

STAFF'S ARGUMENT TO ADOPT THE PROPOSED DECISION

Case History and Background

CalPERS' Office of Audit Services (OFAS) conducted a public agency audit of the County of Glenn (Respondent County) to determine whether increases to member payrates were granted and reported to CalPERS in compliance with the Public Employees' Retirement Law (PERL) and the California Public Employees' Pension Reform Act of 2013 (PEPRA). The audit was limited to the examination of a sample of active and/or retired employee records from July 1, 2012 through June 30, 2017.

On December 6, 2018, OFAS issued its final public agency audit report (Audit) of Respondent County. The Audit found that Respondent County was overreporting payrate to CalPERS. The payrates and total earnings actually paid to Respondent County's employees were correct, but the County was incorrectly reporting special compensation twice: once in payrate and again in special compensation.

Respondent County did not dispute the error and fixed it by removing special compensation from its employees' payrates.

Respondent County's errors caused overpayments of past retirement benefits and required prospective retirement reductions to 56 retirees. Pursuant to Government Code sections 20160(a) and 20164(b),¹ CalPERS sought collection of the overpayments from the retired members for the most recent three years of retirement benefits.

CalPERS then invoiced Respondent County for the remainder of the overpayments that occurred more than three years prior to the determination. The invoices to Respondent County stated:

Based on the retroactive payroll correction, we are limited [to] collecting the overpayment from the members to three years based on Government Code 20164(b)(1). In order to recover the entire overpayment to the system, we are invoicing you for the balance of the overpayment (Internal Revenue Procedure 2015-27, Section 3.02(3)).

Eighteen of the 56 impacted retirees (Respondent Members) appealed CalPERS' determination and requested an administrative hearing in front of an Administrative Law Judge (ALJ). Respondent Members' appeals questioned whether CalPERS had authority to order repayment of the overpayments, and if so, whether section 20164.5 applied, shifting liability for all collectible overpayments to Respondent County. Respondent County appealed, arguing that section 20164(b) barred CalPERS from collecting the remainder of overpayments beyond three years.

¹ All citations are to the Government Code, unless otherwise noted.

Following the filing of the Statement of Issues (SOI), Respondent County filed a Motion to Dismiss, which was granted in the first Proposed Decision (PD). Because the ALJ issued the first PD without taking any evidence, the CalPERS Board of Administration rejected it and remanded the matter back to the Office of Administrative Hearings (OAH) for a hearing on the merits. CalPERS submitted an Amended SOI adding the issue whether section 20164.5 applies to the facts of this case.

The Administrative Hearing and Written Argument

A hearing on the issues was held on February 17, 2022. Respondent Members and Respondent County were both represented by their respective attorneys at the hearing.

CalPERS staff testified about the Audit. Staff explained how Respondent County's reporting errors caused overpayments that CalPERS is mandated to correct under sections 20160 and 20164. Staff also explained why section 20164.5 does not apply to the overpayments at issue.

Section 20164.5 became effective on January 1, 2022, and makes employing agencies responsible for member overpayments and reduced retirement benefits in certain situations. It requires the employing agency to pay for member overpayments if the following requirements are met: (1) the compensation was reported and contributions were made on that compensation while the member was actively employed; (2) the compensation was agreed to in a memorandum of understanding or collective bargaining agreement between the employer and the recognized employee organization as compensation for pension purposes, and the employer and the recognized employee organization did not knowingly agree to compensation that was disallowed; (3) the determination by the system that compensation was disallowed was made after the date of retirement; and (4) the member was not aware that the compensation was disallowed at the time it was reported. (§ 20164.5(b)(3)(A).)

Staff explained that CalPERS issued Circular Letter 200-076-21 on December 29, 2021, which clarifies when section 20164.5 applies and that it may require the employer to pay the entire overpayment. Payroll reporting errors, like Respondent County's here, are not covered by section 20164.5. In addition, Staff explained that Respondent Members and Respondent County paid correct contribution amounts, even though the special compensation was reported twice.

Staff then explained CalPERS' process for the collection of overpayments beyond the most recent three years. When reviewing member overpayments, CalPERS identifies the cause of the overpayment. When the employing agency causes the overpayment, CalPERS sends an invoice to that agency to collect overpayments beyond the most recent three years. Because Respondent County caused the errors by double reporting special compensation, CalPERS invoiced Respondent County for all overpayments made beyond the most recent three years.

