

June 21, 2019

The Honorable Connie Leyva  
California State Senate  
State Capitol  
Sacramento, CA 95814



**RE: Senate Bill 266 (Leyva) – Oppose [As Amended June 17, 2019]**

Dear Senator Leyva:

League of California Cities (LCC), and the California Special Districts Association (CSDA) must respectfully oppose Senate Bill (SB) 266 which will require public agencies to directly pay retirees and/or their beneficiaries, disallowed retirement benefits using general fund dollars. As amended, SB 266 places 100 percent of the total liability for such overpayments on public agencies—abdicating all responsibility previously held by CalPERS to ensure that retirement benefits are calculated and administered correctly. As such, SB 266 is a de facto and retroactive benefit enhancement measure that will further strain local agency budgets at a time where retirement obligations are effectively eliminating agencies ability to provide critical services for the public. Our objections to this measure are rooted in policy, operational, cost, and legal concerns that will inevitably face virtually every state and local government agency should this measure be signed into law.

**As Amended CalPERS has no Incentive to Properly Calculate Benefit Payments:**

In 2012, the California State Legislature passed significant public pension reform legislation known as the Public Employees' Pension Reform Act (PEPRA,) which took effect January 1, 2013. While the reforms were significant, they led to confusion as to what may lawfully be offered as employee pension benefits. As a result, some public agencies and their represented employee organizations came to agreements on benefit packages that did not meet the new legal standards to be considered a pensionable benefit. Those future retirement benefits, which were being paid for by employers and employees into pension systems such as the California Public Employees Retirement System (CalPERS), were at some point determined to violate the law and were terminated. Terminated benefits that violate PEPRA are considered “disallowed benefits.”

Under current law, once a benefit is determined to be disallowed, both the employer and the employee cease making future payments on that benefit, past contributions from the employee are returned to the employee, while past contributions from the employer are applied towards future payment. Unfortunately, in the case of a *retiree* that received the disallowed benefit, the pension system must recoup the overpaid benefit from the retiree. They must do so because it is unlawful to pay out a benefit that is not legally allowable or earned.

Recent amendments to the measure remove all responsibility by CalPERS to ensure benefits are reviewed, calculated and administered correctly. Instead, SB 266 places sole responsibility on the employer—even if the employer exercises their right to have CalPERS review their compensation proposal as proposed in section 5 of the measure. While we understand that CalPERS has asserted that they face IRS plan qualification concerns for paying out an unlawful benefit, the fact that there is zero accountability or assurances afforded to the state or local agency when CalPERS reviews a compensation agreement is irrational.

### **Requirements Under SB 266 will Create Compliance and Implementation Issues**

As stated, under SB 266, state and local agencies would now be issuing direct General Fund payments to retirees. Even though direct payments to retirees will be made outside of the retirement system, such liabilities still trigger GASB 68 reporting requirements. Given the unique circumstances surrounding these overpayments, agencies will now have to track and report these liabilities. Such additional responsibilities will require agencies to hire costly outside actuarial and legal experts to ensure that they follow federal reporting laws.

Additionally, SB 266 currently provides that “make whole” payments can be paid in a lump sum or as an annuity. Under the constructive receipt doctrine, retirees will be immediately taxed on make whole amounts even if they choose to receive an annuity creating unanticipated and adverse tax consequences. We suggest allowing the employer (rather than the retiree) be given the discretion to choose between paying the amount in a lump sum or an annuity in order to avoid this constructive receipt issue and to take into consideration the financial means of the employer.

Moreover, the bill fails to consider the common practice of employees moving from jurisdiction to jurisdiction throughout their careers. What happens when a retiree worked for multiple public employers in different retirement systems? Under normal circumstances, CalPERS pays out the benefit if employee works for multiple agencies who enjoy reciprocity. But under SB 266 it is unclear. Are multiple agencies now responsible for directly paying a retiree or beneficiary? What happens in the case where an employee’s bargaining unit at one employer agreed to a disallowed benefit but worked for the majority of their career for another agency? Is the agency where the retiree worked longest on the hook for an agreement that they were not a party to? Such confusion will lead to compliance, legal and implantation challenges.

