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April 19, 2013

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**VIA CERTIFIED MAIL  
RETURN RECEIPT REQUESTED**

Ms. Karen DeFrank  
Division Chief  
Customer Account Services Division  
California Public Employees' Retirement System  
P.O. Box 942709  
Sacramento, California 94229-2709

**RE: Notice of Appeal to Board of Administration with Respect to Review of Compensation for  
Desi Alvarez Reported by Chino Basin Watermaster**

Dear Ms. DeFrank:

I am writing on behalf of my client, the Chino Basin Watermaster ("Watermaster"). Watermaster provides this written notice of appeal to the Board of Administration of the California Public Employees' Retirement System ("CalPERS"), pursuant to Section 555.1 of Title 2 of the California Code of Regulations ("CCR"). Regarding CalPERS's review of the compensation of Desi Alvarez, the former Chief Executive Officer ("CEO") of Watermaster ("Mr. Alvarez"), that was reported by Watermaster to CalPERS, Watermaster hereby appeals CalPERS' decision to not recognize the compensation reported to CalPERS by Watermaster for purposes of determining Mr. Alvarez's pension benefits, as provided in the letter dated February 20, 2013 from Tomi Jimenez, Manager, Compensation and Employer Review, Customer Account Services at CalPERS (the "Letter") (a copy of which is attached hereto as Exhibit A). This notice of appeal is provided without waiver of any other factual or legal arguments that Watermaster may hereafter discover or assert in response to the Letter.

The Letter does not indicate that the period of time during which Mr. Alvarez was employed by Watermaster will not be counted as credited service for purposes of determining Mr. Alvarez's pension benefit under CalPERS, and Watermaster assumes that there is no intention for CalPERS not to count that period as credited service; however, Watermaster specifically reserves its rights to appeal any such decision should CalPERS make such a finding.

**STATEMENT OF THE FACTS**

***Employment of Mr. Alvarez as CEO***

In February 2011, Kenneth Manning resigned as the CEO of Watermaster. Before Mr. Alvarez was hired, an interim CEO was identified while Watermaster searched for a permanent replacement for Mr. Manning. At the time, Mr. Alvarez was the Deputy City Manager Special Projects for the City of Downey. Based on his performance as the Deputy City Manager and after conducting normal due diligence and interviews, Watermaster offered Mr. Alvarez the CEO position. As with many executives, Mr. Alvarez was unwilling to

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leave his current position without some assurance that he would be compensated adequately for the risk of leaving his current employment to assume the permanent CEO position at Watermaster. Accordingly, Mr. Alvarez and Watermaster entered into a one-year employment agreement, effective May 3, 2011 (the "Employment Agreement"), under which Mr. Alvarez would receive his compensation for the remainder of the one-year period in the event that he was involuntarily terminated without cause. This provided Mr. Alvarez with a certain level of security, in the event that the job change did not work out by providing him the ability to meet his financial obligations while searching for another position.

#### ***Search for New CEO/General Manager***

Shortly after joining Watermaster, it became clear to Watermaster that Mr. Alvarez was not the right person for the CEO position at Watermaster, and he was placed on administrative leave on November 9, 2011. Mr. Alvarez remained on administrative leave through May 4, 2012, the expiration date of the Employment Agreement. Danielle D. Maurizio acted as interim CEO from November 9, 2011 through January 17, 2012. Ken Jeske then acted as interim CEO from January 17, 2012 through September 7, 2012.

During these interim periods, it was determined that the position formerly designated as the CEO would be designated as the General Manager. In very general terms, the change in the position title was made because the General Manager title was thought to be more indicative of the expectations of the position given the type of organization. The CEO and General Manager positions never existed concurrently. As the attached Exhibits B and C illustrate, the job duties of the CEO are virtually identical to the job duties of the General Manager, and once the position of General Manager was established, the CEO position ceased to exist.

The General Manager position was not permanently filled until September 4, 2012 (almost a year and a half after Mr. Alvarez was hired) when Peter Kavounas became the General Manager. During that year-and-a-half period, there had been three different people in the leadership position at Watermaster, and two of those people were acting on an interim basis. The lack of a permanency in the leadership position obviously created a great deal of uncertainty and was challenging for Watermaster. One of the main concerns at that time was finding a person to permanently fill the leadership position at Watermaster. Unfortunately, that was not the only significant event occurring at that time for Watermaster.

