

STAFF'S ARGUMENT TO ADOPT IN PART AND DECLINE IN PART THE PROPOSED DECISION

Overview

At its November 16, 2016, meeting, the CalPERS Board of Administration (Board) declined to adopt the Proposed Decision in this matter and granted a Full Board Hearing in connection with the appeal of Respondent Desi Alvarez (Respondent Alvarez). Staff contends that the Proposed Decision should be adopted in part and rejected in part for the reasons explained below.

Staff recommends the Board adopt the Proposed Decision, in part, as to the compensation earnable finding based on the following:

- I. Salary schedules or matrices provided by Respondent Chino Basin Watermaster (Respondent Watermaster) are not "publicly available pay schedules" because the documents do not comply with statutory and regulatory requirements in that they were not adopted or approved by the Chino Basin Watermaster Board of Administration (Watermaster Board) by public action or consent.
- II. The salary schedules or matrices are not "publicly available pay schedules" as required by statute since the documents were not readily available to the public.

Staff recommends the Board decline to adopt the Proposed Decision, in part, as to Respondent Alvarez's employment status after November 9, 2011 and as to payments constituting final settlement pay, in favor of its own decision, based on the following:

- I. The Proposed Decision fails to properly apply the common law employment test to determine whether Respondent Alvarez remained an employee of Respondent Watermaster after November 9, 2011; and
- II. The Proposed Decision fails to apply the applicable California Public Employees' Retirement Law (PERL) governing "final settlement pay."

Background Facts

On March 31, 2011, a confidential Watermaster Board Closed Session Conference call was held, whereby counsel for Respondent Watermaster was authorized to "extend a binding term sheet for the retention of Alvarez, the new CEO of Watermaster, and to prepare a confirming legal contract for execution by the Watermaster Board Chair." (CalPERS' Exh. 10.)

Respondent Alvarez entered an employment agreement (Employment Agreement) with Respondent Watermaster, effective May 3, 2011, as the Chief Executive Officer (CEO), which states in pertinent part:

1. **Employment:** The Watermaster hereby employs the Executive and the Executive hereby accepts employment with the Watermaster as CEO. During the Employment Term (as hereinafter defined), Executive will have the title, status, and duties of CEO and will report directly to the Watermaster Board of Directors ("Board").
 3. **Scope of Duties: During the Employment Term:**
 - a. The Executive will perform duties assigned by the Board and will be responsible for the administration and oversight of Watermaster functions, including implementation of the Judgment and OBMP. Subject to the control and direction of the Board, the CEO provides day-to-day leadership for Watermaster and is directly responsible to the Board on all matters pertaining to the administration and operations of the Chino Groundwater Basin ("Basin") under the provisions of the Judgment and the Optimum Basin Management Program. The CEO is responsible for overseeing the operating budget and the other employees of Watermaster. The CEO must keep the Board, through the Advisory Committee process, apprised of all applicable federal, state, regional and local policies regulating Watermaster activities.
 4. **Hours of Work:** Executive's hours of work will vary depending on the duties to be performed and depending on what is necessary to completely perform the job of CEO. As general guidance, normal work hours will begin at 8:00 a.m. Monday through Friday.
 - 5e. **Administrative Leave:** Executive shall be allowed twelve days per year of administrative leave ("Administrative Leave"), to be used at the Executive's discretion. Unused Administrative Leave shall not accrue to the following year.
9. **Severance:**
- a. **Termination without Cause:** In the event Executive's employment is terminated without cause prior to the end of the first year of the Employment Term, Watermaster will pay Executive the full salary amount for the first year of the Employment Term plus provide for the health and other benefits that were being provided to Executive for the remaining portion of such first year of the Employment Term, minus the amount of any salary already paid during that first year of the Employment Term. After the first year of the Employment Term, Executive shall not be entitled to any other payment of salary under

this Agreement for a termination without cause, except for payments owed through the date of termination.

