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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

DEBBIE L. ENDSLEY; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Petitioners/Plaintiffs v. JOHN CHIANG, sued herein in his official capacity only; OFFICE OF STATE CONTROLLER Respondents/Defendants	Case No. 34-2010-80000591 **DECLARATION OF JOHN HARRIGAN** Assigned to: Trial Date: None yet assigned Complaint Filed: July 6, 2010 Cross Complaint Filed: July 7, 2010
JOHN CHIANG, in his official capacity as CONTROLLER OF THE STATE OF CALIFORNIA; and the OFFICE OF THE STATE CONTROLLER Cross-Complainants, v. DEBBIE L. ENDSLEY, sued herein in her official capacity only; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Cross-Defendants.	

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I, John Harrigan, declare as follows:

1. I was employed in the State Controller's Office ("SCO") from 1980 until my retirement in 2006. From 1980-2000 and 2002-2006, I was the Division Chief of Personnel Payroll Services Division ("PPSD"). From 2000-2002, I was Chief Deputy Controller. My responsibilities included directing the State's personnel payroll, maintaining the State's official employment roster, setting policy for the state payroll system, training for departmental personnel in the areas of personnel and payroll processing, and implementing wage structures negotiated by the State Department of Personnel Administration ("DPA"). I was responsible for payroll for the approximately 250,000 state employees (including those of the California State University system and the Judicial Council).

2. At all times throughout my employment in the SCO, I interfaced directly with the Information Systems Technology Division ("ISTD"). The ISTD is responsible for maintaining all of the SCO's computer systems, including the State's payroll system. During my term as Chief Deputy Controller, I supervised that department, and at all other times, I worked with those ISTD staff assigned to the payroll systems to implement all required changes to the State's payroll. Such changes were made following, among other things, changes in Federal and State laws, and of entry of new or modified collective bargaining agreements between the DPA and various bargaining units. When changes to pay or benefits structures were required, from whatever source, it was the task of the PPSD, in conjunction with the ISTD staff, to implement those changes.

3. At all times throughout my employment in the SCO, I interfaced directly with the DPA. The DPA negotiates terms and conditions of employment for State employees, dealing with, for example, the Service Employees International Union, or the California Highway Patrol association. DPA negotiates, among other things, hours, salary, benefits, and pension terms. The SCO takes those agreements, interprets the impacts on the payroll system with respect to the bargaining unit at issue, and attempts to implement the changes. Generally the two departments would commence high level discussions as early as possible in advance of any proposed change in order to provide the SCO as much lead time as necessary to make proposed changes, and to

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provide DPA with information about what the system could technically handle. Sometimes the SCO would determine that there was no way to implement the proposed change, allowing DPA to adjust the agreement, if possible, before signing. This happened on numerous occasions because the payroll system is old and not very flexible.

4. The PPSD was the primary user of the payroll system maintained by the SCO's ISTD, and we directed the ISTD regarding what changes to make. For example, if DPA negotiated a contractual change in a collective bargaining agreement, PPSD had to translate that change into a payroll change, first in non-technical terms, and then work with the ISTD to implement the changes on the payroll system. Implementing those changes in the payroll system, as well as maintaining the payroll system, took up all the time of the ISTD staff assigned to the payroll system.

5. While there are twenty-one different bargaining units in the state employee system, another twenty-two different bargaining units in the California State University System, and various supervisory groups without collective bargaining but with meet and confer rights, all of which generated various changing payroll requirements, there were only ten or fewer ISTD staff working on the payroll system. That staff was charged with implementing changes on payroll systems that were built in 1970s using COBOL, an old computer programming language, and assembly language, which is cumbersome.

6. The typical life of a comparable computer system is seven to ten years, and the age of the State's system presented two main problems. First, the system was cumbersome to use, maintain, and change. Second, with the gradual departure of the staff members with original knowledge of the system, it took increasingly longer for new ISTD staff to come up to speed on the system, particularly with regard to being able to make changes to the complex, interconnected, and antiquated system. There are many millions lines of computer code to support the payroll system, and it understandably takes new staff quite some time to have a functional knowledge of them.

7. The antiquated payroll system also limited the range of contractual options the State could offer employees. In fact, DPA routinely consulted with the PPSD over the years to

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determine what terms were possible to implement. It would have been a problem for DPA to have negotiated a contract with a bargaining unit, only to find that the contractual terms were impossible for the SCO to implement. There were a few instances in which DPA agreed to terms that could not be implemented, but in my experience the SCO was able to catch them prior to legislative approval of the contract, and DPA was able to renegotiate based on technical limitations of the payroll system.

8. The SCO would have liked to have been able to provide more flexibility in the payroll system for the State's employees and for DPA's negotiations. Indeed, it is often a great benefit to DPA or a union to be able to offer employees an arrangement that another bargaining unit does not have. Nonetheless, the technical limitations of the system prevented the SCO from being able to implement a number of contractual terms that were at various times attractive to employees, and on their face, seem simple. For example, the vast majority of State employees are paid monthly. A small proportion of the State's employees (including Caltrans Highway Maintenance workers) are paid semi-monthly and 130 people, total, are paid biweekly. The payroll system prevents the option of more frequent paydays from being available to increased numbers of employees. There is also a lack of flexibility in the ability to offer lag vs. non-lag payments (being able to wait to see what time was worked prior to payday), and some bargaining units would prefer a lag system, which cannot presently be offered. The current payroll system mandates a certain uniformity of treatment that does not allow for optimal flexibility.

9. Similarly, DPA wanted to be able to offer flexibility with respect to deferred compensation, but the payroll system was not capable of supporting it. The present system does not contain the capacity for employees to select a percentage of income to be deferred, and the SCO found it too expensive to add that functionality to the system. Another missing option in the current system is the ability for the State to offer deferred compensation contributions on a matching basis.. This would certainly be an attractive option for DPA to have during negotiations. State employer percentage contributions are available for CalPERS contributions, but not for deferred compensation. DPA requested that we add the functionality, but it was determined to be

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a very expensive change to implement and would take an extended time period given the current system's lack of flexibility.

10. Other limitations of the current system are the lack of integrated management information and reporting, which means that DPA has to come to the SCO to ask for information on state employees. The SCO's system includes information regarding state employees, including employment, payroll, retirement and benefits data. DPA does not have information databases that are as comprehensive as those of the SCO's, and planning has always of necessity been a team effort.

11. In response to the various limitations of the payroll system discussed above, as well as other systems, the State began the 21st Century Project in the late 1990s. The 21st Century Project was a multiple constituency effort, including representatives from DPA, the Department of General Services, SCO, the Department of Finance, the Legislative analyst, and the State's Chief Information and Technology Officer.

12. The 21st Century project was authorized by Government Code Section 12432, which provides "The Legislature hereby finds and declares that it is essential for the state to replace the current automated human resource/payroll systems operated by the Controller to ensure that state employees continue to be paid accurately and on time and that the state may take advantage of new capabilities and improved business practices. To achieve this replacement of the current systems, the Controller is authorized to procure, modify, and implement a new human resource management system that meets the needs of a modern state government. This replacement effort is known as the 21st Century Project."

13. In enacting Government Code Section 12432, the legislature recognized the inadequacy of the current payroll system, as shown by the express language quoted in the preceding paragraph.

14. The decided-upon strategy of the 21st Century Project was for the State to not program a new system from scratch, but rather, to procure an off-the-shelf package like Oracle, Peoplesoft, or SAP, and then, through a second procurement, hire a systems integrator to work with state staff to make it responsive to the state's business requirements. The State developed,

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with input from DPA and the SCO, among others, requirements for the procurements. The 21st Century Project was designed to make the state's business practices and technology systems more flexible, be able to accommodate change, and build more functionality into the base. Examples of this system would allow SCO to move to payrolls that could pay with a lag, provide the option of more frequent paychecks, allow employees to select a percentage of their paycheck as deferred compensation, and provide other flexibility for DPA's negotiations. Many of these new capabilities would require DPA to negotiate these changes with the bargaining units' representatives. The new system would also allow DPA to go in and develop their own information queries in a user-friendly manner. It was not specifically designed, however, to address the minimum wage issue, although the flexibility and functionality of any new systems would have given the SCO more options in addressing the minimum wage problem.

