military personnel and civil service employees. Respondent Michelle Milota (Respondent Milota) is the mother and personal representative of the estate of Christian Wells. Christian Wells was a servicemember of Respondent CMD and a "new member" (as discussed below) of CalPERS.

Eligible CMD employees and servicemembers are members of CalPERS and receive CalPERS' pension benefits. Respondent CMD has historically reported Basic Allowance for Housing (BAH) and the Basic Allowance for Subsistence (BAS) for "classic members." CalPERS has accepted the reporting of BAH and BAS as items of "special compensation" for "classic members" and has included these items of "special compensation" in the calculation of the retirement benefits of "classic members."

Effective January 1, 2013, California Public Employees' Pension Reform Act of 2013 (PEPRA)¹ substantially revised the laws governing "all state and local public retirement systems and their participating employers." (§ 522.02(a)(1).) PEPRA established a new retirement plan for "new employees" hired on or after January 1, 2013. The retirement benefits available to "new members" or "new employees" are less favorable than those provided to "classic members" who were hired prior to January 1, 2013. (See §§ 7522.02(b), 7522.02(f); 7522.20-7522.34; *Cal Fire Local 2881* [p. 10].) The "classic members," hired before PEPRA's effective date receive higher benefit formulas with lower retirement ages and are known as "classic benefits." In contrast, PEPRA increased the age of retirement, statutorily established new defined benefit formulas, set a cap on total compensation that could be used to calculate the retirement benefit, increased employee contributions and mandated that the annual compensation used to calculate pension benefits be based on an average of a three-year timeframe as opposed to a one-year timeframe. (See §§ 7522.02(b); 7522.10(c) and (g); 7522.20(a); 7522.30(a); 7522.32(a).)

Just prior to PEPRA's effective date, on December 27, 2012, CalPERS issued a Circular Letter to all agencies, including CMD, notifying them of the PEPRA and the new requirements under PEPRA. The Circular Letter noted that pensionable compensation cannot include reimbursement for housing and vehicles, or any ad hoc or one-time payments. Nonetheless, CMD reported BAH and BAS for "new members" who were hired after January 1, 2013 and subject to the PEPRA.

On May 25, 2017, CalPERS' Office of Audit Services (OFAS) completed a Public Agency Review of CMD's payroll and other relevant records regarding compensation reported to CalPERS.

¹ Gov. Code § 7522 et seq. Except as indicated all statutory references will be to the California Government Code.

CalPERS determined that the BAH and BAS, reported by the CMD, as items of “pensionable compensation” do not qualify as “pensionable compensation” under PEPRA sections 7522.02, 7522.04, 7522.34 and Title 2, Division 1, Chapter 2, Article 4 of California Code of Regulations section 571.1.² CalPERS made the same determination in relation to the BAH and BAS that was reported by CMD, for Mr. Wells. The death benefits payable on Mr. Wells’ account were reduced as a result of the determination.

In sum, CalPERS determined the BAH and BAS do not qualify as “pensionable compensation” under section 7522.34(a), traditionally referred to as “payrate.” This is because these items are not designed as part of the base pay, are not paid as part of the base pay and have never been reported to CalPERS as part of the base pay. Similarly, BAH and BAS do not qualify as “pensionable compensation” under section 7522.34(b), traditionally referred to as “special compensation,” because these items are specifically excluded and cannot be included in the calculation of retirement benefits. Compensation earnable is not simply the amount of remuneration received, by a member. It is “exactly defined to include or exclude various employment benefits and items of pay.” (*Oden v. Board of Administration* (1994) 23 Cal.App.4th 194, 198; citing former §20020 (currently §20630).) “Compensation earnable” is a combination of a “payrate” and “special compensation.” (§§ 20636(a); 570.)

For “classic members,” section 20636, subdivision (g)(2) defines “payrate” for state members as “the average monthly remuneration paid in cash out of funds paid by the employer to similarly situated members of the same group or class of employment ... pursuant to publicly available pay schedules.” The statute then goes on to list what shall be included in “payrate.” Amounts deducted from a member’s salary for deferred compensation, annuity plans, “pick up” of member contributions, disability compensation payments, temporary industrial disability payments and other payments the board “may determine to be within ‘payrate’.” (*Id.*) Section 20636 does not list housing allowances or subsistence allowances as one of the items that must be included in “payrate.” The CalPERS’ Board has never determined the housing or subsistence allowances to be within “payrate.”

