

ATTACHMENT B
STAFF'S ARGUMENT

STAFF'S ARGUMENT TO DECLINE TO ADOPT THE PROPOSED DECISION

Overview

CalPERS staff argues that the Board should decline to adopt the Proposed Decision, in favor of its own Decision, after conducting a full Board Hearing in accordance with its policies. Staff's argument is based on the following:

- I. The Proposed Decision incorrectly rejects the reasoning in the Board's Precedential Decision 12-01, *Craig F. Woods, Respondent and Tahoe Truckee Sanitation Agency, Respondent*, which held that employer-paid deferred compensation is properly excluded as "compensation earnable" for the purpose of calculating retirement benefits because it is specifically excluded by the California Public Employees' Retirement Law (PERL) (Government Code section 20636, subd.(g)(4)(E)).
- II. The Proposed Decision does not correctly analyze the law pertaining to "publicly available pay schedules" (Government Code section 20636(b)(1), California Code of Regulations, title 2, section 570.5).
- III. The Proposed Decision does not address whether the excluded compensation is "final settlement pay" and therefore cannot be included in the calculation of Christine Monsen's (Respondent) pension.

Legal and Factual Background

Respondent was originally hired by Respondent Alameda County Transportation Improvement Authority (ACTIA) as the Deputy Director for Special Projects, and later became the ACTIA Executive Director. Respondent, by virtue of this employment, is a miscellaneous member of CalPERS.

Upon Respondent's application for service retirement in 2010, CalPERS determined that Respondent was not entitled to credit her employer-paid deferred compensation as "compensation earnable."¹ The employer-paid deferred compensation was in the form of payment to a 457 deferred compensation plan which Respondent held. In the early years of her employment, the employer paid 50% of the funds which went into the 457 account. These funds were paid directly to the 457 account and were not included in her payrate. Later, ACTIA directly paid, into Respondent's 457 account, 100% of the maximum amount allowable, without including this amount in payrate. Respondent, as the Executive Director, instructed the Board and Financial Unit how to pay her compensation, both earnable and other. After 2007, with agreement from the ACTIA

¹ "Compensation earnable", by a member, means the payrate and special compensation of the member..."Payrate" means the normal monthly rate of pay or base pay of the member paid in cash to similarly situated members of the same group or class of employment for services rendered on a full-time basis during normal working hours, pursuant to publicly available pay schedules... (Gov. Code §20636)

Board, Respondent informed the Financial Unit that they should roll the amount of the employer-paid deferred compensation into her payrate.

CalPERS program staff reviewed the reported compensation and noted that ACTIA and Respondent intentionally added the exact amount of employer-paid deferred compensation to Respondent's payrate for the purpose of increasing Respondent's final settlement pay three years prior to her retirement, and eliminated the employer-paid deferred compensation benefit. CalPERS determined that adding this amount to payrate did not make it compensation earnable, and that ACTIA had over-reported the compensation earnable of Respondent (in the amount of the employer-paid deferred compensation which had been rolled into payrate). Respondent and ACTIA filed a timely appeal of this determination.

A hearing was held on March 5, 2014 and June 13, 2014, on the issue of whether deferred compensation can be included in the calculation of Respondent's final compensation. In other words, the Administrative Law Judge (ALJ) was asked to decide whether Respondent's payrate could legally include the employer-paid deferred compensation after it was rolled, for that purpose, into Respondent's payrate. Witnesses were heard and documentary evidence was presented.

At the hearing ACTIA and Respondent presented evidence that ACTIA paid Respondent a payrate as well as a separately listed benefit of an employer-paid deferred compensation. ACTIA decided in 2007 to re-characterize the employer-paid deferred compensation as payrate, and added the amount of the employer-paid deferred compensation to Respondent's payrate. ACTIA then added that specific amount of \$20,500 yearly, to Respondent's annual salary.

CalPERS presented testimony and documentary evidence that the ACTIA payrate increases were an attempt to change the characterization of payments (employer-paid deferred compensation) that were not compensation earnable. Testimony of all witnesses established that ACTIA transferred that amount, upon direction of the Respondent, into payrate, in order to reclassify it as compensation earnable. This re-characterization attempted to cloak the identity of the funds that were previously paid for many years as ineligible CalPERS compensation. CalPERS staff testified that this change was insufficient to keep CalPERS from determining the real nature of the payments. CalPERS Precedential Decision 12-01 *Craig F. Woods, Respondent and Tahoe Truckee Sanitation Agency, Respondent*, settled that employer-paid deferred compensation is not compensation earnable, and cannot be included in final compensation nor in the calculation of a member's pension.