15. The 21st Century Project was first slowed down by California's budget crises that began in the late 1990s, which resulted in the loss of funding for the Project. The Project was formally initiated in July 1999, and procurement had been completed by 2001, However, due to State funding issues, the procurement was cancelled prior to signing the contract.

16. In May 2004, the Department of Finance approved the Feasibility Study Report for the 21st Century Project. The Feasibility Study Report established that the existing payroll system was outdated and did not meet the needs of today's government. Based on this approval, the SCO, under then Controller Steve Westley, initiated a two-phased procurement process. The purpose of the first procurement was to select a software product to support the state's human resource management needs. The State thereafter selected SAP as the software system provider. The second procurement was to select a systems integrator. The State shortly thereafter selected BearingPoint as the integrator. BearingPoint had substantial experience with the software and the public sector, but unfortunately went into bankruptcy a couple of years into the project. The bankruptcy and ensuing litigation caused a further three year delay. Ultimately, the State had to authorize another competitive bid for a systems integrator, and wait for the legislature to make another appropriation. An unfortunate byproduct of this delay is that, as the project has dragged on, the State has had fewer experts on hand who could manage and maintain the current payroll

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system and who had a thorough understanding of the programming languages used to design the system.

17. The implementation of a new payroll system requires good project management, as it is very complex, and will affect not only the SCO, but all State departments, managers, supervisors, and CSU campuses and its employees.

18. In my entire career at the SCO, there was a close working relationship between DPA and SCO. During my time at the SCO, there often was a Controller of one political party and a Governor of the same or different political party. During the periods of a party split, the staff of the DPA and the staff of the SCO worked together in a non-political manner on procedural and technical issues. Until the recent dispute, DPA acknowledged, understood, and accepted the technical limitations of the payroll system. I do not understand why DPA seems to have forgotten the limits of the system.

19. There would be severe difficulties in implementing the DPA's minimum wage directive. In addition to the system-based challenges described above, there are also legal and knowledge problems. To comply with FSLA, employees that work overtime during the month have to be paid, on payday, their full month's pay at their full rate. But given the State's no-lag system, an employee's overtime status will not be known when the checks are being issued. While most employers, public and private, use a lag system with pay provided after the payroll period, the State's processes require the checks to be cut approximately a week before. Of the approximately 250,000 State employees during my time at the SCO, approximately 190,000 got paid for time worked on their payday in the check delivered on payday. In addition, based upon my experience while at the SCO, approximately 100,000 state employees regularly work overtime during a pay period. With FSLA under the current State payroll system, if the State was required to pay only minimum wage, at the time when the checks are cut, the State would not have any way to accurately know who worked overtime and thus should get a full paycheck. Thus, the minimum wage payment would be incorrect, and that could bring penalties, interest, and damages.

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20. Even if the SCO was able, after some prolonged effort, to implement in some incomplete fashion the minimum wage order, once the budget is passed the SCO would have to go through and make payroll adjustments to make all employees whole for the salary and wages they should have received during this time period. Based on my twenty-five years of experience directing the process, issuing the payments, and having to make the proper decisions on overtime, I am certain that mistakes will be made, and they will be expensive. The minimum wage plan really requires an upgraded system and key pay practice changes in the way the State pays its employees.

21. Upgrading the system to comply with orders may be theoretically possible, but it undoubtedly will be complicated, time-consuming and expensive. It is not something that you can take lightly and do overnight, or for that matter, in a few months. It is very complicated, and would take considerable effort.

I have personal knowledge of the facts set forth above and, if called as a witness, I could and would testify competently as to those facts.

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

Executed this 9th day of July, 2010, in Sacramento, California.

JOHN HARRIGAN
Former Chief, Personnel/Payroll Services Division
Office of the State Controller

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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

DEBBIE L. ENDSLEY; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Petitioners/Plaintiffs v. JOHN CHIANG, sued herein in his official capacity only; OFFICE OF STATE CONTROLLER Respondents/Defendants	Case No. 34-2010-80000591 **DECLARATION OF THE HONORABLE JOHN CHIANG, CALIFORNIA STATE CONTROLLER** Assigned to: Trial Date: None yet assigned Complaint Filed: July 6, 2010
JOHN CHIANG, in his official capacity as CONTROLLER OF THE STATE OF CALIFORNIA; and the OFFICE OF THE STATE CONTROLLER Cross-Complainants, v. DEBBIE L. ENDSLEY, sued herein in her official capacity only; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Cross-Defendants.	

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I, John Chiang, declare as follows:

1. I am the duly elected Controller of the State of California. As the Controller, I am the chief fiscal officer of the State and am charged by law with superintending the fiscal concerns of the State. Among my responsibilities is the duty to pay employees of the Civil Service and of the California State University system, State elected officials and judges and other State employees.

2. I have reviewed with my staff the three-page draft pay letter sent to me by the Director of the Department of Personnel Administration on July 1, 2010. For purposes of the remainder of this declaration, I assume, but do not concede, that this draft pay letter is a legally valid instruction to me.

3. I have concluded that it would be impossible for my office to comply, or to comply in any substantial measure, with the terms of the July 1 draft pay letter either at the present time or within the likely duration of the present budget impasse. I have further concluded that even the attempt at compliance with the terms of the July 1 draft pay letter at this time would so massively and adversely affect the ability to issue the State's payroll that it would take many months to issue a timely, accurate, and lawful payroll related to the budget impasse.

4. I base my conclusions upon information received from my senior staff, and the recently-received independent assessment prepared by the firm Crowe Horwath.

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

Executed this 12 day of July, 2010, in Sacramento, California.

Hon. John Chiang
California State Controller

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SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

DEBBIE L. ENDSLEY; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION, Petitioners/Plaintiff, v. JOHN CHIANG, sued herein in his official capacity only; OFFICE OF STATE CONTROLLER, Respondents/Defendants.	CASE NO. 34-2010-80000591 **DECLARATION OF BRENT M. EHRMAN IN SUPPORT OF JOHN CHIANG AND THE OFFICE OF STATE CONTROLLER'S OPPOSITION TO THE CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION'S APPLICATION FOR A TEMPORARAY RESTRAINING ORDER AND ORDER TO SHOW CAUSE RE PRELIMINARY INJUNCTION** Assigned to: Hon. Patrick Marlette Trial Date: None yet assigned Hearing Date: July 16, 2010 Complaint Filed: July 6, 2010

DECLARATION OF BRENT M. EHRMAN

I, Brent M. Ehrman, declare as follows:

1. I am over 18 years of age. Except as otherwise noted I have personal knowledge of the facts set forth herein and, if called as a witness, I could and would testify competently to those facts.

Professional Expertise

2. I am a principal with Crowe Horwath LLP ("Crowe"), one of the largest consulting and accounting firms in the United States. I have been a principal for 12 years and have worked at Crowe for 25 years. Founded in 1942, Crowe provides assurance, tax, risk and performance consulting and professional services to thousands of businesses across the United States and internationally. Crowe has substantial experience in information technology and government consulting.

3. I am the Executive in Charge of Crowe's Government Consulting Practice, which provides operational improvement and organizational change management services focused on financial management including payroll system solutions, grant management, case management, constituent management, web content management, and information management solutions. I have provided consulting services to numerous state and public agencies, assisting them with the planning, evaluation and implementation of technological solutions and improved operational procedures.

4. I hold Bachelor of Arts degree in Computer Science and Sociology from DePauw University and I am a Certified Document Imaging Architect.

5. I serve as the Project Executive for the engagement detailed below. My responsibilities involve direct oversight of the project including design and implementation of the methodologies used, and preparation of the project deliverables.

