

KAYE SCHOLER LLP

10 JUL -7 PM 4:23
LEGAL PROCESS #7

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14 Attorneys for Cross-Complainant, JOHN CHIANG,
15 in his official capacity as CONTROLLER OF
16 THE STATE OF CALIFORNIA;
17 and the OFFICE OF THE STATE CONTROLLER

17 SUPERIOR COURT OF THE STATE OF CALIFORNIA
18 COUNTY OF SACRAMENTO

19 DEBBIE L. ENDSLEY; CALIFORNIA)
20 DEPARTMENT OF PERSONNEL)
21 ADMINISTRATION)

21 Petitioners/Plaintiffs)

22 v.)

23 JOHN CHIANG, sued herein in his)
24 official capacity only; OFFICE OF)
25 STATE CONTROLLER)

25 Respondents/Defendants)

26 _____)
27 JOHN CHIANG, in his official capacity)
28 as CONTROLLER OF THE STATE OF)
STATE CONTROLLER)

Case No. 34-2010-80000591

**CROSS-COMPLAINT FOR
DECLARATORY RELIEF**

**Exempt from Fees
(Cal. Gov't Code § 6103)**

Assigned to: Hon. Timothy M. Frawley

Trial Date: None yet assigned

Complaint Filed: July 6, 2010

BY FAX

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Cross-Complainants,)
)
v.)
)
DEBBIE L. ENDSLEY, sued herein in)
her official capacity only; CALIFORNIA)
DEPARTMENT OF PERSONNEL)
ADMINISTRATION)
)
Cross-Defendants.)

Pursuant to California Code of Civil Procedure § 1060, John Chiang, in his official capacity as Controller of the State of California, and the Office of the State Controller cross-complain and allege as follows:

GENERAL ALLEGATIONS

PARTIES

1 Cross-Complainant John Chang (“Controller Chiang” or the “Controller”) is the Controller of the State of California. The Controller, a constitutional officer, is the chief fiscal officer of California, charged with “superintend[ing] the fiscal concerns of the state.” Cal. Gov’t Code § 12410; Cal. Const. art. V, § 11.

2 The Controller has the duty to audit all claims against the state, and may audit the disbursement of any state money for correctness and legality. Cal. Gov’t Code § 12410. The Controller has “the power, indeed the duty, to ensure that the decisions of an agency that affect expenditures are within the fundamental jurisdiction of the agency [T]he power of audit include[s] the duty to ensure that the expenditure in question is authorized by law.” *Tirapelle v. Davis*, 20 Cal App. 4th 1317, 1335 (1993).

3 Cross-Complainant the Office of the State Controller (“SCO”) is a department of the State of California headed by the Controller. Cal. Gov’t Code § 12402.

4 Cross-Defendant California Department of Personnel Administration (“DPA”) is a California state agency statutorily created for the purposes of managing the nonmerit aspects of the state’s personnel system. Cal. Gov’t Code § 19815.2.

1 15. The July 1 letter states that, under *White v Davis*, 68 P.3d 74, 30 Cal 4th 528, 133
2 Cal. Rptr. 648 (2003), in the absence of an approved state budget, the Controller has no legal
3 authority to pay state employee wages and salaries except as required by federal labor law.

4 16. The July 1 letter and Pay Letter call for the Controller to implement salary
5 reductions in light of the budget impasse. Specifically, the Pay Letter directs that the salaries and
6 wages of most state employees be reduced to the federal minimum wage of \$7.25 per hour while
7 others, including teachers and attorneys, would receive no compensation

8 17. The July 1 letter exempts employees in six bargaining units that have reached
9 tentative agreements with the administration. According to the July 1 letter: "The six Bargaining
10 Units with tentative agreements are not included because we are seeking and expect the
11 Legislature to approve a continuous appropriation for these six units. We anticipate passage of a
12 continuous appropriation for these bargaining units before the end of the month."

13 18. As set forth in the Causes of Action below, the Pay Letter directs the Controller to
14 take actions which he believes are contrary to state and federal law and as to which he has
15 inherent authority under the state Constitution to make discretionary decisions. Moreover,
16 because of legislative restrictions on and inherent inadequacies of the legacy payroll system the
17 Controller is compelled to use, the actions specified in the Pay Letter are infeasible.

18 19. On July 2, Collin Wong-Martinusen ("Wong-Martinusen"), the Controller's Chief-
19 of-Staff, responded to Director Endsley's July 1 letter. A copy of Wong-Martinusen's July 2
20 letter, with attachments, is attached hereto as Exhibit B.

