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# CalPERS Legal Update, Emerging Issues, and Common Compliance Problems

Thursday, Sept. 21, 2023

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# **CalPERS Legal Update, Emerging Issues, and Common Compliance Problems**

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## I. INTRODUCTION

CalPERS' contracting agencies have been faced with several significant legal changes over the past few years. First, the Legislature created additional financial penalties for employers that incorrectly report disallowed compensation on behalf of an employee. Second, CalPERS issued new guidance that employers must follow when determining whether a safety member is substantially incapacitated for the purposes of disability retirement, industrial disability retirement, or reevaluation. Finally, CalPERS has proposed new regulations to define the term "limited duration" for retirees serving in post-retirement employment and for employees serving in upgraded positions or classifications. This paper explains these notable changes impacting CalPERS' agencies.

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## II. Senate Bill 278

Senate Bill ("SB") 278 added Government Code section 20164.5 to the Public Employees' Retirement Law ("PERL"), effective January 1, 2022. Government Code section 20164.5 creates additional financial penalties for CalPERS agencies that incorrectly report disallowed compensation on behalf of an employee. Government Code section 20164.5 defines "disallowed compensation" as compensation reported for a member, by an employer, that CalPERS later determines is not in compliance with the California Public Employees' Pension Reform Act of 2013 ("PEPRA"), Government Code section 20636 or 20636.1 of the PERL, or the administrative regulations under California Code of Regulations ("CCR") title 2, section 571 and 571.1.

Prior to SB 278, if CalPERS determined that an employer included a disallowed item of compensation in a retiree's retirement benefit allowance, the retiree had to pay CalPERS back the amount of the overpayment, and the retiree's retirement allowance payments were reduced prospectively based on what the retiree would have received if the improper item of compensation had not been included.

Now, SB 278 transfers nearly all of the risk of misreported compensation to the employer. Section 20164.5 requires contracting agencies to pay directly to CalPERS the full cost of any overpayments made to the retiree based on the disallowed compensation plus a penalty directly to the retiree. The penalty is 20% of the present actuarial value of the difference between the retiree's future pension benefits calculated with the disallowed compensation and

the pension benefits calculated without the disallowed compensation. CalPERS will likely assert that there is no statute of limitations on the penalties it can collect from employers under Government Code section 20164.5.

In the first version of SB 278, 90% of the penalty was to be paid directly to the retiree and 10% of the penalty was to be paid to CalPERS. However, AB 1824 amended Government Code section 20164.5 as of January 1, 2023. Now, as stated above, the entire penalty is paid directly to the impacted retiree. If an employer is required to pay a penalty, CalPERS provides the actuarial calculations to the employer for the amount of the penalty.

Under Government Code section 20164.5, the overpayment and penalty obligations are triggered only if all of the following conditions are satisfied:

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 (“MOU”) or collective bargaining agreement between the employer and the recognized employee organization as compensation for pension purposes, and the employer and the recognized organization did not knowingly agree to compensation that was disallowed.
3. The determination by the system that compensation was disallowed at the time it was reported was made after the date of retirement.<sup>1</sup>
4. The member was not aware that the compensation was disallowed at the time it was reported.

CalPERS’ published guidance clarifies that the following reporting errors are not within the scope of disallowed compensation under Government Code section 20164.5:

- Payroll corrections related to errors.
- Lump sum reporting of reportable compensation.
- Compensation item that is reportable but cannot be used in the final compensation calculation.
- Special Compensation reported solely in the final compensation period.
- Payrate denials.
- Reporting special compensation items above the limit defined in the labor policies and/or agreements.
- Misreporting of payroll, such as:
  - misreported pay rates (e.g. \$10.00 versus \$100.00)
  - misreported pay rate types, such as reporting monthly as an hourly pay rate
  - misidentified special compensation category and type.

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<sup>1</sup> If the determination is made prior to retirement, CalPERS reporting must be corrected to exclude the disallowed compensation and employer and employee contributions on the disallowed compensation are reimbursed.