Scope Of Engagement

6. In March, 2010 Crowe was retained by counsel to the State of California Controller's Office ("SCO") to provide an independent feasibility assessment of SCO's legacy payroll and personnel systems' capacity to comply with business requirements that are premised upon

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application of the Fair Labor Standards Act ("FLSA") and the California Supreme Court's ruling in *White v. Davis*, 30 Cal. 4th 528 (2003), in the event the state should enter a fiscal year without an approved budget and in regard to the payroll recovery required upon budget enactment. Further, Crowe was asked to independently identify and evaluate alternative solutions, if any, to enhance the existing legacy systems' potential for future compliance.

7. At the conclusion of its independent study and assessment, Crowe prepared the following two deliverables:

- The "California Budget Impasse Payroll System Feasibility Assessment Report," delivered July 2, 2010, a true and complete copy of which is attached hereto as Exhibit A.
- The "California Budget Impasse Payroll System Alternative Solutions Assessment Report," delivered July 11, 2010, a true and complete copy of which is attached hereto as Exhibit B.

Crowe's Feasibility Assessment Report

8. At the outset of the engagement, SCO identified and provided Crowe a list of 28 Budget Impasse Business Requirements (the "Business Requirements") which the SCO's legacy payroll and personnel systems must be able to satisfy to comply with the FLSA and *White v. Davis* (*See* Feasibility Assessment Report's Appendix A). Crowe conducted an in-depth analysis of the SCO's legacy systems and processes, identified high-level gaps in those systems and processes, and assessed the capacity for compliance with the Business Requirements.

9. Crowe's three month analysis involved the review of all relevant SCO documentation of its existing systems and processes, and multiple meetings with all appropriate SCO subject matter experts. Crowe's project assessment methodology is detailed in the Feasibility Assessment Report's Section 3 at pages 6-11.

Crowe's Key Findings on Feasibility

10. In brief, Crowe's key findings from our feasibility assessment are as follows:

- There are numerous and substantial gaps in SCO's existing legacy systems and processes to satisfy the budget impasse payroll and payroll recovery Business Requirements.
- The SCO cannot now satisfy the payroll and payroll recovery Business Requirements by utilizing the SCO's existing legacy systems and processes.

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- In its Feasibility Assessment Report, Crowe identified the problems of logical mutual exclusivity whereby no solution can simultaneously satisfy all Business Requirements at all times, regardless of the level of technical automation. This finding of "infeasibility" is explained in Section 4 of the Feasibility Assessment Report at pages 12-16.
- This infeasibility is the direct consequence of the "Negative Pay" system by which the SCO is required to operate.
- Even if all current technical gaps were resolved in the SCO's existing payroll system and processes, the overarching infeasibility problems remain.

Crowe's Alternative Solutions Assessment Report

11. Based upon its independent analysis, Crowe identified and assessed alternative (partial) "solutions" to satisfy the Budget Impasse Business Requirements with recognition that any alternative "solution" identified by Crowe would not provide SCO with the ability to simultaneously satisfy all Business Requirements at all times.

12. Crowe's Alternative Solutions Assessment Report explains its independent analysis of the potential, albeit partial, solutions, and provides details on the three most promising alternative (partial) solutions that Crowe identified. Upon completion of analysis of these alternatives, Crowe identified the most promising alternative for SCO to better satisfy those Budget Impasse Business Requirements that are remediable. This leading alternative is known as the "Payroll Solution with External Minimum Wage Code." While this alternative would require dozens of complex system process and design changes to be implemented, conceptually this alternative would modify the pay status records to reflect the appropriate wage amount to be issued to each employee during a budget impasse. The code written to create the modified pay status records would be externalized to minimize the impact to existing programs.

13. The three most promising (partial) solutions are reported upon in detail in the Alternative Solutions Assessment Report's Section 3.

14. Based on Crowe's independent analysis of the leading (partial) solution (the "Payroll Solution With External Minimum Wage Code"), as well as of the next most promising alternative

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solution (the "Payroll Solution With Modified Payroll Modules"), Crowe concluded that these two (partial) solutions could be implemented at SCO with the following parameters:

- 22 to 48 elapsed months in duration, beginning with the pursuit of implementation of either of these two alternative solutions (with most likely duration being 27.5 months); and
- Approximately 33,000 to 69,000 hours of resource effort (with most likely estimate of effort being 50,847 hours); and
- Approximately $5,600,000 to$11,700,000 of cost for resources (with most likely estimate being $8,695,021).

The third most promising (partial) solution (the "Minimum Wage Pay Differential"), while substantively less desirable for reasons identified in the Alternative Solutions Assessment Report, would require greater implementation time, greater cost, and greater resource effort than the other two more promising solutions.

15. It is essential to reiterate that, because of the finding of infeasibility, should SCO elect or be required to implement any solution, including those studied by Crowe, no technical solution will satisfy all Business Requirements simultaneously and at all times.

16. The overarching problems of infeasibility, which are referred to in Crowe's Feasibility Assessment Report as the "unsolvable puzzles," and the specific Business Requirements in conflict are described in detail in Section 4 of the Feasibility Assessment Report at pages 12-16.

17. Crowe has concluded that the only solution to these infeasibility problems, inherent in the existing Negative Pay system, would be to seek changes to the identified conflicting Business Requirements, which Crowe understands may require legislative and/or constitutional resolution.

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

Executed this 11th day of July, 2010 in Indianapolis, Indiana.

BRENT M. EHRMAN

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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

DEBBIE L. ENDSLEY; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Petitioners/Plaintiffs v. JOHN CHIANG, sued herein in his official capacity only; OFFICE OF STATE CONTROLLER Respondents/Defendants	Case No. 34-2010-80000591 **DECLARATION OF JIM LOMBARD** Assigned to: Hon. Patrick Marlette Trial Date: None yet assigned Complaint Filed: July 6, 2010
JOHN CHIANG, in his official capacity as CONTROLLER OF THE STATE OF CALIFORNIA; and the OFFICE OF THE STATE CONTROLLER Cross-Complainants, v. DEBBIE L. ENDSLEY, sued herein in her official capacity only; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Cross-Defendants.	

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I, Jim Lombard, declare as follows:

1. I am employed in the State Controller's Office ("SCO") as the Chief Administrative Officer. My responsibilities include requesting approval from the Department of Finance for out-of-cycle funding requests for the SCO. Such a request would be required in response to any Temporary Restraining Order ("TRO") in this case.

2. I understand that the Court has before it a request for TRO that would require the SCO to implement the minimum wage plan set forth in the Department of Personnel Administration ("DPA")'s July 1, 2010 pay letter ("Pay Letter").

3. While I understand that there are issues concerning the legality of the Pay Letter, this declaration addresses the budgetary process required if the Court were to grant a TRO. Critically, the SCO would need, among other things, to seek an appropriation to implement any order of the Court. This declaration also addresses the ongoing and pending efforts of the State, along with the Governor, the DPA and the Controller, to replace the State's existing, outdated payroll system.

4. I have been informed that the SCO's outside, independent consultant had concluded that there are overarching problems of infeasibility inherent in the "negative pay" system that the SCO is required to use and that, because of the problems of infeasibility, should SCO be forced to implement any possible solution, including those studied by the consultant, no technical solution will cure those infeasibility problems. The consultant, I am informed, has concluded, however, that even the most promising technical solutions the consultant has identified, while they would not cure the infeasibility problems identified, would take 22 to 48 elapsed months, beginning with the pursuit of implementation of those solutions (which the most likely duration being 27.5 months). Aside from this time frame, the consultants, I am informed, have concluded that these most promising (partial) solutions would take approximately 33,000 to 69,000 hours of resource effort (with the most likely estimate of effort being 50,847 hours), and approximately $5,600,000 to $11,700,000 of cost of resources (with most likely cost estimate being $8,695,021).

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5. In order to support such an urgently needed expenditure of this size, the SCO would need to make an emergency request pursuant to Budget Act item 9840 in the form of a deficiency request in circumstances for which there is no existing appropriation. Since this emergency appropriation would involve upgrades to existing State technology, however, the SCO would first need to petition the State's Chief Information Officer for approval. This is done by preparing and presenting a Special Project Report. If the Chief Information Officer approves the Special Project Report, then the SCO would present the emergency request to the Department of Finance. Based upon my experience, this process could take anywhere between three to six months to complete.