Neither Respondent County nor Respondent Members presented any witnesses at hearing. Respondent County's evidence at the hearing included CalPERS' Policy on the Discharge of Accountability (Policy) and CalPERS Board Agenda Items on the

Discharge of Accountability for Uncollectible Debt. Both of these documents provide that pursuant to section 20164(b)(1), CalPERS is generally required to discharge member debts that are more than three years old.

After the hearing, the parties briefed the issues for the ALJ. Along with the testimony and evidence summarized above, CalPERS made additional arguments based on the Internal Revenue Code (IRC). CalPERS' defined benefit plan is a tax-qualified plan under IRC section 401(a). CalPERS must comply with the requirements of the IRC to maintain its tax-qualified status. (§ 21750; Cal. Code Regs., Tit. 2, § 553.1.) One such requirement provides that CalPERS must operate its defined benefit plan in compliance with the PERL. To the extent benefit payments exceed the amounts payable under the PERL, the Internal Revenue Service (IRS) has provided specific guidance to plan administrators like CalPERS for correction of operational failures without losing the tax-qualified status of the Plan.

Under IRS guidelines, overpayments are benefit payments exceeding “the amount payable to the participant or beneficiary under the terms of the Plan.” (Rev. Proc. 2019-19 §6.06(3), Rev. Proc. 2021-31 §6.06(3).) And “overpayments must be corrected in accordance with section 6.06(3) for defined benefit plans.” (Rev. Proc. 2019-19 §6.06(3), Rev. Proc. 2021-31 §6.06(3).) Under Revenue Procedures 2019-19 and 2021-31 sections 6.06(3) it is appropriate to have “the employer or another person contribute the amount of the Overpayment (with appropriate interest) to the plan instead of seeking recoupment from a plan participant or beneficiary.” (*Id.*) In short, the overpayment must be corrected. (*Id.*) Because section 20164(b)(1) limits overpayment collection from Respondent Members to the most recent three years, CalPERS must then turn to the Respondent County as the employer, plan sponsor, and agency that caused the overpayment. Collecting the remainder of the overpayment from the Respondent County is consistent with the IRS Guidelines and is authorized under the PERL. (Rev. Proc. 2019-19 §6.06(3), Rev. Proc. 2021-31 §6.06(3).)

The PERL provides that CalPERS must “correct all action taken as a result of errors” within the retirement system. (Gov. Code § 20160(b).) Such corrections should be retroactive to the date of the error. (Gov. Code § 20160(e).) Section 20164 expands on CalPERS' error correction duties: it lists different limitations periods for collecting from members. (Gov. Code § 20164(b) – (d).) Conversely, section 20164(a) indicates employer obligations continue more than three years by stating that contracting agency obligations:

to this system in respect to members employed by them, respectively, continue throughout the memberships of the respective members, and the obligations of the state and contracting agencies to this system in respect to retired members formerly employed by them, respectively, continue until all of the obligations of this system in respect to those retired members, respectively, have been discharged.

Section 20164(a)'s requirement that agency obligations continue until discharge for retired and active members supports section 20160(e)'s requirement that corrections be retroactive. Barring overpayment collection from Respondent County precludes

retroactive correction under section 20160(e), while allowing Respondent County to escape its statutory obligations under section 20164(a). For all of those reasons, CalPERS argued that Respondents' appeals should be denied.

The Proposed Decision

After considering all of the evidence introduced, as well as arguments by the parties, the ALJ denied Respondent Members' appeals. However, the ALJ granted Respondent County's appeal, and ruled that CalPERS could not collect the balance of any overpayments to members beyond the most recent three years from Respondent County.

The ALJ agreed with CalPERS that Respondent County's reporting required correction and that section 20164.5 does not apply to the facts of this case. Thus, the ALJ concluded that CalPERS is authorized to correct Respondent Members' retirement allowances prospectively, and to collect from members the most recent three years of benefit overpayments.

However, the ALJ agreed with Respondent County that section 20164(b)(1) bars collection of the balance of any overpayments to members beyond the most recent three years from Respondent County. Although the ALJ agreed that CalPERS must comply with the IRC, he disagreed with CalPERS' arguments that IRS Guidance requires collection from Respondent County. The ALJ opined that collection from employers is one of several permissive correction options.

Accordingly, the ALJ ruled CalPERS was correct to fix the errors caused by Respondent County's reporting errors and was correct in collecting overpayments for the last three years from Respondent Members. However, the ALJ ruled that pursuant to section 20164(b) CalPERS could not collect the balance of any overpayments to members beyond the most recent three years from Respondent County.

Although CalPERS disagrees with the ALJ's interpretation of section 20164(b) as applied to the facts of this case, staff does not oppose the Proposed Decision being adopted by the Board

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