Respondent Alvarez was removed as the CEO effective November 9, 2011. On January 23, 2012, Respondent Alvarez executed a confidential separation agreement (Separation Agreement) the terms of which stated in relevant part:

1. Termination of Active Employment. **Executive's employment in the capacity of Chief Executive Officer of the Watermaster with all of the powers and duties associated therewith ceased on November 9, 2011, and the Employment Agreement is hereby modified effective as of that date. [¶]...[¶] (Emphasis added.)**

2. Transition Period.

A. Term

As partial consideration for this Separation Agreement, Executive shall be continued to be employed with the Watermaster until May 3, 2012 (the "Transition Period"). At the conclusion of the Transition Period, Executive's employment shall be terminated (the "Separation Date") and such termination shall be designated "without cause."

B. Duties.

During the Transition Period and thereafter, **Executive shall have no actual or implied authority to act on behalf of the Watermaster or enter into any agreements on behalf of the Watermaster, and he shall not hold himself out as having any authority to act on behalf of the Watermaster.** Executive acknowledges and understands that he **does not have authority to speak on behalf of or bind the Watermaster in any manner during the Transition Period or thereafter. Executive's sole duty during the Transition Period shall be to assist and provide information to the Watermaster as requested with respect to pending projects and the transition of his duties.** Executive shall endeavor to respond promptly, fully, accurately and in a professional manner to inquiries and requests made by the Watermaster during the Transition Period. Notwithstanding any limitations to the contrary in the Employment Agreement, Executive forthwith may undertake consulting work on his own account and may pursue any other business, provided that he does not act to the detriment of the Watermaster or in violation of his continuing duties thereto. (Emphasis added.)

C. Compensation and Benefits.

During the Transition Period, Executive shall continue to receive his base salary, less applicable withholdings, at the rate in effect on November 9,

2011, paid in accordance with the Watermaster's normal payroll system. Executive shall continue to accrue vacation at the rate of twenty (20) days per year, accruing pro rata on a bi-weekly basis. In addition, the Watermaster shall permit Executive to continue to participate as an employee in any insurance plans, deferred compensation plans, and retirement plans in which he was a participant prior to the Transition Period, on the same terms and conditions as under the Employment Agreement. **The compensation and benefits provided hereunder shall be referred to as the "Severance Compensation."** Executive agrees that the **Severance Compensation**, along with any entitlement to benefits under the California Public Employees' Retirement System ("CalPERS") pursuant to the terms thereof on or after the Separation Date, constitute the entire amount of consideration due to him, and Executive is not entitled to any further or other amounts, including severance and other benefits, whether under the Employment Agreement or any other agreement, or any benefit plan, policy or practice of the Releases, as defined below. Executive agrees that he will not seek any further compensation for any other claimed damage, costs, severance, income, or attorneys' fees. Executive acknowledges that the **Severance Compensation constitutes good and valuable consideration to which he otherwise would not have been entitled.** (Emphasis added.)

[¶]...[¶]

13. Entire Agreement: Modifications.

This Separation Agreement constitutes the sole agreement between the parties with respect to the subject matter hereof, and supersedes all prior discussions, negotiations, understandings or agreements, whether oral or written, among the parties relating to the subject matter of this Separation Agreement, expressly including the Employment Agreement. **Neither the Watermaster nor Executive shall have any further obligations under the Employment Agreement, and the parties' respective obligations thereunder are hereby extinguished.** This Separation Agreement may not be amended, modified or changed (in whole or in part), except by a formal, definitive written agreement expressly referring to this Separation Agreement, which agreement is executed by both of the parties hereto. (Emphasis added.)

Respondent Alvarez worked for Respondent Watermaster as the CEO from May 3, 2011 to November 9, 2011. After November 9, 2011, Respondent Alvarez had no powers or duties, aside from potentially answering questions posed by the Watermaster Board regarding pending projects and the transition of his duties. (CalPERS' Exh. 12, Tr. Vol. I. p. 182:7-12.) After November 9, 2011, Respondent Watermaster appointed Danielle Maurizio as the interim CEO. (CalPERS' Exh.8; Tr. Vol. I. p. 183:10-25.) After being removed as a CEO, Respondent Alvarez no longer reported to the office and did not supervise any employees. Most importantly,

Respondent Alvarez did not assume another employment position with Respondent Watermaster.