6. The Court should understand, however, that while it is possible to make an emergency request pursuant to Budget Act item 9840, the SCO has sought appropriations for this very purpose in the past, and was rejected by the Department of Finance.

7. Most recently, on August 21, 2009, I sent a request to the Department of Finance for a late Budget Change Proposal, or a deficiency request, seeking funds to implement minimum wage scenarios in the event of a budget impasse. A true and correct copy of the letter containing my request is attached as Exhibit A. The Department of Finance rejected that request on August 25, 2009.

8. The State has had a late budget in approximately 20 of the last 30 years, and before 2008, had never switched to a temporary minimum-wage scheme as a result. That was true both before and after the California Supreme Court's decision in *White v. Davis*. Specifically, using the June 15th constitutional deadline to pass an "on time" budget, and June 30 as a benchmark for declaring a budget "late," the first "late" budget occurred in 1969. Since that time, the budget has been late 27 times over the last 41 years. The payroll system was built in approximately 1951. Despite the multiple previous delays in the passage of the budget, no Governor—Reagan, Brown (4 late budgets), Deukmejian (5 late budgets), Wilson (7 late budgets) or Davis (3 late budgets), has ever asked that employee salaries be reduced to minimum wage before the current Governor did so in 2008.

9. In my position as Chief Administrative Officer of the SCO, I have knowledge of the

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funds available in the State Treasury and their relationship to the State's payroll obligation. The State currently has sufficient funds to meet normal payroll.

10. I also serve as the SCO's Project Sponsor for the 21st Century Project. The 21st Century Project is a multiple constituency effort of the State, governed by a Steering Committee comprised of representatives from DPA, the Department of General Services, SCO, the Department of Finance, the State Personnel Board, and the State's Chief Information and Technology Officer. In fact, four of the six of the representatives on the Steering Committee are appointed by the Governor. I am the only member of the Steering Committee who is appointed by and represents the Controller. In response to the various limitations of the payroll system, as well as other systems, the State began the 21st Century Project in the late 1990s.

11. Following the Supreme Court decision in *White v. Davis* in 2003, the Legislature passed, and the Governor approved, Senate Bill 1102 Stats. 2004, c.227, effective August 16, 2004, which added Government Code section 12432.

12. Government Code Section 12432 expressly authorizes the 21st Century Project. Section 12432 was intended to take advantage of new capabilities and improved business practices and to replace the current system. The bill in fact was signed into law by Governor Arnold Schwarzenegger.

13. Government Code Section 12432 provides "The Legislature hereby finds and declares that it is essential for the State to replace the current automated human resource/payroll systems operated by the Controller to ensure that State employees continue to be paid accurately and on time and that the State may take advantage of new capabilities and improved business practices. To achieve this replacement of the current systems, the Controller is authorized to procure, modify, and implement a new human resource management system that meets the needs of a modern state government. This replacement effort is known as the 21st Century Project."

14. The 21st Century Project was designed to make the State's business practices and technology systems more flexible, be able to accommodate change, and build more functionality into the base.

15. The 21st Century Project was first impeded by California's budget crises that began

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in the late 1990s, which resulted in the loss of funding for the Project. In May 2004, the Department of Finance approved the Feasibility Study Report for the 21st Century Project. The Feasibility Study Report established that the existing payroll system was outdated and did not meet the needs of a modern government. Based on this approval, the SCO, under then Controller Steve Westley, initiated a two-phased procurement process. The purpose of the first procurement was to select a software product to support the State's human resource management needs. The State selected SAP as the software system provider.

16. The second phase of the procurement process began in May 2005 with the issuance of a Request for Proposal for system integrator services. The objective of the procurement was to secure the services of an experienced integrator to implement the SAP software solution. In June 2006, a contract was awarded to BearingPoint to provide system integration services for the 21st Century Project. As the prime contractor, BearingPoint had overall responsibility for implementing the solution. BearingPoint had substantial experience with the software and the public sector, but unfortunately went into bankruptcy a couple of years into the project. The bankruptcy and ensuing litigation caused a further three year delay.

17. In January 2009, the State terminated the contract with BearingPoint for failure to meet contractual commitments. The Project thus had to be re-initiated.

18. In the current effort, another two-stage procurement was being conducted to secure system integration services. The first stage selected two vendors, SAP and Accenture, to participate in developing solutions for several critical design issues, to assess the project's status and to submit proposals to complete the development and implementation. The Stage II procurement selected SAP to provide the actual system integration services to complete the project. The Legislature provided an appropriation for this purpose in the 2009-2010 budget, and funding is pending in the stalled 2010-2011 budget currently under consideration by the Legislature.

19. Given this history, including the DPA's and the Governor's direct involvement with the 21st Century Project, the DPA and the Governor are both fully aware of the millions of State dollars that have been directed towards the upgrade of the State's payroll system, the

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software deficiencies in the existing systems, and the fact that the 21st Century Project is currently on schedule to go live in October 2011 with full deployment in October 2012.

20. However, the completion of the 21st Century Project and the correction of the software deficiencies in the existing system is only one piece of the fix necessary to implement a budget impasse minimum wage scenario without violating State and Federal laws. Other critical pieces include, but are not limited to, moving the State from a negative to a positive payroll and adopting a payroll lag, and these would require the Legislature and the Governor to enact new legislation.

I have personal knowledge of the facts set forth above and, if called as a witness, I could and would testify competently as to those facts.

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

Executed this 13 day of July, 2010, in Sacramento, California.

Jim Lombard
Chief Administrative Officer
Office of the State Controller

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EXHIBIT "A"

JOHN CHIANG
California State Controller

August 21, 2009

Veronica Chung-Ng, Program Budget Manager
Department of Finance
915 L Street, Suite 9640
Sacramento, CA 95814

Re: Late Submittal of 2010-11 Budget Change Proposals

Dear Ms. Chung-Ng:

The State Controller's Office (SCO) requests approval for late submittal of two 2010-11 Budget Change Proposals (BCPs) to the Department of Finance (DOF).

Pursuant to Budget Letter 09-12, BCPs are due to DOF on September 14, 2009. However, additional time is required for submission of the 21st Century Project (Project) BCP, the Integrating with New CalPERS Retirement Solutions BCP, and the Minimum Wage Implementation BCP, in order to provide complete and accurate information of SCO needs.

As detailed in the Project's last approved Special Project Report (SPR) 3, the Project is currently in the procurement phase to acquire a new systems integrator to complete the MyCalPAYS solution. Until the procurement is completed, the Project schedule and system integrator costs will not be known. During the preparation of SPR 3 and the 2009-10 Finance Letter, an agreement was reached to wait until the completion of the procurement to document out-year costs in SPR 4. Final proposals are currently due on August 24, 2009 and the current procurement schedule will enable the SCO to submit SPR 4 and the associated 2010-11 BCP no later than November 2, 2009. The SCO needs to complete the procurement in order to

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accurately estimate funding needs for 2010-11 and the remainder of the Project. Therefore, we respectfully request your approval to submit a late BCP.

CalPERS is nearing implementation of a comprehensive replacement of their retirement system. CalPERS is scheduled to retire the existing legacy systems in April 2010, with system testing to occur in fall 2009 between the SCO's legacy payroll and personnel records and the records and accounts at CalPERS. CalPERS has notified SCO that the Personnel and Payroll Services Division will be responsible for researching and correcting kick-outs of record discrepancies once the new system is in operation. This is a new workload because of the design of the new system, and the desire of CalPERS to investigate all records that do not pass their audits. It will be necessary for PPSD staff to be knowledgeable in both legacy and retirement systems. The potential workload could be very large, since SCO legacy files input over 5,000,000 records annually into the CalPERS systems. However, CalPERS is unable to estimate the volume of kick-outs prior to system testing in fall 2009. At this time, we estimate that the BCP can be provided by December 4, 2009. Therefore, we respectfully request approval to submit a late BCP or a finance letter on this issue.