#### ***Events Occurring During the Search for a Permanent General Manager***

Watermaster is a consensus-based organization facilitating development and utilization of the Chino Groundwater Basin. Watermaster's mission and primary objective is to manage the Chino Groundwater Basin in the most beneficial manner and to equitably administer and enforce the provisions of the Chino Basin Watermaster Judgment. During the period when Watermaster was trying to find a permanent General Manager, Watermaster also was involved in implementing an amendment to the recharge master plan (the overall plan between certain cities, water districts, water companies, agricultural, commercial and other private concerns for maintaining the safe yield of the Chino Basin) concerning what facilities would be built over the next ten years and how the cost for those facilities would be shared. The implementation of an amendment to the recharge master plan was integral to the mission and purpose of Watermaster, and getting approval of such an amendment naturally involved numerous stakeholders, since Watermaster is a consensus-based organization, as well as many court dates. In addition, the parties to the Chino Basin Watermaster Judgment, which is administered by Watermaster, were involved in litigation, involving a contractual dispute, which reached the California Court of Appeal. After extensive negotiations in early 2012, the litigation was eventually resolved through a settlement finalized in April 2012. At the same time, following a long drought period in California, an abundance of water became available to recharge water reserves. Given this availability, Watermaster also was trying to make decisions, involving millions of dollars, about whether to purchase those water rights in advance for recharge purposes. These key events

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and decisions were being made at a time when Watermaster did not have a permanently-filled leadership position.

***Conclusion Set Forth in the Letter***

As described above, Mr. Alvarez received compensation from Watermaster for the period May 3, 2011 through May 4, 2012. During that period, Watermaster reported to CalPERS monthly compensation of \$19,000 for Mr. Alvarez, based on his annual salary of \$228,000.

According to the Letter, none of the compensation that was reported to CalPERS by Watermaster (\$19,000 per month for the period from May 2011 through May 2012) will be taken into account in determining Mr. Alvarez's pension benefit because the compensation is not pursuant to a publicly available pay schedule that complies with all of the criteria set forth in CCR §570.5 and because the position of CEO is not located on the salary matrix provided to CalPERS by Watermaster. Instead, the Letter states that Mr. Alvarez's pension benefit is to be calculated based on the amount of compensation that Mr. Alvarez received while working for the City of Downey because the position that he held while employed by the City of Downey, Deputy City Manager Special Project, is located on the salary matrix provided by the City of Downey to CalPERS.

Watermaster respectfully disagrees with the conclusion set forth in the Letter, and this appeal notice sets forth the reasons why Watermaster believes that Mr. Alvarez's payrate should be based on the compensation reported by Watermaster.

***Watermaster Believed that it Complied with the Requirements of Section 570.5(a)***

As set forth above, at the time Section 570.5 became effective, Watermaster was focused on implementing an amendment to the recharge master agreement, evaluating a multimillion dollar opportunity to purchase water rights, and attempting to evaluate Mr. Alvarez's performance as CEO. As stated in its correspondence with Nicole Horing, Manager, Compensation & Employer Review, with the Customer Account Services Division of CalPERS, Watermaster believed that it was in compliance with the requirements of Section 570.5 since all compensation information, including that of the CEO/General Manager, is available upon request through Watermaster's website. As stated to Ms. Horing, the compensation of Kenneth Manning, the CEO prior to Mr. Alvarez, previously had been disclosed, as requested, in 2010 to a journalist at *The Sun and Inland Valley Daily Bulletin*. We note that the \$228,000 base compensation paid to Mr. Alvarez is not significantly more than the \$216,972 base compensation that was paid in 2011 to Mr. Manning as the CEO just prior to his resignation.

***Mr. Alvarez's Employment was not a Salary "Spiking" Situation***

We are aware that CalPERS is concerned about circumstances in which an individual is hired at a high salary for a short period of time, without any intention of that individual remaining in the position on a permanent or long-term basis, in order to "spike" the individual's compensation, thereby causing the individual to receive a higher pension benefit from CalPERS. While Mr. Alvarez's situation might, at first blush, have appeared to be such a "spiking" situation, as the facts above establish, Watermaster fully intended for Mr. Alvarez to operate as the CEO on a long-term basis. The one-year Employment Agreement solely was to provide Mr. Alvarez protection in the event that he was involuntarily terminated by Watermaster during his first twelve months of employment. As with any high-level executive (or any other employee), Mr. Alvarez was concerned about giving up his current job, at which he had an established reputation and was successful, to take on a new, more challenging position at a different organization. All of us would want to make sure that we could pay our bills while we looked for a new job, and the one-year employment agreement provided Mr. Alvarez with that security as an incentive for him to give up his old job

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and become the CEO of Watermaster. Unfortunately for everyone, things did not work out as everyone had hoped. While we believe we understand the scrutiny being given to Mr. Alvarez's compensation, as opposed to the scrutiny given to other individuals who retired subsequently from Watermaster, the situation with Mr. Alvarez does not involve the spiking of his compensation.