21 20. In the July 2 letter, Wong-Martinusen addressed DPA's claim, contained in its July
22 1 letter, that in June 2003, then-Controller Steve Westly made a statement to the effect that the
23 technical tasks involved in changing pay for more than 200,000 employees could be
24 accomplished. Wong-Martinusen clarifies that then-Controller Westly's statement was a
25 preliminary opinion offered after only six months in office. Wong-Martinusen explained that,
26 "Thirteen months later, after having the opportunity to thoughtfully study the matter, [then-
27 Controller Westly] notified the Legislature that his office 'had conducted a study and concluded it
28 is not feasible to pay some employees full salary and others minimum wage under the state's

1 current payroll system.” Wong-Martinusen also attached a copy of the referenced notification by
 2 then-Controller Westly, and offered to facilitate a meeting between SCO and the former
 3 Controller’s payroll chief to “clarify any misunderstandings upon which you have come to
 4 detrimentally rely.” Wong-Martinusen further stated: “I urge you to avail yourself of this
 5 opportunity, if for no other reason than to confer with someone who oversaw the design of the
 6 existing payroll system when it was built in the early 1970’s and can inform your understanding
 7 of what this system can and cannot do.”

8 21. On July 6, DPA filed a lawsuit in this Court, treating as final its draft Pay Letter
 9 and seeking enforcement of its terms. Prior to filing the lawsuit, Cross-Defendants made no
 10 effort to confer with Controller Chiang or SCO concerning a resolution of the issues previously
 11 raised by Controller Chiang regarding potential violations of federal and state law and
 12 infeasibility.

13 22. In prior litigation arising from the fiscal year 2008-2009 budget impasse, DPA
 14 initiated a lawsuit against Controller Chiang and the SCO in this court seeking to enforce the
 15 terms of a pay letter issued to SCO in August 2008. *Gilb v. Chiang*, No. 34-2008-8000026
 16 That pay letter also called for the Controller to implement salary reductions in light of the fiscal
 17 year 2008-2009 budget impasse, but differs in important respects from the July 1 Pay Letter.

18 23. On March 18, 2009 the Sacramento County Superior Court entered a Ruling After
 19 Hearing finding in favor of DPA. The Controller and SCO appealed that ruling to the Third
 20 District Court of Appeals. *Gilb v. Chiang*, No. C061947. On July 2, 2010, that court issued an
 21 opinion affirming in certain respects the trial court’s decision. The Third District further noted in
 22 its opinion: “If the Controller believed DPA’s [Aug. 2008] pay letter violated the law, the
 23 Controller should have initiated judicial resolution of the dispute” Slip Op. at 24.

24 24. In keeping with the Third District’s guidance, the Controller now seeks judicial
 25 resolution of the dispute between SCO and DPA arising from DPA’s efforts to enforce its latest
 26 Pay Letter
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DECLARATORY RELIEF SOUGHT

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2 25. An actual controversy has arisen and now exists between Cross-Complainants and
3 Cross-Defendants concerning their respective rights, duties, and obligations under state and
4 federal laws. The controversy is definite and concrete, of sufficient immediacy, and touches on
5 the legal relations of the parties having adverse legal interests, as well as the thousands of hard-
6 working California state employees whose salaries would be adversely affected by the Pay Letter.

7 26 As set forth more fully herein, the Controller contends that the DPA's Pay Letter
8 forces the Controller to choose between violating the Pay Letter or violating various federal and
9 state laws. Cross-Complainants are informed and believe that Cross-Defendants dispute these
10 contentions. The Controller therefore seeks a declaration of his rights and duties with respect to
11 the Pay Letter.

12 27. On the basis of prior communications between DPA and SCO, including litigation
13 with respect to the budget impasse of 2008-2009, as well as prior budget impasses, DPA is well
14 aware of the issues described above and in the Causes of Action below, including the Controller's
15 determination and finding -- communicated as recently as late June during oral argument before
16 the Third District Court of Appeals and again in the SCO's July 2 letter -- that the SCO's legacy
17 payroll systems (i) cannot satisfy (without remedial legislation, at a minimum) the requirements
18 of state and federal law during a budget impasse, and (ii) has substantial technical and operational
19 gaps and lacks the functionality and flexibility required to implement the salary reductions and
20 related changes sought by DPA during a budget impasse. Although DPA's July 1 letter claimed
21 that "[m]y staff is prepared to work with you to develop and implement the necessary
22 mechanisms to comply" with the Pay Letter, DPA has not made any serious effort to work with
23 the Controller to reach a resolution of the issues, or to provide clarification to the Controller
24 regarding his rights, duties, and responsibilities.

25 28. Cross-Complainants seek to enforce their rights and to obtain a declaration with
26 respect to both Cross-Complainants' and Cross-Defendants' obligations under the law. In
27 particular, Cross-Complainants ask this Court to declare that the Pay Letter issued by DPA to the
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1 Controller is unlawful and legally invalid. Such a declaration of rights is necessary, warranted
2 and appropriate.