Lastly, given the State's economic outlook, there is a strong possibility that the budget deliberations for the 2010-11 fiscal year will not be completed by the constitutionally required date. Given such a delay, the Governor could opt to require the SCO to pay State employees minimum wage. At this time, the SCO is unprepared to implement minimum wage payments. Efforts to prepare for such a scenario are underway, but it is unlikely that cost estimates will be ready in sufficient time to meet the deadline for BCPs. Therefore, we respectfully request your approval to submit a late BCP and/or a deficiency request for this issue.

Please contact Tom Yowell, Budget Officer, at 322-5320, if you have any questions. Thank you for your consideration.

Sincerely,

JIM LOMBARD
Chief Administrative Officer

cc: Bill Steffenhagen, Assistant Program Budget Manager
Oscar Chavez, Principal Program Budget Analyst
Greg Bruss, Staff Finance Budget Analyst

Steven S. Rosenthal (SBN 109739)
Marc S. Cohen (SBN 65486)
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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

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

DEBBIE L. ENDSLEY; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Petitioners/Plaintiffs v. JOHN CHIANG, sued herein in his official capacity only; OFFICE OF STATE CONTROLLER Respondents/Defendants	Case No. 34-2010-80000591 **DECLARATION OF LISA CROWE** Assigned to: Hon. Patrick Marlette Trial Date: None yet assigned Complaint Filed: July 6, 2010
JOHN CHIANG, in his official capacity as CONTROLLER OF THE STATE OF CALIFORNIA; and the OFFICE OF THE STATE CONTROLLER Cross-Complainants, v. DEBBIE L. ENDSLEY, sued herein in her official capacity only; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Cross-Defendants.	

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I, Lisa Crowe, declare as follows:

1. I am employed in the State Controller's Office ("SCO") as the Division Chief of Personnel Payroll Services Division. My responsibilities include directing the State's personnel payroll, maintaining the State's official employment roster, setting policy for the State payroll system, training departmental personnel in the areas of personnel and payroll processing, and implementing wage structures negotiated by the State Department of Personnel Administration ("DPA"). I am responsible for the payroll for all 314,000 State employees (including those of the California State University system and the Judicial Council).

2. On July 7, 2010, I sent a letter to the DPA asking a series of questions regarding the proposed implementation of the DPA Pay Letter of July 1, 2010 ("Pay Letter"). The questions were:

a. How will we deal with the fact we will not have actual time worked datawhen Master payroll runs? (Thus we will be in violation of FLSA if anyone has worked overtime during the month since we'll pay them minimum wage when in fact they should have been paid at full salary plus)

b. What strategies do you have for insuring we are in compliance with FLSA prompt payment requirements once a budget is passed? (For example, what if the budget is passed on August 24th, just after Master Payroll has run)

c. What is your role in helping us to validate the continuous appropriation portion of payroll which will continue with full salary?

d. Best we understand there are no current continuous appropriations in Bargaining Units 5, 8, 12, 16, 18 and 19, rather this is a concept contained within the tentative agreements that recently were established. What is the timeline to actually have these appropriations in place? And, in the absence of that happening what is the legal authority for paying these employees full salaries?

e. What are the implications to employees in not withholding all health benefits from minimum wage payroll?

f. What is the plan to recover these payments after a budget is passed?

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g. What communication are you planning to do with employees if all miscellaneous deductions are not withheld during the budget impasse?

h. What is the plan for the deductions not withheld once a budget is passed? (E.g. how do we catch-up with what should have been withheld or do we do any catch up?)

i. What communication do you plan to do with deduction companies or is that up to us to handle?

j. What is the legal authority to pay lump sum payments in full vs. minimum wage?

k. What is the legal authority for the distinction in dates for disability payments?

l. What about group legal? (This was to be withheld from minimum wage payments in the first iteration of the pay letter)

m. What is the plan for supervisory, managerial, confidential and excluded employees in each of the bargaining units with tentative agreements?

n. Is there any plan to provide some departments with mandatory overtime, thus requiring them to be assumed to work overtime during the pay period therefore requiring full pay?

o. What should we be doing with the employee portion of retirement calculation during the budget impasse?

A true and correct copy of my July 7, 2010 letter is attached as Exhibit A.

3. To date, I have received no response to my inquiries of July 7, 2010. This is not the first time the questions have been asked, nor that they have remained unanswered. The Personnel Payroll Services Division posed similar questions to DPA in 2008, and they remain unanswered.

4. During the budget impasse in 2008, the Governor issued an executive order instructing all State agencies and departments to refrain from authorizing overtime for State employees (except for employees providing services and functions deemed critical, or in

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emergency situations to preserve and protect human life and safety). Notwithstanding the Governor's plea for restraint, during the 2008 budget impasse, 72,485 State employees across all departments and functions worked overtime, for a total of 3,931,112 hours, at a total cost of $166,185,035.20.

5. Assuming the SCO could implement the Pay Letter as written (which it cannot), the SCO would not be in compliance with the prompt pay provisions of the FLSA. This would be because the Pay Letter does not account for overtime or make an exception for overtime, and given the State's negative pay system, the SCO would not know which employees worked overtime during a particular pay period. Using for example the overtime numbers from the 2008 budget impasse (72,485 employees who worked overtime at a cost of $166,185,035.20), the average monthly salary for nonexempt employees working overtime would be approximately $5,000. As directed by the July 1, 2010 Pay Letter, minimum wage is an average of $1,247, a $3,753 shortfall in the regular rate of pay that to comply with the FLSA must be paid during the pay period in which the employee works any overtime. If the overtime numbers were the same for this year, the potential penalty for FLSA violations (*i.e.*, a doubling of the underpayment) would be at least $272,036,205 ($3,753 monthly salary gap multiplied by the 72,485 employees who worked overtime at least once a month). That amount would be paid by the State as liquidated damaegs on top of making the affected employees whole.

6. I have been informed that the DPA has requested a temporary restraining order requiring the SCO to implement its Pay Letter. If a temporary restraining order is issued, the SCO simply cannot comply. It is impossible to implement "the necessary mechanisms to comply with . . . . the Fair Labor Standards Act" (FLSA) (as urged by the DPA's letter of July 1, 2010) simply because during the indeterminate length of the budget impasse, we cannot possibly "guess" at the amount of actual time worked each month for the majority of employees and make corrections thereafter. A temporary restraining order would, to say the least, alter the status quo of normal business operations.

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I have personal knowledge of the facts set forth above and, if called as a witness, I could and would testify competently as to those facts.

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

Executed this 13th day of July, 2010, in Sacramento, California.

Lisa Crowe
Chief, Personnel/Payroll Services Division
Office of the State Controller

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EXHIBIT "A"

Questions for DPA on Pay Letter 10-XX

July 7, 2010

1. How will we deal with the fact we will not have actual time worked data when Master payroll runs? (Thus we will be in violation of FLSA if anyone has worked overtime during the month since we'll pay them minimum wage when in fact they should have been paid at full salary plus)
2. What strategies do you have for insuring we are in compliance with FLSA prompt payment requirements once a budget is passed? (For example, what if the budget is passed on August 24th, just after Master Payroll has run)
3. What is your role in helping us to validate the continuous appropriation portion of payroll which will continue with full salary?
4. Best we understand there are no current continuous appropriations in Bargaining Units 5, 8, 12, 16, 18 and 19, rather this is a concept contained within the tentative agreements that recently were established. What is the timeline to actually have these appropriations in place? And, in the absence of that happening what is the legal authority for paying these employees full salaries?
5. What are the implications to employees in not withholding all health benefits from minimum wage payroll?
6. What is the plan to recover these payments after a budget is passed?
7. What communication are you planning to do with employees if all miscellaneous deductions are not withheld during the budget impasse?
8. What is the plan for the deductions not withheld once a budget is passed? (E.g. how do we catch-up with what should have been withheld or do we do any catch up?)
9. What communication do you plan to do with deduction companies or is that up to us to handle?
10. What is the legal authority to pay lump sum payments in full vs. minimum wage?