Despite separating Respondent Alvarez from employment as CEO, Respondent Watermaster continued to report his full-time earnings to CalPERS. Respondent Watermaster reported an annual salary of \$228,000, which calculates to a monthly salary of \$19,000, from May 3, 2011 through May 4 2012.

On May 2, 2012, Respondent Alvarez submitted to CalPERS an application for service retirement. (CalPERS' Exh. 9.) In his application, Respondent Alvarez requested that CalPERS use the amount received from Respondent Watermaster as his final compensation. (*Id.*, at p. 1.)

Staff's Determination

On February 20, 2013, CalPERS informed Respondents that the compensation reported by Respondent Watermaster, for Respondent Alvarez, is not reportable for retirement purposes because it is not paid pursuant to a "publicly available pay schedule" and the payrate failed to comply with Government Code section 20635(b)(1) and Title 2, California Code of Regulations section 570.5 of the PERL. (CalPERS' Exh. 4.) CalPERS notified Respondents that it will instead use the monthly payrate and special compensation reported by the City of Downey, Respondent Alvarez's previous employer, to calculate Respondent Alvarez's retirement benefits. (*Id.*)

Respondents appealed CalPERS' February 20, 2013 determination on April 19, 2013, and provided additional information concerning the circumstances surrounding Respondent Alvarez's employment and separation with Respondent Watermaster. (CalPERS' Exh. 8.)

Thereafter, on May 23, 2013, the Watermaster Board retroactively adopted a Salary Matrix for Fiscal Year (FY) 2011/2012 and a Salary Matrix for FY 2012/13 during open session. (CalPERS' Exh. 14.) Prior to 2013, the Salary Matrix "from FY 2011/2012 and FY 2012/2013 [had] never been approved in open session by the Watermaster Board." (CalPERS' Exh. 16, p. 2; Tr. Vol. I, p. 96:1-12.)

According to Respondent Watermaster, the Salary Matrix was "used to develop and create the final budget for any position that's listed or that's currently filled at Watermaster" (Tr. Vol. I, p. 99:3-11.) The budget, which is approved in open session, does not have the Salary Matrix attached to it. (Tr. Vol. I, p. 99:16-20.)

In response to Respondents' appeals, CalPERS issued an Amended determination on June 17, 2013, informing Respondents that the pay provided to Respondent Alvarez from November 9, 2011 to May 4, 2012 (Severance Compensation) constitutes "final settlement pay" under Government Code section 20636(f) and will not be used to calculate his retirement benefits. Staff therefore determined the payments made by Respondent Watermaster after November 9, 2011 did not constitute "compensation"

as defined by Government Code section 20360 or "compensation earnable" as defined by Government Code section 20636.

Dissatisfied with CalPERS' action, Respondents appealed CalPERS' determination. On September 4, 2014, CalPERS served a Statement of Issues (SOI) and referred the matter to the Office of Administrative Hearings to conduct an evidentiary hearing and prepare a proposed decision.

CalPERS issued a supplemental determination letter on February 12, 2015, informing Respondent Alvarez that pursuant to Government Code sections 20069(a), 20028(b), 20125, and the common law employment test, he was not considered an employee of Respondent Watermaster after the effective date of the Separation Agreement, from November 10, 2011 through May 4, 2012. (CalPERS' Exh. 6.) As a result, services provided by Respondent Alvarez after November 9, 2011 are not reportable to CalPERS. (CalPERS' Exh. 6.)

On the same date, CalPERS filed an amended SOI, incorporating its determination that Respondent Alvarez was not in the employ of Respondent Watermaster after November 9, 2011. (CalPERS' Exh. 3.)

Proposed Decision

On September 7, 2016, the Administrative Law Judge issued a Proposed Decision finding the salary reported by Respondent Watermaster between May 3, 2011 and May 4, 2012, cannot be a basis for calculating Respondent Alvarez's final compensation.

The Proposed Decision, however, finds that Respondent Alvarez was an employee of Respondent Watermaster from November 9, 2011 to May 4, 2012 and thus is entitled to service credit for that timeframe.