3 29. Cross-Complainants lack an adequate remedy at law.

4 30. The Controller will continue to seek this relief even if a state budget is passed prior
5 to the final adjudication of this dispute on the merits.

6 **FIRST CAUSE OF ACTION**

7 **Cross-Complaint for Declaratory Relief, Cal. Code Civ. Proc. § 1060**

8 31. The Controller hereby incorporates by reference all of the foregoing paragraphs as
9 though fully set forth herein.

10 32. Some state employees covered by the Pay Letter are paid salary or wages from
11 continuing appropriations or from other funding sources not requiring legislative action. The Pay
12 Letter fails to exempt those employees from its terms or otherwise to provide the Controller with
13 lawful instructions regarding payment to such employees, contrary to state law

14 33. For the foregoing reasons, the Controller believes the Pay Letter to be unlawful
15 and is in genuine doubt as to his legal rights, duties, and responsibilities with respect to it.
16 Accordingly, the Controller seeks a declaration that the Pay Letter is legally invalid.

17 **SECOND CAUSE OF ACTION**

18 **Cross-Complaint for Declaratory Relief, Cal. Code Civ. Proc. § 1060**

19 34. The Controller hereby incorporates by reference all of the foregoing paragraphs as
20 though fully set forth herein.

21 35. Contrary to federal law and to orders entered by the U.S. District Court for the
22 Northern District of California in *Plata v. Schwarzenegger*, No. 3:01-cv-01351-TEH, including,
23 without limitation, orders appointing a receiver ("Receiver") and conferring upon him the powers
24 of the Secretary of the California Department of Corrections and Rehabilitation and orders to
25 which the California State Controller has been made subject, the Pay Letter has failed to exempt
26 from its coverage state employees subject to the direction and control of the Receiver or to
27 otherwise provide lawful instructions with respect to such state employees as evidenced by the
28 consent of the Receiver or of the U S District Court Further, the Pay Letter provides no

1 instructions or information by which the Controller is able to identify state employees subject to
2 the direction and control of the Receiver

3 36. For the foregoing reasons, the Controller believes the Pay Letter to be unlawful
4 and is in genuine doubt as to his legal rights, duties, and responsibilities with respect to it.
5 Accordingly, the Controller seeks a declaration that the Pay Letter is legally invalid.

6 THIRD CAUSE OF ACTION

7 **Cross-Complaint for Declaratory Relief, Cal. Code Civ. Proc. § 1060**

8 37. The Controller hereby incorporates by reference all of the foregoing paragraphs as
9 though fully set forth herein.

10 38. Federal and state law requires that deductions be made from the salary and wage
11 amounts paid to some or all state employees, for (without limitation) federal income tax, state
12 income tax, state disability insurance, and state retirement contributions. The Pay Letter fails to
13 provide the Controller with lawful instructions as to such deductions.

14 39. For the foregoing reasons, the Controller believes the Pay Letter to be unlawful
15 and is in genuine doubt as to his legal rights, duties, and responsibilities with respect to it.
16 Accordingly, the Controller seeks a declaration that the Pay Letter is legally invalid.

17 FOURTH CAUSE OF ACTION

18 **Cross-Complaint for Declaratory Relief, Cal. Code Civ. Proc. § 1060**

19 40. The Controller hereby incorporates by reference all of the foregoing paragraphs as
20 though fully set forth herein.

21 41. The federal Fair Labor Standards Act ("FLSA") requires that, in a given pay
22 period, certain state employees (known as nonexempt employees) who work overtime during that
23 pay period must be paid, on a timely basis, their full regular rates of pay plus time-and-a-half for
24 the overtime worked. During the budget impasse, the Controller has no way of accurately
25 determining which of these state employees will have worked overtime during that pay period
26 and must be paid during that pay period their full regular rates of pay. The Pay Letter provides no
27 lawful instructions to ensure such results and therefore is in conflict with the FLSA and state law.
28

1 Hence the Controller's compliance with the Pay Letter (a) is infeasible, and (b) would inevitably
2 result in violation of the FLSA and state law.

3 42. For the foregoing reasons, the Controller believes the Pay Letter to be unlawful
4 and is in genuine doubt as to his legal rights, duties, and responsibilities with respect to it.
5 Accordingly, the Controller seeks a declaration that the Pay Letter is legally invalid.

6 **FIFTH CAUSE OF ACTION**

7 **Cross-Complaint for Declaratory Relief, Cal. Code Civ. Proc. § 1060**

8 43. The Controller hereby incorporates by reference all of the foregoing paragraphs as
9 though fully set forth herein.

10 44. The legacy negative pay system which the SCO is required to administer, also
11 called the anticipatory pay system, covers the vast majority of State employees, and may be
12 altered only by legislation and collective bargaining. State law also requires that, at all times, the
13 Controller pay only for time actually worked.