11. What is the legal authority for the distinction in dates for disability payments?
12. What about group legal? (This was to be withheld from minimum wage payments in the first iteration of the pay letter)
13. What is the plan for supervisory, managerial, confidential and excluded employees in each of the bargaining units with tentative agreements?
14. Is there any plan to provide some departments with mandatory overtime, thus requiring them to be assumed to work overtime during the pay period therefore requiring full pay?
15. What should we be doing with the employee portion of retirement calculation during the budget impasse?

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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

DEBBIE L. ENDSLEY; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Petitioners/Plaintiffs v. JOHN CHIANG, sued herein in his official capacity only; OFFICE OF STATE CONTROLLER Respondents/Defendants	Case No. 34-2010-80000591 **DECLARATION OF DON SCHEPPMANN** Assigned to: Hon. Patrick Marlette Trial Date: None yet assigned Complaint Filed: July 6, 2010 Cross-Complaint Filed: July 7, 2010
JOHN CHIANG, in his official capacity as CONTROLLER OF THE STATE OF CALIFORNIA; and the OFFICE OF THE STATE CONTROLLER Cross-Complainants, v. DEBBIE L. ENDSLEY, sued herein in her official capacity only; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION Cross-Defendants.	

KAYE SCHOLER LLP

I, Don Scheppmann, declare as follows:

1. I have personal knowledge of the facts set forth above and, if called as a witness, I could and would testify competently as to those facts.

2. I was employed as the Chief, Personnel/Payroll Services Division (the "Division" or "PPSD") of the Office of the California State Controller (the "Controller" or "SCO"), from 2006 until my retirement in 2009. In that position, I was responsible for managing the organization that pays the approximately 314,000 State employees (including those of the California State University ("CSU") system and the Judicial Council), and for the payroll systems that are used for processing over 500,000 payroll transactions per month. I was employed in the PPSD since 1979. During my employment in the SCO, I held several different management positions, with a primary focus on managing the analytical support for the division to ensure that necessary functionality is available to reflect State laws, policies, and procedures. Since my retirement, I have worked as a consultant for the SCO. As a consultant, I have, among other things, been a part of the team responsible for overseeing the feasibility study (as discussed below) of the State's payroll systems performed by the independent consulting firm of Crowe Horwath.

3. Based on my experience, I am familiar with the practices and policies of the SCO with regard to the operation and implementation of the State payroll systems. I have personally worked with all State control agencies, as well as the Department of Personnel Administration ("DPA"), to implement programs, and have worked closely with the SCO Information Systems Technology Division ("ISTD"), the SCO's technology support organization, to develop strategies and functionality to ensure that PPSD is prepared to implement programs in a timely and accurate manner. In that role, I at times had to tell certain parties, including the DPA, and the Legislature that some functionality cannot be delivered through the existing systems.

4. The SCO is responsible for issuing pay to employees of the State Civil Service, the CSU, Judicial Council and judges, and elected officials. Employees are spread throughout California and in other states, ranging from elected officials, managers and supervisors, and higher education faculty, to rank and file workers in a variety of occupations. The State includes over 150 departments and 24 CSU campuses. To meet its responsibility, the SCO operates large, complex

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legacy systems. Payroll duties includes establishing the individuals gross pay; performing the gross to net calculations; reporting taxes and retirement calculations; applying, reporting and remitting mandatory and voluntary deductions; maintaining leave balances and applying leave usage; complying with requirements for various disability programs; and dealing with the differences in the 33 employee organization bargaining units.

5. The SCO operates a variety of pay plans to pay these employees. These include the following:

- A monthly anticipatory plan otherwise known as a "negative" pay system, where monthly paid employees are issued their pay on the last day of the pay period;
- A monthly plan with a lag, otherwise known as a "positive" pay system, where pay is issued after the close of the pay period based on attendance reporting;
- A semi-monthly positive plan, a semi-monthly plan with a lag; and
- A bi-weekly plan with a lag.

6. The vast majority of State employees (82%; 257,000 of 314,000 in total) are paid through the monthly negative pay system. For these individuals, they are paid the amount that is entered on their personnel record, unless the hiring agency notifies the SCO to make an adjustment prior to running payroll. Since pay is calculated based on what is anticipated, and the time payroll is executed is approximately the 21st day of the month, the SCO does not know at the time of pay calculation if an employee has worked overtime, used vacation, or if the employee has unpaid time off. In other words, the pay of an employee on the negative system would be generated on or about the 21st day of the month and, at that time, calculated through the end of the month on the assumption that the employee will continue to work the remainder of the month or, in the alternative, have compensable leave credits which could be used to justify the full pay. If not, an accounts receivable is established and the overpayment is recouped in a subsequent month.

7. Included in the payroll calculations are all mandatory and voluntary deductions or salary reductions. Some deductions are pre-tax, and some are post-tax. Deductions such as retirement calculations, taxes, and garnishments are mandatory, while benefits, credit unions and union dues are voluntary. A portion of deductions, such as retirement and State sponsored benefits,

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have State share contributions. Each of these deductions is calculated on a pre or post-tax basis, the funds remitted to the receiving agency, and reports provided on the amounts.

8. The current payroll systems depend on technology installed in the 1970's, and lack the needed functionality or the necessary flexibility or reliability of a more modern system. The State payroll systems are based on the antiquated COBOL, or Common Business Oriented Language programming, a code first introduced almost 50 years ago. Few present employees can even work with this code.

9. Moreover, the payroll systems were designed to deal with a far simpler payroll that did not involve 33 bargaining units and over 30 payment types and that involved limited deductions, all of which were applied on a post-tax basis. The systems were also originally not required to address the multitude of retirement and disability programs that now exist, nor deal with tax or legal issues with the complexity of today's environment.

10. In order to accommodate today's needs, PPSD has had to extensively modify the systems, place some limits on what an employer can implement, and utilize hundreds of ad hoc programs that run outside of the payroll system, but that feed information to the system to allow it to operate. While there are interfaces between the various systems, they were designed as separate applications, and thus are not integrated. Notably, the Controller must pay from its own operating budget for any changes, upgrades or patches it develops for the State's payroll systems. Funds are not provided by the party requesting the changes, including the DPA.

11. The DPA is responsible for, among other things, representing the Governor in matters pertaining to State personnel employer-employee relations, including all issues related to salaries and benefits, job classifications, and training. For most employees, these matters are negotiated through the collective bargaining process.

12. As part of the collective bargaining process, the DPA has negotiated and executed various collective bargaining agreements ("CBAs"). In the past, the SCO has worked closely with the DPA in implementing any necessary changes in and modifications to the payroll. Based on my experience, when possible, the DPA provides the SCO advance notice of any potential payroll changes that may result from the DPA's negotiations with various collective bargaining units. In

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fact, the DPA sometimes includes language in a CBA which explicitly recognizes that certain parts of the CBA cannot become effective until the SCO has implemented the necessary changes or modifications to the payroll system.

13. In my time working with the DPA on potential changes or modifications to the payroll systems, it has been my experience that when implementing new payroll terms negotiated by the DPA, the time needed for the SCO to implement, test and confirm the changes to the payroll system is usually measured in months, not days.

14. For example, in 2006, the DPA negotiated a benefit for certain new State employees -- a vesting process for health benefits. Under this agreement, a new employee would receive 50% of the State contribution for his or her benefits for dependents for the first year, and thereafter the benefit would incrementally increase until the benefit was fully vested in the employee's third year. DPA was informed that the current payroll systems did not have the capacity to track and make the necessary adjustments to implement this benefit for these employees, and that the SCO would have to develop new ad hoc programs in order to implement these changes. Even though this new benefit only applied to a few employees (2 out of the 21 bargaining units represented by the DPA), it took the SCO over 3 months to build a work-around for this problem. In fact, the solution that the SCO reached is not fully automated, and still requires a significant amount of manual support by SCO employees.

15. In addition, I have at other times had to tell the DPA that some requested functionality could not be delivered through the existing systems. For example, over the years, the DPA has been informed that the current payroll systems cannot deliver the following requested functionality: (1) the ability to provide electronic earning statements; (2) the ability to make contributions directly into a Roth IRA; (3) the ability to have a payroll deduction as a percentage, rather than a flat rate; (4) the ability to deal with employer matching contributions to savings/retirement plans; and (5) the ability to provide bi-weekly pay for more than a small number of employees. Thus, the DPA is well aware of the present limitations of the current payroll system.