### **Gift of Public Funds is a Violation of the California Constitution**

To be clear, Senate Bill 266 will require agencies to issue monthly, unlawful, payments to former employees and/or their beneficiaries in perpetuity. Public agencies cannot continue to make payments to retirees as proposed by SB 266 for the same legal basis that requires pension systems to recoup their disallowed retirement benefit payments to retirees. Continued payment of a disallowed benefit to a retiree would constitute a gift of public funds, in violation of Section 6, Article 16 of the California Constitution. Such violation would leave a public agency left to defend itself from costly litigation lawsuits filed by members of the public.

Again, it is unfortunate that after an agency and their bargaining unit came to an agreement on benefits and those benefits had been paid for any amount of time for the benefit to be taken from the retiree. Although public agencies may feel morally or ethically compelled to do so, public agencies simply cannot continue to make payments directly to a retiree for an unlawful benefit.

### **Findings and Decelerations of the Measure Cause Concerns:**

Our organizations take exception to section 1 (f) in the findings and decelerations of the measure. While public employers stipulate that submitting MOU’s and reporting said compensation to CalPERS is required by law, the findings fail to acknowledge that such agreements are done so with mutual agreement and understanding of the laws that guide pensionable compensation. Sophisticated and highly trained legal counsel for **both employers and employees mutually agree** to terms of employment and compensation through the collective bargaining process. Moreover, it is the responsibility of all parties, including CalPERS, the administrative body who promulgates regulations that guide agencies to ensure that compensation as mutually agreed by both labor and management legal teams is in fact a lawful benefit. The findings fail to recognize this reality and insinuate that the employer is solely at fault for a process that includes labor, management, and CalPERS.

In section 1 (j) the findings set a dangerous legal precedent that would strongly indicate that it is the intent of the Legislature to perpetuate the continued misappropriation of public dollars for an “alleged misapplication or calculation of compensation occurs”. To be clear, when CalPERS determines that a benefit is unlawful such a determination is not “alleged” but rather definite. It should be noted that if an active employee or a retiree has a dispute with the manner in which CalPERS calculates their full compensation, there are current and effective avenues to appeal such determination through the administrative law judge (ALJ) process.

Once an error is identified and corrected, the spirit of the law is upheld. Lawmakers should exercise caution in supporting language that undermines the California Constitution and the public’s trust.

**No Indication that Sponsors are Willing to Negotiate on Workable Solutions**

While our organizations are opposed to this measure, we offered a series of amendments to try and make the measure lawful and workable. All proposed amendments were rejected by the sponsors. Amendments including but not limited to:

- Eliminating the retroactivity provisions in the bill.
- Establishing a pre-retirement audit system through CalPERS that would enable the retiree to begin receiving base-salary pensionable compensation immediately allowing CalPERS to review special pay compensation. When an employee submits an application for retirement, CalPERS could provide an estimate of retirement benefits based solely on compensation that is indisputable (base salary), while it takes time to approve compensation that needs further review or that has been flagged as potentially non-PERSable. Additionally, CalPERS could begin making benefit payments on compensation that is indisputable and withhold benefits that are subject to review by CalPERS. Under this proposal, once the audit is complete, the retiree would receive all lawful pensionable compensation dated back to their initial retirement and would have future checks be adjusted accordingly to reflect the proper special pay. This would alleviate the concern regarding retirees’ detrimentally relying on erroneous benefit calculations and would avoid a situation where CalPERS needs to reduce benefits paid in error.
- Allowing CalPERS to review and certify that proposed pensionable compensation meets standards set forth by CalPERS. Such certification would indemnify the agencies for liability resulting from a future CalPERS error.

For these reasons, the League of California Cities and the California Special Districts Association must oppose SB 266. Please feel free to contact Dane Hutchings (LCC) at 916-230-6935 or Dillion gibbons (CSDA) at 916-442-7887 if you have any questions.

Sincerely,



Dane Hutchings, Director, Government Affairs  
(Representing League of California Cities)



Dillion Gibbons  
Senior Legislative Representative  
California Special Districts Association

CC:

The Honorable Freddie Rodriguez, Chair, Assembly Public Employment and Retirement

Members, Assembly Public Employment and Retirement

Che Salinas, Chief Deputy Legislative Affairs Secretary for Operations, Office of Governor Gavin Newsom