14 45. The legacy negative pay system requires that the Controller prepare the payroll 8-
15 10 days in advance of the end of the last day of the pay period. Consequently, because of the
16 required application of the negative pay system during the budget impasse, the Controller has no
17 way of accurately determining at the point when the SCO prepares that negative payroll: (i)
18 which state employees will not have worked the requisite hours and days during those final days
19 of the pay period in order to be paid in full in conformance with state law at the end of the pay
20 period, and (ii) which nonexempt employees will have worked overtime during that pay period
21 that, in compliance with federal law, would require the payment during that pay period of the
22 employees' full regular wages for all non-overtime hours worked during that pay period. Hence,
23 on this basis alone, the Controller's compliance with the Pay Letter would inevitably result in
24 violations of the FLSA and state law and would be infeasible.

25 46. For the foregoing reasons, the Controller believes the Pay Letter to be unlawful
26 and is in genuine doubt as to his legal rights, duties, and responsibilities with respect to it.
27 Accordingly, the Controller seeks a declaration that the Pay Letter is legally invalid
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EIGHTH CAUSE OF ACTION

Cross-Complaint for Declaratory Relief, Cal. Code Civ. Proc. § 1060

53. The Controller hereby incorporates by reference all of the foregoing paragraphs as though fully set forth herein.

54. The Pay Letter necessarily envisions that, when the current budget impasse has ended, state employees whose timely pay has been reduced during the budget impasse shall be restored the amounts that they were not paid during the impasse but that, under *White v Davis*, they are entitled to be paid at the end of the budget impasse. The Pay Letter is devoid of instructions as to how the Controller shall accomplish such immediate restoration in the face of the inherent infeasibility of the existing legacy pay systems and processes with which the Controller remains encumbered.

55. For the foregoing reasons, the Controller believes the Pay Letter to be unlawful and is in genuine doubt as to his legal rights, duties, and responsibilities with respect to it. Accordingly, the Controller seeks a declaration that the Pay Letter is legally invalid.

NINTH CAUSE OF ACTION

Cross-Complaint for Declaratory Relief, Cal. Code Civ. Proc. § 1060

56. The Controller hereby incorporates by reference all of the foregoing paragraphs as though fully set forth herein.

57. Contrary to Cal. Gov't Code § 19826 and state law reserving to the Legislature exclusive and ultimate authority over the non-merit economic conditions of state employment with respect to state employees covered by the Dills Act and who have chosen an exclusive representative under said act ("Represented Employees"), the Pay Letter unlawfully fails to exempt Represented Employees from its coverage. Further, the Pay Letter provides no instructions or information by which the Controller is able to identify Represented Employees subject to the Pay Letter's coverage. The Controller recognizes that this claim was the subject of prior litigation with DPA and was decided against the Controller. Such prior litigation is not final, and is subject to review by the California Supreme Court.

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1 58. For the foregoing reasons, the Controller believes the Pay Letter to be unlawful
2 and is in genuine doubt as to his legal rights, duties, and responsibilities with respect to it.
3 Accordingly, the Controller seeks a declaration that the Pay Letter is legally invalid.

4 **PRAYER**

5 WHEREFORE, Cross-Complainants pray that judgment be entered against Cross-
6 Defendants, and each of them, as follows:

- 7 1 For a declaration that the Pay Letter issued by DPA to the Controller is legally
- 8 invalid;
- 9 2. For appropriate declaratory relief with respect to the Controller's rights, duties,
- 10 and responsibilities with respect to each of the Causes of Action above,
- 11 3. For costs of suit incurred herein;
- 12 4. For such costs and further relief as the Court deems just and proper.

13 Dated July 7, 2010

Respectfully submitted,

OFFICE OF THE STATE CONTROLLER

By: Steven S. Rosenthal / *[Signature]*

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Attorneys for Cross-Complainant, JOHN
CHIANG, in his official capacity as
CONTROLLER OF THE STATE OF
CALIFORNIA; and the OFFICE OF THE
STATE CONTROLLER

EXHIBIT "A"

DEPARTMENT OF PERSONNEL ADMINISTRATION

OFFICE OF THE DIRECTOR
1515 "S" STREET, NORTH BUILDING, SUITE 400
SACRAMENTO, CA 95811-7258



July 1, 2010

The Honorable John Chiang
California State Controller
300 Capitol Mall, Suite 1850
Sacramento, California 95814

Dear Controller Chiang,

Today is July 1, 2010, and there is no state budget. Regrettably, we must take the steps outlined in the attached pay letter to adjust wages and salaries during this budget impasse. The six Bargaining Units with tentative agreements are not included because we are seeking and expect the Legislature to approve a continuous appropriation for these six units. We anticipate passage of a continuous appropriation for these bargaining units before the end of the month.

In May 2003, the California Supreme Court held in *White v. Davis* that in the absence of an approved state budget, the Controller has no legal authority to pay state employee wages and salaries except as required by federal labor law.

In 2008, the Department of the Personnel Administration (DPA) issued a pay letter directing the payment of wages and salaries in compliance with *White v. Davis*. You did not implement that pay letter. You cited your computer system as one of the reasons you could not pay minimum wage for state employees during a budget impasse. Based on your refusal, the DPA sued and won in the trial court. You appealed to the appellate court and we are waiting for a decision.

However, in June 2003, your predecessor, Steve Westly, stated that the "technical tasks involving changing pay for more than 200,000 employees can be accomplished." Based on this statement, it appears that there is a way to implement changes to your computer system to comply with *White v. Davis* and the Fair Labor Standards Act (FLSA).

I urge you to take the necessary steps to make changes to your computer system to comply with state law. My staff is prepared to work with you to develop and implement the necessary mechanisms to comply with the California Constitution, *White v. Davis*, and the Fair Labor Standards Act.

Sincerely,

A handwritten signature in black ink, appearing to read "Debbie Endsley".

Debbie Endsley
Director

PAY LETTER: 10-XX
ISSUE DATE:

**DEPARTMENT OF PERSONNEL ADMINISTRATION
SECTION I**

For questions regarding Section I, call (916) 323-3343
Technical questions will be referred to the Personnel Services Branch

To comply with federal labor law and the California Supreme Court's decision in White v. Davis, in the absence of an approved budget WWG 2, E, and SE classes shall be paid as follows:

All Regular Pay for all employees is delayed until a budget is signed with the exception of the Bargaining Units identified below. Until a Budget is signed employees in Work Week Group 2 and WWG E are eligible for Pay Differential XXX. Employees in WWG SE are not entitled to Regular Pay or the Minimum Wage Pay Differential in the absence of a Budget.

SECTION 14: PAY DIFFERENTIALS

PAY DIFFERENTIAL XXX
WHITE VS. DAVIS NO BUDGET/MINIMUM WAGE PAY DIFFERENTIAL RANK AND
FILE AND EXCLUDED EMPLOYEES is established: (Effective 07/01/10)

Excluded from Minimum Wage Differential:

Bargaining Units 5, 8, 12, 16, 18 and 19

**PAY DIFFERENTIAL XXX
WHITE VS. DAVIS NO BUDGET/MINIMUM WAGE PAY DIFFERENTIAL -
RANK AND FILE AND EXCLUDED EMPLOYEES**

Established. 07/01/10

CLASS TITLE	CB/ID	RATE	DEPARTMENT
All classes with WWG 2 designation with the exception of positions that have a continuous appropriation	R01, R02, R04, R06, R07, R09, R10, R11, R13, R14, R15, R17, R20, R21, S01, S04, S05, S06, S07, S08, S09, S11, S12, S13, S14, S15, S17, S20, U01, U04, U07, U09, U12, U15, U19, E, E97, E98, and confidential employees tied to the above rank-and-file bargaining units.	Rate 1	All Departments
All classes with WWG E designation with the exception of positions that have a continuous appropriation	R01, R02, R03, R07, R09, R10, R11, R17, R21, S01, S02, S03, S04, S06, S07, S08, S09, S10, S12, S11, S14, S15, S17, S18, S19, S20, S21, M01, M02, M05, M06, M07, M08, M09, M10, M11, M12, M13, M14, M15, M16, M17, M18, M19, M20, M21, M21, U01, U02, U09, U10, U19, E97, E98, E99	Rate 2	

RATE	EARNINGS ID
<p><u>RATE 1 -WWG 2</u></p> <p>Full-time employees shall be eligible for:</p> <p> \$1,218 for a 21 day pay period \$1,276 for a 22 day pay period</p> <p>Intermittent employees shall be eligible for</p> <p> \$7 25 per hour</p> <p>Daily rate employees shall be eligible for:</p> <p> \$58.00 per day</p>	

SECTION 14:

PAY DIFFERENTIALS

RATE	EARNINGS ID
<u>RATE 2 - WWG E</u>	
Full-time employees shall be eligible for <p style="text-align: center;">\$1,971.66 per pay period</p>	
Intermittent employees shall be eligible for. <p style="text-align: center;">\$11.36 per hour</p>	
Daily rate employees shall be eligible for <p style="text-align: center;">\$91.00 per day</p>	

CRITERIA
Employees in classes with a Work Week Group designation of 2 and E are eligible for this pay differential with the exception of employees in Bargaining Units 5, 8, 12, 16, 18, and 19. These bargaining units have a continuous appropriation and will receive their regular compensation.
All health benefits will not be withheld from this minimum wage pay differential for 90 days.
Group legal will be withheld from this minimum wage pay differential.
Miscellaneous deductions will be withheld from this minimum wage payment.
Employee's lump sum payments will not be based on this minimum wage payment.
Disability payments which occurred prior to July 1, 2010 will not be subject to minimum wage.
Supplemental payments for disability will be based on minimum wage as of July 1, 2010.

IF APPLICABLE, SHOULD PAY DIFFERENTIAL BE:	
PRO RATED	Yes
SUBJECT TO QUALIFYING PAY PERIOD	No
ALL TIME BASES AND TENURE ELIGIBLE	Yes
SUBJECT TO PERS DEDUCTION	Yes

INCLUSION IN RATE TO CALCULATE THE FOLLOWING BENEFIT PAY	
OVERTIME	No
IDL	No
EIDL	No
NDI	No
LUMP SUM VACATION	No
LUMP SUM SICK	No
LUMP SUM EXTRA	No

EXHIBIT "B"



JOHN CHIANG
California State Controller

July 2, 2010

Debbie Endsley, Director
Department of Personnel Administration
1515 "S" Street, North Building, Suite 400
Sacramento, CA 95811-7258

Dear Ms. Endsley:

Thank you for your letter of July 1, 2010, which includes a draft pay letter calling for the salaries and wages of most State employees to be reduced to the federal minimum of \$7.25 per hour while others, including criminal prosecutors and teachers, will receive no compensation.

Controller John Chiang agrees that it is regrettable that the new fiscal year has begun without a spending plan in place. It is also regrettable that innocent Californians pay the price whenever the Governor and lawmakers fail in their Constitutional responsibility to pass a timely and honestly-balanced budget. While the current focus is on state public servants, the list of those who have been called to shoulder the fiscal mismanagement of its Sacramento leaders during the past 36 months includes 450,000 IOU recipients, taxpayers who had more than \$3 billion of tax refunds withheld, businesses which provide goods to the State, and California taxpayers who must now pay millions in extra debt service to offset credit ratings which are the worst in the nation.

Your letter refers to segments of the 2003 Supreme Court decision in *White v. Davis* which provide that the State must follow the minimum requirements of the federal labor laws in the absence of a budget, but conveniently ignores the Court's declaration that "the Controller's claim of infeasibility was not fully litigated, and thus we do not believe it would be appropriate to attempt to definitively resolve the claim at this juncture." In short, the Court acknowledged then-Controller Davis's argument that system limitations coupled with existing labor laws prevent the State from reducing wages to the federal minimum level without violating various provisions of the federal Fair Labor Standards Act, but left the issue to be litigated at a future date. Today's ruling issued by the 3rd District Court of Appeal actually goes further by saying that "unfeasibility would arguably excuse the Controller from the declaratory judgment to comply with *White v. Davis* . . ."

Your letter quotes a June 2003 statement by then-Controller Westly who, in only his sixth month in office, offered a preliminary opinion that the State's payroll system could be reprogrammed to pay federal minimum wage. Thirteen months later, after having the opportunity to thoughtfully study the matter, he notified the Legislature that his office "had conducted a study and concluded it is

Debbie Endsley
July 2, 2010
Page 2

not feasible to pay some employees full salary and others minimum wage under the state's current payroll system." I have attached a copy of that letter and am willing to facilitate a meeting between you and the previous Controller's payroll chief to clarify any misunderstandings upon which you have come to detrimentally rely. I urge you to avail yourself of this opportunity, if for no other reason than to confer with someone who oversaw the design of the existing payroll system when it was built in the early 1970's and can inform your understanding of what this system can and cannot do.

I appreciate your offer to work with us in developing the necessary mechanisms to reduce 250,000 Californians' wages to the federal minimum or to zero. Let's begin with issues raised by then-payroll chief Don Scheppmann in his August 2008 letter addressed to your deputy director of labor relations. It provided your office with a list of legal and mechanical challenges that would need to be resolved in order to mitigate the risk of California taxpayers incurring billions of dollars in damages associated with violating federal labor laws and the Constitution. To date, we have received no response from you or your staff. If you have solutions to the identified challenges, it would be in the State's best interests for you to share them. While all the issues raised in the 2008 letter deserve your full attention, there are three vital challenges which your office has remained unusually silent. They have been summarized and are attached to this letter.

Finally, it is important to note that the Administration has been working in close partnership with the Controller on the nation's largest payroll modernization effort. The new payroll system will have the capacity to address the State's current and future business needs, including the lawful reduction of wages in the absence of a budget. As one of four Administration representatives to the project's six-person steering committee, you approved the current schedule which anticipates initial roll-out in 2011, and the subsequent decommissioning of the existing payroll system. In your role, you also know that no other state payroll system in the nation is asked to pay minimum wage during a budget stalemate or under any other circumstances.