16. Indeed, during the budget impasse in 2008, after the DPA presented the SCO with its Pay Letter, I had several conversations and a meeting with representatives of the DPA,

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including Julie Chapman and Jerri Judd, to discuss, among other things, the 2008 Pay Letter and its implementation. I made it clear during these conversations and the meeting that the SCO could not implement that pay letter as requested. I also repeatedly asked the DPA for its guidance and input on how it thought the pay letter could be implemented. In fact, on August 11, 2008, I sent a letter Ms. Chapman asking a series of questions regarding the proposed implementation of the pay letter. Those questions were:

- How CSU employees should be treated under the pay letter;
- Whether the DPA could certify that every department will freeze all transactions during the budget impasse;
- Whether the DPA had any legal interpretations or Court rulings supporting its interpretations and conclusions contained in the pay letter;
- Whether the DPA had any legal opinions supporting its conclusions that separated employees could be paid immediately in full as required by the Labor Code during a budget impasse;
- Whether the DPA had any legal opinions supporting its conclusion that certain deductions, including voluntary, retirement and SDI deductions, not be withheld from minimum wage payments;

A true and correct copy of my August 11, 2008 letter is attached to this declaration as Exhibit A.

17. I never received a substantive response from the DPA to my inquiries.

18. SCO has pursued its responsibilities with respect to upgrading the payroll systems. The Controller has, in good faith, exercised his duties and has made all reasonable efforts to deliver the functionality requested by the DPA and other parties, including payment of the minimum wage as discussed in *White v. Davis*.

19. Specifically with respect to the payment of minimum wage during a budget impasse, during the pendency of *White v. Davis*, the Controller initiated a study to determine the feasibility of adjusting the current State payroll systems (a) to accurately adjust the pay of hourly employees, as to whom overtime is not expected, to reflect the minimum wage and then to accurately and promptly reverse the changes when a budget is enacted, and (b) to maintain the

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regular rate of pay of hourly employees who are expected to incur overtime during times in which no budget is in place. At that time, the Controller examined various solutions for reducing pay to a minimum wage and promptly restoring it to the correct amount after adoption of a budget. These solutions assumed that the State would continue to operate as an ongoing business organization in accordance with regular payroll payment practices and those employees should receive accurate pay in a timely manner that is consistent with law.

20. After approximately 10 months spent creating and testing programs the SCO came to the conclusion that it was infeasible to accurately and reliably reduce wages to minimum wage, and then promptly reinstate full pay, with the current payroll systems. This was in part due to the limitations of the systems and in part due to the complexity of State laws and rules and business practices under which the systems were designed.

21. The SCO's efforts to upgrade and modernize the payroll systems did not end after that study. The SCO has continued its efforts to upgrade and modernize the State's payroll systems through the 21st Century Project. The 21st Century Project is a State multiple constituency effort overseen by a Steering Committee of six, four of whom are chosen by the Governor, and only one of which is appointed by the Controller. The 21st Century Project includes representatives from DPA, the Department of General Services, SCO, the Department of Finance, the Legislative analyst, and the State's Chief Information and Technology Officer.

22. The 21st Century Project was authorized by Government Code Section 12432 in 2004, which provides "The Legislature hereby finds and declares that it is essential for the state to replace the current automated human resource/payroll systems operated by the Controller to ensure that state employees continue to be paid accurately and on time and that the state may take advantage of new capabilities and improved business practices. To achieve this replacement of the current systems, the Controller is authorized to procure, modify, and implement a new human resource management system that meets the needs of a modern state government. This replacement effort is known as the 21st Century Project."

23. The decided-upon strategy of the 21st Century Project was for the State to not program a new system from scratch, but rather, to procure an off-the-shelf package like Oracle,

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Peoplesoft, or SAP, and then, through a second procurement, hire a systems integrator to work with State staff to make it responsive to the State's business requirements. The State developed, with input from DPA and the SCO, among others, requirements for the procurements. The objective of the 21st Century Project was to make the State's business practices and technology systems more flexible, be able to accommodate change, and build more functionality into its base. For example, the new system would be designed to allow SCO to move to positive payrolls that could pay with a lag, provide the option of more frequent paychecks, allow employees to select a percentage of their paycheck as deferred compensation, and provide other flexibility in support of DPA's negotiations. Many of these new capabilities would require DPA to negotiate these changes with the bargaining units' representatives and/or legislative resolution. The new system would also allow DPA to go in and develop its own information queries in a user-friendly manner

24. In May 2004, the Department of Finance approved the Feasibility Study Report for the 21st Century Project. The Feasibility Study Report established that the existing payroll system was outdated and did not meet the needs of modern government. Based on this approval, the SCO, under then Controller Steve Westley, initiated a two-phased procurement process. The purpose of the first procurement was to select a software product to support the State's human resource management needs. The State selected SAP as the software system provider. The second procurement was to select a systems integrator. The State selected BearingPoint as the integrator. BearingPoint had substantial experience with the software and the public sector, but unfortunately went into bankruptcy a couple of years into the project. The bankruptcy and ensuing litigation caused a further three year delay. Ultimately, the State had to authorize another competitive bid for a systems integrator, and wait for the legislature to make another appropriation.

25. Even though the State is pursuing upgrades to the payroll systems through the 21st Century Project, in the interim, the SCO has continued to search for alternative solutions to address critical shortcomings, including those related to payment of minimum wage during a budget impasse. Specifically, following the Superior Court's ruling in *Gilb v. Chiang*, the SCO commissioned another study to be conducted by an independent consulting firm, Crowe Horwath, to analyze the ability of the State's payroll systems. The purpose of this study was, in part, to

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determine the feasibility of complying and conforming with the State's business requirements that are premised upon the application of the FLSA and *White v. Davis*, and to assess potential solutions, if any, that could realistically be applied to a minimum wage scenario during any budget impasse.

26. In my role as consultant to the SCO, I have played an active role as part of the high-level team that the consultants interfaced with when doing their work. Once Crowe Horwath was selected to work on the project, I and others at the SCO provided all requested information and documentation to Crowe Horwath. In my capacity as consultant, I also participated in numerous meetings and conference calls with Crowe Horwath.

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

Executed this 13th day of July, 2010, in Sacramento, California.

Don Scheppmann
DON SCHEPPMANN
Former Chief, Personnel/Payroll Services Division
Office of the State Controller

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EXHIBIT “A”

JOHN CHIANG
California State Controller

August 11, 2008

Ms. Julie Chapman
Deputy Director of Labor Relations
Department of Personnel Administration
1515 S Street, North Building, Suite 400
Sacramento, CA 95814-7243

Dear Ms. Chapman,

At our meeting August 7, I said I would need two days to determine when we could provide an answer to you regarding your proposed concept relating to the implementation of the Department of Personnel Administration's (DPA) pay letter, dated August 5, 2008. We have determined that we will need at least until the end of this week to provide a thoughtful and thorough analysis of your proposed Option 1.

As we discussed, employee pay is extremely important, and we must ensure that any action we take provides each individual with the appropriate and legal pay provided under state and federal statutes.

Because of the lack of details in the three concepts you briefly outlined Thursday, and because of the substantial logistical and legal questions they raise, your department's active involvement will be required to assist us in expediting this reply. Specifically, we seek your response, and any supporting documentation, to the following issues:

- The process you suggested for suspending all pay, and issuing minimum wage payments as a separate pay, would require that all payments – not just regular pay – be held. That would be similar to the process we established over the years to use when withholding pay for approximately 600 executives and legislators during a no-budget period. That is a far different scenario from addressing more than 180,000 employees in a few short weeks. For example, your concept would not only require stopping pay, but also issuing minimum wage payments and determining the appropriate treatment of multiple deductions for each employee. Then, after the budget is passed, we would need to restore full pay and again determine the appropriate level of deductions offsetting the prior adjustments.