#### **STATEMENT OF THE LAW**

Subsection (a) of Section 570.5 of Title 2 of the CCR ("Section 570.5") limits the amount of "compensation earnable" (for purposes of pension benefits under CalPERS) to the payrate listed on a pay schedule complying with the requirements of that section. In broad terms, that section requires the payrate schedule to be publicly disclosed. While Section 570.5 was adopted on April 13, 2011, Section 570.5 did not become effective until August 10, 2011.

If an employer fails to meet the requirements of subsection (a) of Section 570.5, the Board of Administration of CalPERS (the "Board") has broad authority to determine the amount that will be considered the payrate for purposes of determining compensation earnable. In making its determination, the Board may take "into consideration all information it deems relevant including, but not limited to, the following:

- (1) Documents approved by the employer's governing body in accordance with requirements of public meetings laws and maintained by the employer;
- (2) Last payrate listed on a pay schedule that conforms to the requirements of subdivision (a) with the same employer for the position at issue;
- (3) Last payrate for the member that is listed on a pay schedule that conforms with the requirements of subdivision (a) with the same employer for a different position;
- (4) Last payrate for the member in a position that was held by the member and that is listed on a pay schedule that conforms to the requirements of subdivision (a) of a former CalPERS employer."

(Cal. Code Regs., tit. 2, § 570.5(b).).

#### **ANALYSIS**

For the reasons set forth below, Watermaster respectfully disagrees with the conclusion set forth in the Letter that Mr. Alvarez's pension benefit should be based on the payrate applicable while he was employed by the City of Downey.

***The Facts Support a Finding by the Board that Mr. Alvarez's Payrate is his Annual Compensation of \$228,000***

Regardless of whether Watermaster failed to satisfy the requirements of subsection (a) of Section 570.5, the Board has discretionary authority under subsection (b) of Section 570.5 to determine Mr. Alvarez's payrate based on all of the information the Board deems relevant. Watermaster believes that the facts set forth above provide sufficient grounds for the Board to determine, in accordance with the discretionary authority granted to it under subsection (b) of Section 570.5, that the payrate for determining Mr. Alvarez's pension benefit is his annual compensation of \$228,000 while he was employed by Watermaster. As set forth above, the facts demonstrate that the disclosure regulation was a new requirement that had only

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recently become effective, there is not a "spiking" issue, and Watermaster believed that it complied with the disclosure requirements of Section 570.5.

***Section 570.5 Cannot be Applied Retroactively***

If the Board concludes that Mr. Alvarez's pension benefit should not be based on his annual compensation of \$228,000, Watermaster contends that Mr. Alvarez's pension benefit should be based on the \$19,000-per-month compensation that was reported to CalPERS by Watermaster for the period of May 2011 through August 2011. The Letter states that "CalPERS has determined that the Agency [Watermaster] reported a payrate for Mr. Alvarez that is not pursuant to a publicly available pay schedule that complies with all of the criteria set forth in CCR §570.5" See page 3 of the Letter. The analysis in the Letter fails to take into account the effective date of Section 570.5. Section 570.5 did not become effective until August 10, 2011 and cannot be applied retroactively. Accordingly, Section 570.5 cannot be applied to the compensation that was reported to CalPERS by Watermaster prior to the effective date of the regulation. (See *McKeon v. Hastings College* (1988) 185 Cal.App.3d 877, 887.) Therefore, the payrate for the period of May 2011 through August 2011 should be the \$19,000 per month that was reported to CalPERS by Watermaster.

***CEO Position Redesignated as General Manager Position; Pension Benefit Should be Based on Highest Payrate for the General Manager Position on the 2012/2013 Salary Matrix***

The Letter also states that Watermaster provided CalPERS with a copy of the Employment Agreement which references Mr. Alvarez's position as CEO and that the CEO position is not listed on the Chino Basin Watermaster Salary Matrix 2012/2013 (a copy of which is attached as Exhibit D) that was also provided to CalPERS. As discussed above, the leader position title changed from CEO to General Manager, which is why the salary matrix provided does not list the position of CEO.

While Watermaster concedes that the salary matrix does not contain any position providing for a salary of \$228,000, if the Board concludes that Mr. