

ATTACHMENT A
THE PROPOSED DECISION

BEFORE THE
BOARD OF ADMINISTRATION
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATE OF CALIFORNIA

In the Matter of the Appeal Regarding
Calculation of Final Compensation of:

DANIEL KLAFF,

Respondent,

and

ASSOCIATION OF CALIFORNIA
WATER AGENCIES – JOINT POWERS
INSURANCE AUTHORITY,

Respondent.

CalPERS Case No. 2013-0059

OAH No. 2014030259

PROPOSED DECISION

This matter was heard before Administrative Law Judge Dian M. Vorters, State of California, Office of Administrative Hearings (OAH), on October 29, 2014, in Sacramento, California.

Rory J. Coffey, Senior Staff Counsel, represented the petitioner California Public Employees' Retirement System (CalPERS).

Daniel Klaff was present and represented himself.

There was no appearance on behalf of the Association of California Water Agencies, Joint Powers Insurance Authority (ACWA/JPIA or the Authority).

Evidence was received and the record closed on October 29, 2014.

ISSUE

Whether the lump sum payment of \$36,666.67 reported to CalPERS by respondent's employer is properly included as final compensation for purposes of calculating respondent's retirement allowance?

CALIFORNIA PUBLIC EMPLOYEES'
RETIREMENT SYSTEM
FILED Dec 1, 2014
C. Bodily

FACTUAL FINDINGS

1. The Statement of Issues was made and filed on March 7, 2014, by Karen DeFrank, Chief of the Customer Account Services Division, California Public Employees' Retirement System, in her official capacity.

2. ACWA is a public agency that contracted with the CalPERS Board of Administration for retirement benefits for its eligible employees. (Gov. Code, § 20460 et seq.) The provisions for public agencies contracting with CalPERS are set forth in the Public Employees' Retirement Law (PERL). (Gov. Code, § 2000 et seq.)

3. ACWA is a statewide coalition of public water agencies. JPIA is a joint powers authority formed in 1979 to provide cost-effective liability insurance for public water agencies. Respondent was employed by ACWA/JPIA (the Authority) in 1991 as an insurance program underwriter. In 1995, he was appointed Chief Executive Officer (CEO) of the Authority. By virtue of this employment, respondent became a miscellaneous member of CalPERS subject to the provisions of the Government Code.

4. Respondent submitted his Service Retirement Election Application (Application) on September 30, 2011. He retired effective October 16, 2011, after reaching the age of 65, with over 25 years of service credit. He has been receiving his retirement allowance from that date.

5. In the mid-2000s, respondent was being recruited by other Joint Powers Authorities. The Authority wanted to retain him so the Board of Directors decided to offer him a more attractive compensation package. On January 27, 2007, while already acting as its CEO, respondent executed an employment contract with the Authority. The 2007 employment contract extended respondent's vacation time, increased his annual compensation to \$170,258, and provided for a monthly automobile allowance of \$700. Additionally, the contract provided for a lump sum incentive if respondent stayed until he turned 65. The relevant contract language specifically stated:

3.9 Pay Upon Termination of Employment.

3.9.1 - If the Authority terminates the CEO for any reason other than gross incompetence,...or if the CEO terminates his employment on or after his 65th birthday, the CEO shall be paid as severance pay, a lump sum cash payment equal to 2 months salary at his then current rate. If the Authority terminates the CEO for gross incompetence, the CEO shall be paid no severance pay.

6. Respondent turned 65 in April 2011. When he retired in October 2011, his monthly pay was \$18,333.33. As such, commensurate with his 2007 employment contract; he received a lump sum payment in the amount of \$36,666.67. The Authority reported this payment to CalPERS on respondent's behalf as an item of special compensation given during

the service period of September 18, 2011, through October 1, 2011. The Authority specifically identified this special compensation as "Management Incentive Pay."

7. CalPERS analysts in the Compensation and Employer Review Unit examined the compensation earnable reported on respondent's behalf by his employer. Tomi Jimenez, a manager in that Unit, mailed letters to respondent and the Authority explaining that the payroll reported did not conform to the PERL. CalPERS acknowledged that respondent's monthly payrate during the final year (October 1, 2010, through October 15, 2011), was \$18,333.33. However, the payment of \$36,666.67 during the final period of September 18, 2011, through October 1, 2011, did not fit the definition of Management Incentive Pay.

8. In her letter dated May 8, 2012, Ms. Jimenez explained that "special compensation" as defined in the PERL, "includes a payment received for special skills, knowledge, abilities, work assignment, workdays or hours, or other work conditions." (Gov. Code, § 20636, subd. (c)(1).) By regulation, items of special compensation must also meet additional criteria including that they not be "paid exclusively in the final compensation period" nor be considered "final settlement pay." (Cal. Code Regs., tit. 2, § 571, subd. (b)(7) & (8).)

In addition, regulations provide an exclusive list of special compensation items that the board has approved as reportable compensation. Management incentive pay is included in this list and is defined as "Compensation granted to management employees in the form of additional time off or extra pay due to the unique nature of their job... reported periodically as earned and must be for duties performed during normal work hours..." (Cal. Code Regs., tit. 2, § 571, subd. (a)(1).)

9. Final settlement pay is defined in the PERL as "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 pay rate or compensation earnable." (Cal. Code Regs., tit. 2, § 570.)

10. After reviewing respondent's 2007 contract, CalPERS determined that the \$36,666.67 lump-sum cash payment was given in connection with his separation from employment. As such, it met the definition of "final settlement pay" not "management incentive pay," and was disallowed under the PERL. Accordingly, CalPERS recalculated respondent's retirement benefits excluding the severance payment and using only the regular pay rates reported by the Authority through October 15, 2011. On April 5, 2012, the Authority complied with CalPERS' directive to reverse the \$36,333.67 payroll posting.

CalPERS' Final Compensation Determination

11. Samuel Camacho is a Retirement Program Analyst II in the Employer Compensation Review Unit at CalPERS. He has worked for CalPERS for over eight years. He is familiar with a variety of benefits and compensation issues involving State and local public agency employers. Public agencies include schools, local entities, water districts, and

joint powers authorities. Shortly after respondent retired, an analyst in this unit reviewed respondent's file and noted that the lump sum payment was reported as "management incentive pay." CalPERS requested the Authority to provide them with a copy of respondent's labor agreement. Mr. Camacho was not the original analyst. However, he reviewed respondent's case file including the 2007 employment contract. He noted that the employment contract specifically referred to the lump sum cash payment as "severance pay" which is not "compensation earnable" and cannot be used to calculate respondent's retirement benefit.

12. Respondent testified that the contract provision granting payment upon termination was actually established in an earlier 2004 contract. These employment contracts also extended other benefits such as increasing the value of his life insurance from \$200,000 to \$300,000. Respondent stated that they intended to comply with CalPERS' requirements and he would not have retired six months after turning 65 if he had not thought the \$36,000 would be included in his retirement calculations. Respondent reiterated that the lump sum payment was meant to be an "incentive to stay," not final separation pay.

13. CalPERS correctly determined that the \$36,666.67 reported by the Authority as "management incentive pay" was in essence "final settlement pay" as defined under the PERL. This type of compensation received in the final compensation period is excluded from payroll reporting to CalPERS as either pay rate or compensation earnable. As such, it cannot be used in the calculation of respondent's retirement allowance.

LEGAL CONCLUSIONS

Applicable Statutes and Regulations

1. CalPERS is a "prefunded, defined benefit" retirement plan. (*Oden v. Board of Administration* (1994) 23 Cal.App.4th 194, 198). The formula for determining a member's retirement benefit takes into account: (1) years of service; (2) a percentage figure based on the age on the date of retirement; and (3) "final compensation" (Gov. Code, §§ 20037, 21350, 21352, 21354; *City of Sacramento v. Public Employees Retirement System* (1991) 229 Cal.App.3d 1470, 1479.)

2. Government Code section 20630 defines "compensation" as the remuneration paid out of funds controlled by the employer in payment for the member's services performed during normal working hours or for time during which the member is excused from work because of holidays, sick leave, industrial disability leave, vacation, compensatory time off, and leave of absence. Compensation shall be reported in accordance with section 20636 and shall not exceed compensation earnable, as defined in section 20636. (Gov. Code, § 20630, subs. (a) & (b).)

3. "Compensation earnable" is composed of (1) pay rate, and (2) special compensation, as defined in Government Code section 20636.

4. "Pay rate" 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. "Pay rate" for a member who is not in a group or class, means the monthly rate of pay or base pay of the member, paid in cash and pursuant to publicly available schedules, for services rendered on a full-time basis during normal working hours, subject to the limitations of paragraph (2) of subdivision (e). (Gov. Code, § 20636, subd. (b)(1).)

5. "Special compensation" of a member includes a payment received for special skills, knowledge, abilities, work assignment, workdays or hours, or other work conditions." (Gov. Code, § 20636, subd. (c)(1).)