Staff Recommends The Board Adopt The Portion Of The Proposed Decision Related to Respondent Alvarez's Final Compensation.

The Proposed Decision correctly held that the salary paid to Respondent Alvarez, by Respondent Watermaster, was not paid pursuant to a "publicly available pay schedule" as required by statute and regulation.

"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(b)(1).) The meaning of "publicly available pay schedule" as described in Government Code section 20636, is clarified by Title 2, California Code of Regulations, section 570.5, and further explained and analyzed by case law and precedential Board decisions.

Each word of the phrase “publicly available pay schedule” has been interpreted by the courts and/or this Board. “Publicly’ means ‘in a public or open manner or place’ and ‘in the name of the community’ and ‘by public action or consent’.” (Presidential Decision, *In re the Matter of Randy Adams*, OAH 2012030095 (*Adams*), p. 20.) For pay schedules to be “publicly” available, they “shall be public records available for the public scrutiny.” (Gov. Code § 20636(b)(1)(d).) In addition, the Legislature stated that the pay schedule “would have to be publicly noticed by the government body” when explaining the requirements for compensation earnable. (CalPERS Request for Official Notice, attach. (1)(C), p. 6, Senate Floor Analysis, SB 53, 5/1/93.) Essentially, as clarified by Title 2, California Code of Regulations, section 570.5, to meet the “public” requirement of Government Code section 20636, the pay schedule must be approved or adopted by the governing body. Here, the Proposed Decision correctly held that Respondents failed to establish that the “salary schedules or salary matrixes were published or made available to those attending the meetings or that either the Board’s agendas or minutes available for public review contained the employee salary information stated on the salary schedules or matrices.” (PD, p. 6.)

As noted by the Board in *Adams*, “‘available’ means ‘suitable or ready for use’ and readily obtainable.” (*Adams* p. 20.) The Proposed Decision correctly held that the salary matrices were not readily available to the public without reasonable difficulty because the members of the public had to follow a “very specific procedure” to obtain the information. (PD, p. 18.) The information was not available on the website, the public had to specifically request the information and staff had discretion to not release the information. (PD, p.19.)

Very recently, another court analyzed the phrase “pay schedule” as it is used in Government Code section 20636(b)(1). (*Tanner v. California Pub. Employees' Ret. Sys.* (2016) 248 Cal. App. 4th 743.) The court held that a “pay schedule is a written or printed list, catalog or inventory of the rate of pay or base pay of one or more employees who are members of CalPERS.” (*Id.* at p. 755.) The court further held that an employment agreement does not meet the definition of a “pay schedule” because such documents do not qualify “as a list, catalog, or inventory of the rate of pay or base pay of one or more employees.” (*Id.*) To be considered a “pay schedule,” the document must isolate the rate of pay or base pay of its employees. (*Id.*) Such a document “more readily informs the public of the payrate that will or may be used in determining the amount of an employee’s retirement benefit” and prevents spiking. (*Id.* at 756.) This Board also previously reached the same conclusion in *Adams* and held that as a matter of law, an individual employment agreement, even if available to the public, cannot qualify as a publicly available pay schedule.

The Proposed Decision correctly held that the Employment Agreement does not qualify as a publicly available pay schedule. The Proposed Decision also points out that, as to the last six months’ of Respondent Alvarez’s employment, he did not hold the CEO position after November 9, 2011 and “it cannot be established that any pay schedule or similar document was ever made public showing the position respondent held his last six months at Watermaster.” (PD, p. 21.)

Staff Recommends The Board Reject The Portion Of The Proposed Decision Related To Respondent Alvarez's Employment Status After November 9, 2011 And Conclusion About Final Settlement Pay.

There are two major flaws in the Proposed Decision. First, the Proposed Decision acknowledges but fails to correctly apply the common law employment test to determine whether Respondent Alvarez was an employee from November 9, 2011 to May 4, 2012. Next, the Proposed Decision fails to properly apply the applicable provisions of the PERL and applicable regulation concerning "compensation earnable" and "final settlement pay."