As Controller Chiang has advised both the Governor and legislative leaders, California cannot afford another day of political paralysis in resolving the state budget crisis, nor can it afford a "shoot first, and aim later" approach to governing. In the form of budget shght-of-hand and reckless political stunts, too many mistakes have been made in recent years that have served to exacerbate the State's fiscal woes. Until we can properly manage the billion dollar risk associated with the Governor's minimum wage proposal, let's not add to that list of mistakes

Sincerely,
Original signed by

COLLIN WONG-MARTINUSEN
Chief-of-Staff
California State Controller John Chiang

Attachments

- California utilizes a “negative payroll system,” which means that the calculation of state workers’ pay is completed **in advance** of the conclusion of the pay period. For example, during the July pay period (July 1 through July 31), State employees will receive their pay warrants on August 1st, but the State Controller will calculate payroll on or about July 20th. This negative payroll system is enshrined in State law and cannot be altered except by legislation or through collective bargaining.

California does not have a “real-time” attendance accounting system. Instead, state employees complete a time sheet reflecting actual hours worked during the first week of the subsequent pay period. For example, employees will generally complete their respective timesheets reflecting actual hours worked in the July pay period during the first week of August.

This begs the question: “With a negative payroll system and the lack of real-time attendance accounting, how does the Controller know who has worked overtime during the first 20 days of the month and who will work overtime during the final 10 days of the month?” In short, we don’t. Instead, we calculate payroll on the 20th of each month using the presumption that all employees have worked their full, normal hours.

As you already know, the FLSA provides that an employee who works overtime is entitled to full pay for their regular hours on his/her normal pay day, in addition to overtime wages. Because of the payroll environment described above, California will assuredly violate the FLSA should it attempt to pay its employees federal minimum wage. Returning to our example: On July 20th, the Controller will have no means to determine who has or will work overtime during the July pay cycle in order to comply with the overtime provisions of the FLSA.

Just so you get a sense of how many potential violations could occur: During the April 2010 payroll period, nearly 72,000 state employees worked more than 1.5 million hours of overtime.

- The California Constitution prohibits expenditures unless there is a legislative appropriation authorizing the spending. Most, but not all, appropriations are found in the annual budget act which is required to be enacted by no later than July 1 of each year and expires the following June 30. Regrettably, this Constitutional requirement has only been met 5 times in the past 20 years.

Because payroll is calculated on or about the 20th of every month, California is at substantial risk of violating the prompt pay provisions of the FLSA if it attempts to reduce wages to the federal minimum level. Specifically, if there is a budget impasse on the date on which the State calculates payroll, the Controller will be forced to make those calculations based on the presumption that there will be no budget agreement during the final 10 or 11 days of the month. If there is a budget agreement enacted during that window of time, it is infeasible for our existing Vietnam-era payroll system to undo the prior calculations and revert back to paying normal, full wages by the regular pay day.

- While reducing pay at the onset would be impossible without placing the State at risk of violating the overtime and prompt pay provisions of the FLSA, the time it would take to make state employees whole for wages owing in the wake of a budget deal would **guarantee** violations of the prompt pay provisions of the FLSA.

Our payroll technical experts estimate that it would take **at least 6 months** before all employees would be made whole once a budget is in place.

A recent example of the incredible task we face in restoring full pay followed a court ruling that determined that California's Governor acted unlawfully in furloughing employees at the State Compensation Insurance Fund, the California state agency responsible for providing worker's compensation insurance coverage to businesses. In fulfillment of the court's order to retroactively restore lost wages to this agency's 8,000 employees, it took 4+ weeks. Note that the universe of employees who would either be paid federal minimum wage or no wages is approximately 250,000.

CONTROLLER STEVE WESTLY

STATE OF CALIFORNIA

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Sacramento, CA 95814
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FOR IMMEDIATE RELEASE:
July 8, 2004

CONTACT: PAUL HEFNER
916-324-2356

Westly Pledges to Fund Key Services Until Budget Completed

SACRAMENTO – Controller Steve Westly today outlined plans to keep state funds flowing to preserve vital services until a final budget is adopted.

“We all know we need a budget as soon as possible,” Westly said. “In the meantime, as the state’s chief financial officer, I will do everything I can to provide payments for essential services.”

In a letter to members of the Legislature, Westly said he would continue to pay the salaries of state employees, and to pay state vendors for services provided before the new fiscal year began July 1. In addition, Westly will continue making payments required by federal law, authorized by the State Constitution or allowed via continuous legislative appropriation.

Westly said that the state’s cash position is substantially improved from last year, due to passage of Proposition 57 and the improved economy.

But Controller Westly cautioned that while no large payments were immediately threatened, several claims will come due later this month – including payments to community colleges and to school districts for categorical programs – that cannot be paid until a budget is signed.