"Special compensation shall be limited to that which is received by a member pursuant to a labor policy or agreement or as otherwise required by state or federal law, to similarly situated members of a group or class of employment that is in addition to payrate. If an individual is not part of a group or class, special compensation shall be limited to that which the board determines is received by similarly situated members in the closest related group or class that is in addition to payrate, subject to the limitations of paragraph (2) of subdivision (e)." (Gov. Code, § 20636, subd. (c)(2).)

"Special compensation shall be for services rendered during normal working hours and, when reported to the board, the employer shall identify the pay period in which the special compensation was earned." (Gov. Code, § 20636, subd. (c)(3).)

6. "The board shall promulgate regulations that delineate more specifically and exclusively what constitutes 'special compensation' as used in this section. A uniform allowance, the monetary value of employer-provided uniforms, holiday pay, and premium pay for hours worked within the normally scheduled or regular working hours that are in excess of the statutory maximum workweek or work period applicable to the employee . . . shall be included as special compensation and appropriately defined in those regulations." (Gov. Code, § 20636, subd. (c)(6).)

7. Special compensation does not include: "(A) Final settlement pay, (B) Payments made for additional services rendered outside of normal working hours, whether paid in lump sum or otherwise, or (C) Other payments the board has not affirmatively determined to be special compensation." (Gov. Code, § 20636, subd. (c)(7).)

8. California Code of Regulations, title 2, section 570 defines "Final Settlement Pay" to mean any pay or cash conversions of employer 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 CalPERS, in either pay rate or compensable earnable. (Gov. Code, § 20636, subd. (f).)

9. California Code of Regulations, title 2, section 571 exclusively identifies and defines special compensation items for members employed by contracting agency that must be reported to CalPERS if they are contained in a written labor policy or agreement. (Cal.

Code Regs., tit. 2, § 571, subd. (a).) The Board has determined that all items of special compensation listed in subsection (a) are:

- (1) Contained in a written labor policy or agreement;
- (2) Available to all members in the group or class;
- (3) Part of normally required duties;
- (4) Performed during normal hours of employment;
- (5) Paid periodically as earned;
- (6) Historically consistent with prior payments for the job classification;
- (7) Not paid exclusively in the final compensation period;
- (8) Not final settlement pay; and
- (9) Not creating an unfunded liability over and above PERS' actuarial assumptions.

(Cal. Code Regs., tit. 2, § 571, subd. (a).) Regulations further provide:

- (c) "Only items listed in subsection (a) have been affirmatively determined to be special compensation. All items of special compensation reported to PERS will be subject to review for continued conformity with all of the standards listed in subsection (b)." (Cal. Code Regs., tit. 2, § 571, subd. (c).)
- (d) "If an item of special compensation is not listed in subsection (a), or is out of compliance with any of the standards in subsection (b) as reported for an individual, then it shall not be used to calculate final compensation for that individual." (Cal. Code Regs., tit. 2, § 571, subd. (d).)

Legal Cause

10. An applicant for retirement benefits has the burden of proof to establish a right to the entitlement, absent a statutory provision to the contrary. (*Greator v. Board of Administration* (1979) 91 Cal.App.3d 54, 57.)

11. Respondent did not meet his burden to establish that compensation he received for remaining on the job until he reached age 65 was properly included as compensable earnable for the purpose of calculating his retirement benefits. This payment component is specifically excluded by the PERL. (Gov. Code, § 20636, subd. (g)(4)(G).)

Legal Analysis

12. Respondent's 2007 employment contract clearly identified the lump sum payment upon termination of employment after he reached age 65, "as severance pay." This constitutes "final settlement pay" and is an impermissible salary increase under the PERL. (Gov. Code, § 20636, subd. (f); Cal. Code Regs., tit. 2, § 570.)

13. Case law supports a finding that the benefits at issue here are not a part of compensation earnable for purposes of calculating retirement benefits. "An employee's compensation is not simply the cash remuneration received, but is exactly defined to include or exclude various employment benefits and items of pay." (*Oden v. Bd. of Admin. Of the Public Employees' Retirement System* (1994) 23 Cal.App.4th 194, 198.)

Conclusion

14. CalPERS correctly determined that respondent's compensation earnable for purposes of calculating his retirement benefits cannot include the lump sum cash payment of \$36,666.67. CalPERS' adjustment to respondent's final compensable earnable is supported by the PERL. (Gov. Code, § 20636; Cal. Code Regs., tit. 2, §§ 571, 570.)

ORDER

The appeal of respondent Daniel Klaff and the Association of California Water Agencies – Joint Powers Insurance Authority, to include in compensation earnable, a lump sum cash payment equal to two months salary, as reflected in a one-time payment of \$36,666.67, is DENIED.

DATED: November 24, 2014



DIAN M. VORTERS
Administrative Law Judge
Office of Administrative Hearings