I. The Applicable Common Law Employment Test Was Incorrectly Applied To Determine Employee Status.

Government Code section 20125 provides that the Board "shall determine who are employees and is the sole judge of the conditions under which persons may be admitted to and continue to receive benefits under this system." Government Code section 20028(b), defines "employee" of a contracting agency to mean "any person in the employ of a contracting agency." Both the California Supreme Court in *Metropolitan Water District of Southern California v. Superior Court* (2004) 32 Cal.4th 491 (also known as "Cargill") and the Board have determined that the common law right to control test is to be utilized when determining whether an individual is an employee of a contracting agency. (See *In the Matter of the Application for CalPERS Membership Credit by Lee Niedengard and Tri-Counties Association for the Developmentally Disabled* (CalPERS Precedential Decision No. 05-01, effective April 22, 2005).) The most important factor under the common law test to determine employee status is the right of the employer to control the manner and means of accomplishing the result desired, regardless of whether that right is exercised with respect to all details. The other factors to be taken into consideration include:

- Whether or not the individual performing the services is engaged in a distinct occupation or business.
- The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of a principal without supervision.
- The skill required in the particular occupation.
- Whether the principal or the individual performing the services supplies the instrumentalities, tools and the place of work for the individual performing the services.
- The length of time for which the services are performed.
- The method of payment, whether by the time or by the job.
- Whether or not the work is part of the regular business of the principal.
- Whether or not the parties believe they are creating the relationship of employer and employee.

Tieberg v. Unemployment Ins. App. Bd. (1970) 2 Cal 3d 943, 949.

After November 9, 2011, Respondent Alvarez did not serve as an employee, rather he performed services, if at all, as an independent contractor. Contrary to the Proposed Decision, there is no evidence that Respondent Watermaster controlled the manner or means by which Respondent Alvarez performed his work, if any, after November 9, 2011.

After November 9, 2011, Respondent Alvarez did not report to work, did not supervise any employees, was relieved of all of his duties and powers as the CEO, was no longer responsible for the daily responsibilities of Respondent Watermaster, did not attend Watermaster Board meetings, and had no authority to act on behalf of Respondent Watermaster. In addition, Respondent Alvarez was not required to forgo any other work during the relevant time period. There is no evidence Respondent Watermaster had the right to control the manner or means of accomplishing any services performed, and there is no evidence that control was actually exercised by Respondent Watermaster. Respondent Alvarez merely answered a handful of inquiries, over the phone, when he was contacted by the Watermaster Board.

When considering the other factors under the common law employment test, Respondent Alvarez also fails to meet the test. There is no evidence demonstrating that Respondent Watermaster furnished any equipment, supplies, or other materials to Respondent Alvarez after November 9, 2011. Respondent Alvarez was to be paid the same amount each month, regardless of whether he performed any work. As CEO of Respondent Watermaster, Respondent Alvarez's employment had been "at will," as would be the case with an employee. However, the November 9, 2011 Separation Agreement, had a specific end date, as would be the case with an independent contractor.

Furthermore, while the Proposed Decision states Respondent Alvarez remained an employee of Respondent Watermaster after November 9, 2011, it fails to state in what capacity. Respondent Alvarez ceased to be the CEO after November 9, 2011 and no evidence was presented to show he was appointed to another position, nor was there any position with Respondent Watermaster that can be linked to the consulting services provided by Respondent Alvarez after November 9, 2011.

Setting aside Respondent Watermaster's attempt to create an appearance of an employment relationship, by assigning Respondent Alvarez a duty to answer questions on an as needed basis, it is clear that Respondent Alvarez was no longer an employee after he was removed as the CEO on November 9, 2011. The purpose of the Separation Agreement was to sever the employment relationship between Respondent Alvarez and Respondent Watermaster and to provide a severance package to Respondent Alvarez, as promised in the original Employment Agreement. (See CalPERS' Exh. 11, p. 4, para. 9.) Although Respondent Alvarez was terminated from employment as CEO, the appearance of an employment relationship allowed Respondent Watermaster to provide the severance package, as initially promised and required under the Employment Agreement, and allowed Respondent Alvarez to spike his pension.

A new Board decision should be issued finding that Respondent Alvarez, under the common law employment test, was not an employee of Respondent Watermaster from November 9, 2011 to May 4, 2012. Instead, the evidence supports and staff recommends the Board find that Respondent Alvarez was an independent contractor during that time and was therefore not eligible to participate as a member in CalPERS pursuant to Government Code section 20300(b).

II. The Proposed Decision Failed To Correctly Apply The PERL When Determining Whether The Payments To Respondent Alvarez Are Reportable For Retirement Purposes.

Even if the Board finds Respondent Alvarez continued to remain an employee of Respondent Watermaster after November 9, 2011, the payments made to him during that time (Severance Compensation) are not reportable to CalPERS because the payments were not "compensation earnable" and constituted "final settlement pay" under the PERL.

A member's service retirement benefit is calculated based on the member's age, service credit, retirement formula and final compensation. "Final compensation" means ". . . the highest average annual compensation earnable by a member during the three consecutive years (or one year) of employment immediately preceding the effective date of his retirement or the date of his last separation from state service if earlier or during any other period of three consecutive years (or one year) during his membership in the system which he designates . . ." (Gov. Code §§20037, 20042.) Compensation earnable is comprised of a member's payrate and special compensation. (Gov. Code §§20636, 20636.1)

For payments to be reportable to CalPERS for retirement purposes, they must constitute "compensation earnable" as defined in section 20636. "Compensation earnable" is a combination of a "payrate" and "special compensation." (Gov. Code §20636(a); Cal. Code Regs., Title 2, §570.) As noted above, under Government Code section 20636(b)(1): " '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. (Emphasis added.) "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(b)(1).) Similarly, "special compensation" shall be for services rendered during normal working hours. (Gov. Code §20636(c)(3).)

Here, the "Severance Compensation" must be excluded because it was not paid for services performed during normal business hours and it constitutes final settlement pay.

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**A. The Proposed Decision Fails To Correctly Apply The PERL
"Compensation Earnable" Definitions, Applicable CalPERS
Regulations, And Cases Interpreting The PERL.**

Government Code Section 20630 provides in part:

"(a) As used in this part, "compensation" means 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 any of the following:

- (1) Holidays.
 - (2) Sick leave.
 - (3) Industrial disability leave, during which, benefits are payable pursuant to Sections 4800 and 4850 of the Labor Code, Article 4 (commencing with Section 19869) of Chapter 2.5 of Part 2.6 . . .
 - (4) Vacation.
 - (5) Compensatory time off.
 - (6) Leave of absence.
- (b) When compensation is reported to the board, the employer shall identify the pay period in which the compensation was earned regardless of when reported or paid. Compensation shall be reported in accordance with Section 20636 and shall not exceed compensation earnable, as defined in Section 20636.

The Proposed Decision incorrectly assumes Respondent Alvarez was placed on administrative leave despite the fact that the Employment Agreement limited administrative leave to twelve days per year. The Separation Agreement does not place Respondent Alvarez on administrative leave or even make mention of administrative leave. Any mention of administrative leave or any type of leave of absence was absent until the theory was presented by Respondent Watermaster's counsel in their April 19, 2013 appeal letter. The Proposed Decision incorrectly relied on the self-serving testimony of Respondent Alvarez, and incorrectly ignored the clear language of the Employment Agreement and the Separation Agreement on this issue. Both the Employment Agreement and the Separation Agreement documented the agreement of the parties and the true intent of the parties at the time of employment and at the time of separation.

After November 9, 2011, Respondent Alvarez was relieved of duties as a CEO and was replaced by Danielle Maurizio. Although he may have responded to questions posed by the Watermaster Board, there is no evidence that Respondent Alvarez performed any services during normal working hours after November 9, 2011. The Severance Compensation paid to Alvarez was in exchange for his separation from employment, not for services performed during normal working hours. Although Respondent Watermaster is free to provide such Severance Compensation, the Severance Compensation does not qualify as compensation under section 20630 as it was paid to separate Respondent Alvarez from his position of a CEO. Respondents may argue that the Severance Compensation was paid to Respondent Alvarez for the "information" he

continued to provide to Respondent Watermaster after November 9, 2011; however, such an argument would require the Board to ignore the plain language and titles of the Separation Agreement, which provides for Severance Compensation. Staff recommends the Board find that the Severance Compensation did not meet the definition of Compensation under the PERL.