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- We question how we should treat California State University employees. Your concept did not contain any information on how CSU staff should be handled. In fact, you stated that they were not within the scope of your assignment. However, under your interpretation of *White v. Davis*, we would have to consider the impact on all CSU employees. As you know, when implementing a court decision, the Controller's Office cannot pick and choose to whom we apply the ruling. Thus, your scenario proposes to withhold all pay for approximately 25,000 teachers, resulting in a significant impact on CSU teaching staff.

- A premise of your approach is that the State will freeze all personnel activity, such as hires, transfers, docking pay, etc., to make it easier to calculate the recovery payment. Can you certify that every department has frozen all transactions as of August 1, 2008?

- You suggested you have legal interpretations of the court ruling to support your concepts and have offered to provide those legal opinions. In order to prevent adverse legal action later, and to protect the rights of employees, please provide us with any written legal opinions to support your interpretations.

- You also suggest that separated employees can be paid immediately in full as required by the Labor Code, and state that employees who leave their jobs can be paid full wages due out of the respective agencies' revolving funds. We request legal opinions supporting your proposal, as well as evidence that the agencies have sufficient funds to make appropriate payments and may legally make those payments without a budget appropriation.

- You propose that voluntary, retirement and State Disability Insurance deductions not be withheld from minimum wage payments. Please provide legal opinions or rulings that bolster your assertion.

- Based on the concept you have outlined, we still need to determine whether it provides a viable solution in no-budget times, and how long it would take to restore full pay once a budget is signed.

- You also propose that employees pay taxes on the minimum wage payment but you do not propose adjusting the taxes once the full salary is restored. That could result in employees having excessive taxes withheld until they file their tax return. The implications of this approach on working taxpayers are significant and must be evaluated.

Typically, modifications to legacy payroll applications require a feasibility study and impact assessment. This would include the analysis of business requirements, development of design specifications, development and modification of new or existing computer programs, and the conducting of various levels of testing and quality assurance. Furthermore, prior to deployment, we would need to create procedures to run these new or modified programs. Please keep in mind that to perform DPA's concept this assessment would need to be followed for each component, which includes stopping payment, issuing minimum wage payments with the appropriate deductions and taxes applied, then restoring full salary, adjusting the deductions and taxes, and recovering the minimum wage payment to ensure each employee is compensated correctly in a timely manner.

Adding to the complexity, there are four significant pay categories that must be considered: Those that would receive minimum wage (Work Week Group 2); those salaried employees that are exempt from FLSA (Work Week Group E); those employees whose payment would be suspended (Work Week Group SE, which includes doctors, teachers and lawyers); and those agencies that the administration has exempted from the executive order.

As you know, the termination last week of thousands of part-time, retired annuitant and seasonal employees already had sparked litigation regarding allegations that separated State employees did not receive the full pay to which they are entitled under law.

We all are aware of the implications of implementing payroll systems that have not been thoroughly tested, as seen with the recent incident in the Los Angeles Unified School District. Implementing system changes of the magnitude needed to accurately pay each employee should not be taken lightly. If they are not performed thoughtfully and accurately, the system changes could subject the state to further litigation and unnecessary costs.

Considering the State's already fragile fiscal health, Controller John Chiang is deeply concerned about the financial liability these lawsuits may pose. Fiscal prudence and the desire to avoid the expense of lengthy litigation demand that we thoroughly vet any proposal regarding its impact on the 180,000 public servants you have targeted, as well as the potential 55,000 CSU employees who may be affected. Each individual employee of this State must receive all legally entitled pay for wages earned for their work on behalf of all Californians.

Finally, as I communicated with you over the weekend, the Controller's Office has identified a list of funds that are continuously funded, regardless of the signing of a new budget each year. Because of the legal authority for their establishment, payments from these funds are not dependent upon signing a budget. As I explained, the list you provided of funds in this category that were identified by the Department of Finance included a number of funds that are not used for payroll and failed to identify others that are continuous appropriations. These omissions and mistakes clearly illustrate how important it is to analyze carefully each concept put forth to support everyone's goal of issuing accurate and timely payroll that is legally supportable.

It is important that we take sufficient time to ensure that we are fulfilling our mutual responsibility to California state employees. Thank you in advance for understanding that we must be thorough in our analysis and for providing us with any assistance to the many questions we have regarding your recent proposed concepts for reducing employee pay.

Sincerely,

Original signed by,

Don Scheppmann
Chief, Personnel/Payroll Services Division
California State Controller's Office

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Attorneys For Respondents/Defendants

SUPERIOR COURT FOR THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

DEBBIE L. ENDSLEY; CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION, **Petitioners/Plaintiffs,** **JOHN CHIANG, sued herein in his official capacity only, OFFICE OF STATE CONTROLLER,** **Respondents/Defendants.** **AND RELATED ACTION.**	**CASE NO. 34-2010-80000591** **PROOF OF SERVICE**

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 13, 2010, I served the foregoing document described as follows:

1. OPPOSITION OF RESPONDENTS/DEFENDANTS JOHN CHAING AND THE OFFICE OF THE STATE CONTROLLER TO PETITIONERS/PLAINTIFFS DEBBIE L. ENDSLEY AND THE DEPARTMENT OF PERSONNEL ADMINISTRATION'S EX PARTE APPLICATION FOR A TEMPORARY RESTRAINING ORDER AND ORDER TO SHOW CAUSE RE PRELIMINARY INJUNCTION;

2. DECLARATION OF DON SCHEPPMANN IN SUPPORT OF JOHN CHIANG AND THE OFFICE OF THE STATE CONTROLLER'S OPPOSITION TO THE CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION'S APPLICATION FOR A TRO AND ORDER TO SHOW CAUSE REGARDING PRELIMINARY;

3. DECLARATION OF JOHN HARRIGAN IN SUPPORT OF JOHN CHIANG AND THE OFFICE OF THE STATE CONTROLLER'S OPPOSITION TO THE CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION'S APPLICATION FOR A TRO AND ORDER TO SHOW CAUSE REGARDING PRELIMINARY;

4. DECLARATION OF THE HONORABLE JOHN CHAING, CALIFORNIA STATE CONTROLLER IN SUPPORT OF JOHN CHIANG AND THE OFFICE OF THE STATE CONTROLLER'S OPPOSITION TO THE CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION'S APPLICATION FOR A TRO AND ORDER TO SHOW CAUSE REGARDING PRELIMINARY;

5. DECLARATION OF BRENT M. EHRMAN IN SUPPORT OF JOHN CHIANG AND THE OFFICE OF THE STATE CONTROLLER'S OPPOSITION TO THE CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION'S APPLICATION FOR A TRO AND ORDER TO SHOW CAUSE REGARDING PRELIMINARY INJUNCTION;

6. DECLARATION OF LISA CROWE IN SUPPORT OF JOHN CHIANG AND THE OFFICE OF THE STATE CONTROLLER'S OPPOSITION TO THE CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION'S APPLICATION FOR A TRO AND ORDER TO SHOW CAUSE REGARDING PRELIMINARY INJUNCTION;

7. DECLARATION OF JIM LOMBARD IN SUPPORT OF JOHN CHIANG AND THE OFFICE OF THE STATE CONTROLLER'S OPPOSITION TO THE CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION'S APPLICATION FOR A TRO AND ORDER TO SHOW CAUSE REGARDING PRELIMINARY INJUNCTION.;

[ ] 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**

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[ ] **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.

[X] **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.

[XX] **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 13, 2010, at Los Angeles, California.

Vickie J. Huntley

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SERVICE LIST

Linda A. Mayhew, SBN 155049 Assistant Chief Counsel Christopher E. Thomas, SBN 186075 Labor Relations Counsel Department Of Personnel Administration 1515 S Street, North Building, Suite 400 Sacramento, California 95814 Telephone: (916) 324-0489 Telecopy: (916) 323-4723 E-Mail: lmahew@dpa.ca.gov E-Mail: cthomas@dpa.ca.gov	**ATTORNEY FOR PLAINTIFF/PETITIONERS** **Debbie L. Endsley; California Department Of Personnel Administration**

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