The ALJ issued a Proposed Decision on June 30, 2014, granting the appeal by Respondent and striking down the determination by CalPERS denying Respondent's claim to employer-paid deferred compensation as part of compensation earnable. In the Proposed Decision, the ALJ held that the evidence showed that Respondent's salary of \$17,104.92 per month was "publicly available" as required by the PERL. However, she did not specify what evidence supported her ruling. The ALJ also

rejected the reasoning of CalPERS Precedential Decision 12-01 *Craig F. Woods, Respondent and Tahoe Truckee Sanitation Agency, Respondent*, and held that Respondent's salary of \$17,104.92 did not include deferred compensation paid by her employer. The Proposed Decision concluded that Respondent was entitled to claim the additional amounts paid for employer-paid deferred compensation as compensation earnable once it was reclassified as payrate by the employer.

Why the Proposed Decision Should Be Rejected

The Board and CalPERS staff have a fiduciary duty not to pay benefits in excess of those authorized by the PERL. CalPERS staff contends that the Proposed Decision contains the following errors:

- I. The Proposed Decision incorrectly rejects the reasoning in the Board's Precedential Decision 12-01, *Craig F. Woods, Respondent and Tahoe Truckee Sanitation Agency, Respondent*, which held that employer-paid deferred compensation is properly excluded as "compensation earnable" for the purpose of calculating retirement benefits because it is specifically excluded by the PERL (Government Code section 20636, subd.(g)(4)(E)).

The ALJ should have applied the reasoning of the *Craig F. Woods* Precedential Decision to find that the amount of employer-paid deferred compensation that was rolled into Respondent's payrate was not compensation earnable, no matter how ACTIA and the Respondent tried to disguise the true nature of those funds. The ALJ in this case tried to distinguish the *Craig F. Woods* Precedential Decision on the basis that after 2007, the deferred compensation amount of \$1,708.34 per month was rolled into Respondent's pay and she directed that those funds be diverted from her salary into a deferred compensation plan. Thus, the ALJ decided these amounts are not considered "employer payments" and are included in a member's payrate. (Gov. Code sec. 20636, subd. (b)(2)(A)).

The ALJ also rejected the reasoning in the *Craig F. Woods* case because in that case, she asserted, the employer-paid deferred compensation was directly paid by the employer into the deferred compensation plan, and because the employer's board intended to include in final payrate two portions of Woods' salary that the board knew were disallowed. In addition to misstating the facts of the *Craig F. Woods* case, the ALJ's superficial analysis completely ignores the policy against spiking and elevates form over substance.

In *Craig F. Woods*, three of the Factual Findings, as follows, are pertinent to this discussion:

4. ...respondent and CalPERS staff engaged in numerous correspondence over CalPERS' exclusion of certain amounts **paid directly to respondent by TTSA in addition to his monthly base pay.** The additional

payments consisted of a monthly car allowance of \$800 and a **\$920 monthly allowance for his deferred compensation plan** (PERS 457 program)... (Emphasis added.)

6. ... (c) Paragraph six of Agreement #2 stated that TTSA would pay respondent an **additional \$920 per month “for deposit in Employee’s retirement fund, PERS 457 program**, additional retirement service credit and/or similar retirement programs.”... (Emphasis added.)

10. ...Hence, amendment #2 sought to delete all references to two components of respondent's original compensation package: car allowance and deferred compensation, **and to subsume these components into one rate of pay.** (Emphasis added.)

The facts in this case are practically identical to those in the *Woods* Precedential Decision. Here, the ACTIA Board in 2007 gave Respondent a three percent raise and the additional amount of \$20,500, which was identified as “deferred compensation.” ACTIA did not deposit any amount directly into a deferred compensation plan on Respondent’s behalf. However, neither did TTSA in the *Woods* case. In *Woods*, as here, the contract amendment combined into one hourly rate *Woods*’ base salary, \$800 per month for an auto allowance, and \$920 per month for deferred compensation. As the ALJ bluntly stated in *Woods*, “The restructuring of components of compensation does not alter the nature of the pay. The law does not respect form over substance.” As such, Mr. *Woods* was not allowed to include employer-paid deferred compensation, which had been rolled into his base pay and reflected in an increased hourly rate, for purposes of calculating his service retirement. The same analysis applies equally to the instant case.