B. "Severance Compensation" Provided to Respondent Alvarez, After November 9, 2011, Must be Excluded as "Final Settlement Pay"

"Final settlement pay" is excluded from payroll reporting to CalPERS under Government Code section 20636(f) and Title 2, California Code of Regulations, section 570 either as payrate or special compensation. It is defined as any employee's pay in excess of compensation earnable that is granted or awarded to a member **in connection with, or in anticipation, of a separation from employment.** (Emphasis added.) Severance pay is precisely the type of pay that is specifically excluded as "final settlement pay". (Cal. Code Regs., Title 2, §570.) Final settlement pay is singled out for legislative and regulatory treatment because it is the quintessential example of pension spiking. It has the effect of generating a large unfunded liability, by increasing compensation in the last year or years of employment.

The plain and unambiguous language of the Separation Agreement demonstrates that the payments and benefits set are not normal payrate or special compensation, but are instead Severance Compensation, paid in anticipation of Respondent Alvarez's separation from employment. The Severance Compensation was provided to Respondent Alvarez to settle all disputes between him and Respondent Watermaster, and constituted "the entire amount of consideration due to [Alvarez], and [Alvarez] is not entitled to any further or other amounts, including severance and other benefits, whether under the Employment Agreement or any other agreement, or any benefit plan, policy or practice. . ." (CalPERS' Exh. 12, p. 2.) Respondent Alvarez also agreed to fully release and discharge Respondent Watermaster from any and all claims, wages, demands, rights, liens, agreements, and liabilities whether known or unknown to him. (*Id.*) Therefore, the evidence clearly demonstrated that the Severance Compensation was made to secure the peaceful separation from employment and to eliminate all claims and liabilities arising from Respondent Alvarez's employment as CEO.

The Proposed Decision failed to apply the correct law and facts to the payments made to Respondent Alvarez after November 9, 2011. The Proposed Decision only briefly discusses "final settlement pay" and in doing so fails to apply the applicable CalPERS' regulation, Title 2, California Code of Regulations, section 570, to the facts in this case. The Proposed Decision also fails to analyze why the payments were made to Respondent Alvarez. Such a determination is crucial in this case and renders this portion of the Proposed Decision erroneous. California courts have looked to the purpose of the payment and have rejected the argument that once an amount in question is converted to salary, its original purpose is irrelevant. (*Hudson v. Board of Administration* (1997) 59 Cal.App.4th 1310.) As noted above, the payments were made in anticipation of Respondent Alvarez leaving the position of CEO and to buy out his contract.

Staff recommends that the Board find that the Severance Compensation was not payable, special compensation, or compensation earnable and were instead made to buy out Respondent Alvarez's contract, and therefore constitute "final settlement pay." Accordingly, the staff recommends the Board find that these payments were not reportable under the PERL and cannot be used to calculate Respondent Alvarez's retirement benefits.

Recommendation

The Proposed Decision correctly held that the compensation paid to Respondent Alvarez was not pursuant to a publicly available pay schedule and did not constitute payable. Therefore, CalPERS staff urges the Board to adopt the Proposed Decision in part as to this conclusion. The Proposed Decision incorrectly found Respondent Alvarez remained an employee after November 9, 2011 and failed to exclude the Severance Compensation. The Severance Compensation does not constitute "compensation earnable" and must be excluded as "final settlement pay." Thus, CalPERS staff urges the Board to reject the Proposed Decision, in part, and instead find that Respondent Alvarez severed his employment relationship with Respondent Watermaster as of November 9, 2011 and find that the Severance Compensation was not reportable for retirement purposes.

December 21, 2016



PREET KAUR
Senior Staff Attorney