The overpayment and penalties provided in Government Code section 20164.5 applies retroactively to CalPERS' determinations made on or after January 1, 2017, but only if an appeal has been filed and the member has not exhausted their administrative or legal remedies.

Employers may submit an MOU, collective bargaining agreement, or other labor policy to CalPERS for review regarding items of disallowed compensation. CalPERS will complete the review within 90 days of receiving all the required information. However, CalPERS is not bound by the conclusions it reaches in this review.

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### **III. LEGISLATION Additional CalPERS Requirements for IDR Determinations**

On March 15, 2023, CalPERS issued new requirements for contracting agencies to follow when determining whether local safety members are substantially incapacitated from their usual duties for the purposes of a disability retirement. CalPERS now requires agencies to submit additional information, including several new CalPERS forms, when certifying an application for disability retirement, industrial disability retirement, and re-evaluation for continuous eligibility for disability retirement.

As context, an employee is eligible for a non-industrial disability retirement if the member is credited with five years of service, regardless of age, and is found to be substantially incapacitated from the performance of duty as a result of a non-industrial (not work-related) disability.

A safety employee is eligible for an industrial disability retirement if the member is substantially incapacitated from service as a result of a disability that is caused by a job-related injury or illness. A safety member is eligible for an industrial disability retirement regardless of age and service credit. Pursuant to Government Code section 21151(b), CalPERS' contracting agencies can amend their CalPERS' contract to extend industrial disability retirement eligibility to miscellaneous members.

Previously, CalPERS only required agencies to certify the following information when making a decision regarding a member's application for disability retirement:

1. A statement certifying under penalty of perjury that the agency made the determination based on a competent medical opinion.
2. A statement certifying under penalty of perjury that the agency did not use the determination as a substitute for the disciplinary process.
3. A finding indicating the member's substantial incapacitation from the performance of their usual duties.
4. A statement confirming whether the member filed a Workers' Compensation claim for their disabling condition(s), and if so, a statement as to whether the claim was accepted.
5. A finding by the agency as to whether the member's incapacity is industrial.

6. A statement documenting the member's last day on payroll.
7. A statement as to whether there is the possibility of third party liability.
8. A statement identifying the disability condition(s)/body parts.
9. A statement supported by competent medical evidence that the duration of the disabling condition is expected to be permanent, last at least 12 consecutive months, or result in death.
10. A statement identifying the monthly amount and beginning date of Advanced Disability Payments, if they have been or will be paid to the member.

Now, in addition to these ten requirements, agencies are required to submit the following additional information:

1. Physical Requirements of Position/Occupational Title (Local Safety) form.
2. Job Duty Statement.
3. Physician's Report on Disability (Local Safety) form.
4. Worker's Compensation Carrier Request (Local Safety) form.
5. All medical reports used in making the medical determination for Disability retirement benefits including reevaluation.<sup>2</sup>
6. The determination resolution or certification.

The Physical Requirements of Position/Occupational Title (Local Safety) form (#1 above), requires agencies to indicate how often the member performs a variety of physical activities, such as interacting with others, lifting weight, sitting, standing, walking, running, climbing, reaching, and operating hazardous machinery.

The form also requires the employer to state the usual number of hours the member works every day as well as whether the member has been through the reasonable accommodation process. If the member has been through the reasonable accommodation process, the employer must provide CalPERS their documentation of the process. Both the member and a representative from the agency must sign the form.

The Physician's Report on Disability (Local Safety) form (#3 above), must be completed by a physician or medical specialist who specializes in the member's disabling condition. In this form, the physician must provide their diagnosis and findings from any x-rays, EKGs, laboratory or diagnostic testing performed. The physician must also indicate whether, based on their examination, they find the member to be substantially incapacitated from performance of the usual duties of the position for their current employer.