Section 20636(g)(3) defines “special compensation” for state members and includes “living quarters, board, lodging, fuel, laundry and other advantages of any nature furnished to a member by their employer in payment for the member’s services.”

PEPRA restricted the type of compensation that could be reported for the purpose of calculating pension benefits of “new members.” (See §§ 7522.02 and 7522.34.) PEPRA also changed the terminology, referring to reportable compensation as “pensionable compensation” rather than “compensation earnable” or “special compensation.” (See § 7522.34.) For purposes of determining “pensionable compensation,” regulation section 571.1(a) identifies the criteria that must be met in order for pay to constitute

² Except as indicated all regulatory references are to Title 2 of the California Code of Regulations.

“pensionable compensation” under PEPRA. Regulation section 571.1(b) exclusively identifies what was previously referred to as “special compensation” under section 20636. Unlike section 20636, section 7522.34 does not differentiate between compensation for state and local agency employees. The definition of “pensionable compensation” under section 7522.34 applies to all “new members.” (See § 7522.34(a).) Section 571.1 of PEPRA also equally applies to all “new members,” whether they are state employees or local employees.

Most importantly, while section 20636 specifically included board, lodging and other monetary payments as items of “special compensation” for “classic members,” section 7522.34 specifically *excludes* any employer provided allowances, including but not limited to housing allowances.

Respondent CMD and Respondent Milota separately appealed CalPERS’ determinations and exercised the right to a hearing before an Administrative Law Judge (ALJ) with the Office of Administrative Hearings (OAH). Both appeals were consolidated, and a hearing was held on July 18, 2019 and November 13, 2019. Respondent CMD was represented by counsel at the hearing.

Prior to the hearing, CalPERS explained the hearing process to Respondent Milota and the need to support her case with witnesses and documents. CalPERS provided Respondent Milota with a copy of the administrative hearing process pamphlet. CalPERS answered Respondent Milota’s questions and clarified how to obtain further information on the process. Respondent Milota did not appear at the hearing and the case proceeded as a default under section 11520, as to Respondent Milota only.

Respondent CMD presented the testimony of CMD staff. Respondent CMD argued that the Legislature did not intend PEPRA to apply to CMD and even if it does, BAH and BAS qualify as “pensionable compensation” because BAH and BAS are part of the base payrate.

After considering all of the evidence introduced, as well as arguments by the parties, the ALJ denied Respondent CMD’s appeal. The ALJ found that PEPRA applies to CMD and BAH and BAS do not qualify as “pensionable compensation” under PEPRA.

The ALJ applied the rules of statutory construction. The ALJ looked at the plain meaning of the statute, the legislative history, and reasonableness of a proposed construction to determine the intent of the Legislature. The ALJ held that CMD employees and servicemembers have been members of CalPERS since 1961 and are subject to the PERL. Similarly, those members are also subject to PEPRA because “PEPRA does not include a carve out” for them and the Legislature has not amended the PERL to state CMD is exempt from PEPRA.

The ALJ held that BAH and BAS do not qualify as “pensionable compensation” under PEPRA. The ALJ found that “[t]he evidence established that BAH and BAS are separate from, and not a part of, a servicemember’s Basic Pay or payrate.” The ALJ noted that

the documents and pay scales published by the Department of Defense, the State Controller's Office, and CalHR list BAH and BAS separately from the base pay. Also, the ALJ noted that "...CMD has historically reported Basic Pay, BAH and BAS to CalPERS in separate categories." Based on this information and in light of section 7522.34(c), the ALJ held that BAH and BAS are not "pensionable compensation."

In the Proposed Decision, the ALJ concludes that CalPERS correctly determined that BAH and BAS cannot be reported as "pensionable compensation in the calculation of final compensation for purposes of servicemember retirement" and denied the appeals.

Pursuant to Government Code section 11517 (c)(2)(C), the Board is authorized to "make technical or other minor changes in the proposed decision." In order to avoid ambiguity, staff recommends that the word "public" on page 2, line 1 of paragraph 1 should be replaced with the word "state," so that the line reads: "The California Military Department (CMD) is a state agency comprised..."

For all the above reasons, staff argues that the Proposed Decision be adopted by the Board.

June 17, 2020

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