“The real date to watch for is July 28. That’s when I will not be able to make major payments to community colleges and California’s schools,” Westly said.

Westly said he cannot make payments to vendors for services provided since July 1. He also said he would continue the practice of withholding salaries and per diem from state elected officials and appointed staff until a budget is adopted.

Text of letter follows.

-More-



STEVE WESTLY
California State Controller

July 8, 2004

Dear Legislators:

Thank you for working hard to finalize California's budget. To help you respond to your constituents' concerns, let me outline what obligations I can and cannot pay until a budget is signed into law.

The state's cash position is substantially better this year than last, due to passage of Prop. 57 and the improving economy.

As the State's chief financial officer, I will do everything I can to continue to provide payments for essential services. However, there are a number of constitutional and other restrictions that will prevent me from making payments scheduled for month's end to community colleges, school districts' categorical programs and local governments.

What We Can Pay

In the absence of a budget, I am authorized to make the following types of payments:

1. **State Employees** – In *Jarvis vs. Westly*, the state Supreme Court ruled that payment to state employees was proper under the Fair Labor Standards Act. The court left open the question of whether the payment was to be for full or minimum wages and whether or not minimum wage payments were feasible. My office did a study and concluded it is not feasible to pay some employees full salary and others minimum wage under the state's current payroll system. We are in the process of replacing our payroll system – which has been in place since the 1970s – but that work will not be completed until 2008.
2. **Prior Year Obligations** – These payments are for costs incurred in the prior fiscal year. These include vendor payments for services provided before June 30.
3. **Constitutional Authorizations** – These are financial obligations set out in the State Constitution, such as debt service and related interest payments, and revenue limit education payments.
4. **Federal Mandates** – Even without a budget, California must comply with federal law. Therefore, I will continue making federally mandated payments such as Medi-Cal and CalWorks.

5. **Continuous Legislative Appropriations** - I will continue to pay those expenses with ongoing authorization of the Legislature, such as unclaimed property payments and income tax refunds.

What We Cannot Pay

1. Payments to community colleges, school districts, local governments, some non-profit organizations and other entities not allowed as specified above.
2. Payments to vendors for services provided during the new fiscal year.
3. Salaries and per diem of state elected officials and their appointed staff.

I hope this information is helpful to you. Please call me if you have any questions.

Sincerely,

Original signed by:

STEVE WESTLY
California State Controller

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COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is 1999 Avenue of the Stars, Suite 1700, Los Angeles, California 90067.

On July 7, 2010, I served the foregoing document described as follows: **CROSS COMPLAINT FOR DECLARATORY RELIEF**

BY E-MAIL SERVICE: SEE ATTACHED SERVICE LIST

BY FACSIMILE The above-referenced documents (without exhibits and attachments thereto) were transmitted via facsimile transmission to the addressee(s) as indicated above on the Date thereof. The transmission was reported as completed and without error.

ELECTRONIC SERVICE SEE SERVICE LIST

BY FEDERAL EXPRESS I am readily familiar with Kaye Scholer LLP's business practices of collecting and processing items for pickup and next business day delivery by Federal Express. Under said practices, items to be delivered the next business day are either picked up by Federal Express or deposited in a box or other facility regularly maintained by Federal Express in the ordinary course of business on that same day with the cost thereof billed to Kaye Scholer LLP's account. I placed such sealed envelope for delivery by Federal Express to the offices of the addressee(s) as above on the date hereof following ordinary business practices.

MAIL I am readily familiar with the firm's practice of collection and processing Correspondence for mailing. Under that practice it would be deposited with the U.S. postal service on that same day with postage thereof fully prepaid at Los Angeles, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

BY PERSONAL SERVICE

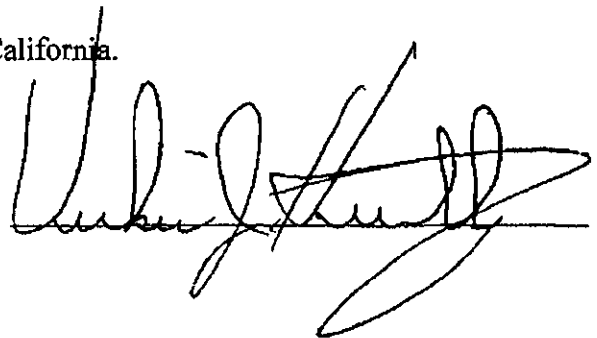
- by personally delivering such envelope to the addressee.
- by causing such envelope to be delivered by messenger to the office of the addressee.

STATE I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

FEDERAL I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed on July 7, 2010, at Los Angeles, California.

Vickie J. Huntley



KAYE SCHOLER LLP

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Of Personnel Administration**