The form instructs the physician that "substantial incapacity" must be due to a medical condition of permanent or extended duration that is expected to last at least 12 consecutive months or will result in death. It also states that disability is not necessarily an inability to perform fully every function of a given position. Rather, the form states that courts have

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<sup>2</sup> Reevaluation refers to the employer that granted the IDR subsequently conducting a review as to whether the retiree remains disabled.

concluded that the test is whether the employee has a substantial incapacity to perform the usual and customary duties of the position. The form also highlights that prophylactic restrictions are not a basis of a disability retirement.

If the physician finds that the member is substantially incapacitated, the physician must describe specifically which job duties the member is unable to perform due to incapacity, based on the member's job duty statement. Additionally, the physician must indicate whether the incapacity will be permanent, meaning for these purposes it will last at least 12 months.

CalPERS instructs the agency to complete the first portion of the form and then forward the entire form, along with the member's job duty statement and the completed Physical Requirement of Position/Occupational Title form (#1 above) to the physician or medical specialist to complete. Once completed by the physician or medical specialist, the form must be sent back to the agency along with all the medical reports and diagnostic test reports referenced in the form.

The Workers' Compensation Carrier Request (Local Safety) form (#4 above) must be completed by the agency's workers' compensation insurance carrier if the employee has filed a workers' compensation claim for the illness or injury directly related to the application for disability or industrial disability retirement.

The form asks the workers' compensation insurance carrier to send a copy of all medical reports for the related claim to the employer. The insurance carrier is also asked to send all job descriptions, job analyses, depositions, investigation reports, videotapes, and approved orders from the Workers' Compensation Appeals Board to the employer. Additionally, the insurance carrier is asked to list each of the employee's claims and indicate whether it accepted liability and whether a settlement was reached.

CalPERS instructs the agency to complete a portion of the form and then sends the entire form to the workers' compensation insurance carrier for completion. The workers' compensation insurance carrier then sends the completed form back to the agency.

As indicated above, agencies must also submit a job duty statement (#2 above) and all medical reports used in making the determination (#5 above.) Additionally, agencies are still required to submit a resolution or certification (#6 above), that certifies to the 10 requirements previously needed to submit a determination to CalPERS.

CalPERS states in its guidance that the additional information is necessary to ensure that disability retirement and industrial disability retirement benefits are provided only to eligible members. CalPERS also notes that the new requirements are necessary to adhere to Government Code sections 21232 and 21233, which in part, provide limitations on employment while a retiree is receiving disability retirement or industrial disability retirement benefits.

CalPERS cites Government Code sections 20221 and 21028 as its authority for implementing these changes. Government Code section 20221 requires agencies provide to CalPERS any information concerning its members that CalPERS may require in the

administration of its system. Government Code section 20128 requires that members or beneficiaries provide information that CalPERS deems necessary to determine its liability with respect to an individual's entitlement to benefits.

Although it is not yet clear how CalPERS intends to use the additional information, CalPERS appears to require this additional information to more closely scrutinize contracting agencies' decisions regarding local safety members' disability retirement and industrial disability retirement applications. For example, many agencies rely solely on workers' compensation reports, which may contain presumptions or prophylactic work restrictions that are inapplicable under the PERL.

As a result of the new requirements, agencies may need to request more Independent Medical Examinations ("IME") for their members. Although CalPERS does not require that an IME be completed for an IDR application, as stated above, CalPERS does require that a physician or medical specialist who specializes in the member's disabling condition conduct an examination, report their diagnosis, and report whether the member is substantially incapacitated from their usual duties for a permanent or extended duration. Although this report could be completed by the member's personal physician or a workers' compensation treating physician, if such doctors are unable or unwilling to complete the required forms, an agency may need to request an IME.

Nevertheless, Government Code section 21154 provides that contracting agencies, rather than CalPERS, are responsible for determining whether local safety members (other than school safety members) are incapacitated from their duties. It is uncertain if these new requirements will have the practical effect of transferring the decision making authority from the employer to CalPERS.