If the Proposed Decision in this case were allowed to stand, it will provide CalPERS members a simple road map for accomplishing a type of pension spiking that the law has been designed to prevent. Any employer could merely inflate the base pay of any employee to account for the amount of deferred compensation that the employer agreed to pay. This would be legal, according to the ALJ in this case, because the employer would not be DIRECTLY paying the amount into a deferred compensation plan on behalf of the employee. Surely, this would be elevating form over substance, which the law abhors.

II. The Proposed Decision does not correctly analyze the law pertaining to “publicly available pay schedules” (Government Code sec. 20636(b)(1), California Code of Regulations, title 2, section 570.5).

The ALJ should have determined that there was no publicly available pay schedule, as required by Government Code section 20636 subd.(b)(1) and California Code of Regulations, title 2, section 570.5. The now defunct agency, ACTIA, did not present at

the hearing any credible proof of publication of its pay schedules. To the contrary, testimony at the hearing by witnesses for ACTIA and Respondent actually supported CalPERS' determination that there were no publicly available pay schedules. Testimony established that Respondent's payrate was discussed in closed sessions of the ACTIA Board. The amount of payrate and changes to payrate were occasionally reported, but no witness could point to a process or requirement that pay schedules be made publicly available. An agency's mere willingness to respond with such information, if asked, is not public availability. The most that this testimony established was that subsequent entities, which supplanted ACTIA, created websites which contained Respondent's payrate information.

Additionally undermining Respondent's testimony on this point, both Respondent and her witness testified that neither could verify publishing her payrate information during the time the pay schedule was in effect, and they admitted they did not want the public to know the payrate details due to concerns the public would react negatively to this information. While ACTIA and Respondent wanted to provide Respondent with a six percent pay increase, the testimony from the Mayor of Union City and Respondent was that a larger increase was not politically palatable, so they reduced the raise to three percent and boosted the employer contribution to deferred compensation (previously only half of the maximum 457 contribution) to 100 percent of the maximum 457 contribution. This was an attempt to conceal the pay increases by awarding them through a vehicle other than payrate.

Thus, there is no credible evidence in the record to support the assertions that Respondent's pay schedules were published. To the contrary, there is plentiful testimony that both ACTIA and Respondent were trying to disguise the true total remuneration paid to Respondent. This lack of credible evidence could explain why the ALJ flatly concluded that Respondent's payrate information had been publicly available, without citing to any evidence to support that conclusion.

Employer-paid deferred compensation is not compensation earnable. ACTIA, having taken elaborate steps to conceal from the public the amount of pay increase it gave to Respondent, should be legally constrained from then re-characterizing the employer-paid deferred compensation as an increase in base pay.

III. The Proposed Decision does not address whether the excluded compensation is "final settlement pay" and therefore cannot be included in the calculation of Respondent's pension.

The ALJ did not make any findings addressing the issue of "final settlement pay."² Respondent presented evidence from two witnesses that although she did not intend to

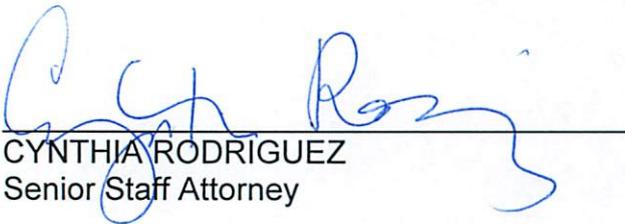
² "Final settlement pay" means any pay or cash conversions of employee benefits in excess of compensation earnable, that are granted or awarded to a member in connection with or in anticipation of a separation from employment...final settlement pay is excluded from payroll reporting to PERS, in either payrate or compensation earnable...it is generally, but not always paid during the period of final compensation...(California Code of Regulations, title 2, section 570.)

retire three years after she, as Executive Director, rolled her employer-paid deferred compensation into her payrate, she did retire at that time because she did not want to reapply for her position when ACTIA was absorbed into another agency. The testimony, proffered to refute the violation of the final settlement pay rules against raising pay in the final years of employment and therefore raising pension value, was neither logical nor credible. By holding a full Board Hearing, the Board can explore this issue fully and make a finding as to whether any remuneration to Respondent can be correctly classified as "final settlement pay" under the applicable statutes and regulations.

Proposed Board Action

Based on the serious flaws of the Proposed Decision's analysis, CalPERS staff urges the Board to reject the Proposed Decision and hold a full Board Hearing. Once the Board considers all the evidence and arguments in full context, the Board can then decide for itself whether the ALJ has analyzed the applicable law correctly. In short, the Board should grant a full Board Hearing so that the Board's final Decision, whatever it may be, is supported by a correct and reasonable application of law and the Board's Precedential Decision in *Woods*.

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