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#### **IV. Proposed Regulation: Definition of "Limited Duration," 2 C.C.R. § 574.1**

In April 2022, the CalPERS Board of Administration issued a proposed regulation to define the term "limited duration" employment as referenced in Government Code sections 7522.56, 21224, and 21229 for retired annuitant appointments, and Title 2 CCR section 571(a)(3), for employees working in an upgraded position or classification.

The California Regulatory Notice Register published a Notice of Proposed Regulatory Action regarding CalPERS' proposed regulation on June 17, 2022. A 45-day written comment period then began on June 17, 2022 and ended on August 1, 2022. After reviewing the comments received during that period, CalPERS revised the proposed regulation. A new comment period based on the proposed modifications opened on December 1, 2022 and ended on December 16, 2022.

Following the modifications in December 2022, the proposed regulation at 2 CCR section 574.1(a), concerning working after retirement, defines "limited duration" as "a limit of twenty-



four consecutive months per appointment of a retired person in the employ of a CalPERS-covered public employer, regardless of how many months or hours in those months the retired person served in the appointment during that twenty-four consecutive month period.”<sup>3</sup>

CalPERS can grant up to two twelve month extensions beyond the twenty-four consecutive months. To obtain a twelve month extension, the employer must certify at a public meeting the following: the position title, the description of the duties to be performed during the extension, the reason the appointment needs to be extended, the reason the position duties cannot be performed by non-retired employees, that a plan is in place to transition position duties to non-retired employees or another retired person, the anticipated end date for the extension, and its approval of the extension.

If an employer needs a further extension beyond the forty-eight consecutive months (the initial twenty-four consecutive months provided for all employees, plus two twelve month extensions) it may request one of two exemptions, either: a) an exemption authorizing a continuous extension if the appointment does not exceed 120 hours per fiscal year, or b) an exemption authorizing an extension of twelve consecutive months, regardless of how many months or hours in those months the retired person served during that extension period. To gain this additional extension, the employer’s governing body must again make a resolution at a public meeting, certifying: the position title, the reason the appointment needs to be extended, the reason the position duties cannot be performed by either non-retired persons or another retired person, either the reason a plan to transition one of more of the duties to non-retired employees or another retired person was not successful or the reason that such plan cannot be implemented; either that the employer completed a recruitment within the twelve consecutive months prior to the date of the exemption request for the position duties and was unable to fill the position with that recruitment or the reason that such a recruitment cannot be completed; the anticipated end for an exemption, and its approval for the exemption.

The proposed regulation at 2 CCR section 574.1(b), clarifies that if a collective bargaining agreement explicitly provides the duration of permissible employment for a retired person, then the definition provided in the agreement applies, except that in no event may the employment exceed sixty consecutive months.

Under the proposed regulation at 2 CCR section 574.1(c), “limited duration” for an employee serving in an upgraded position/classification is defined as twenty-four consecutive months, regardless of how many months or hours in those months the employee served in the upgraded position or classification during the twenty-four month period. An individual may serve in the same upgraded position or classification more than once within the twenty-four month period but may not exceed a time period of twenty-four consecutive months. There are limited provisions for granting a subsequent twenty-four month period.

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<sup>3</sup> The Proposed Regulation states that employment by a retired annuitant prior to the effective date of the regulation will not count towards the limit of twenty-four consecutive months.

Next, CalPERS must resubmit the amended regulation to the Office of Administrative Law (“OAL”) for review. The OAL reviews for compliance and either approves or disapproves of the regulation. If approved, OAL files the proposed regulation with the Secretary of State, making it officially part of the California Code of Regulations. If denied, OAL will return the proposed regulation to CalPERS for revision. CalPERS has reported that it expects to submit the amended regulation to OAL in the fall of 2023. If OAL approves the proposed regulation, CalPERS anticipates that the regulation could be published in the summer or fall of 2024, at the earliest. As of the date of drafting this paper in August 2023, we are not aware of any further developments regarding this regulation. It is also unclear in the event it is adopted, if it will render moot all existing post-retirement restrictions in favor of a single restriction, based on time in the appointment. CalPERS has not stated what it believes this regulation will mean for the other existing rules.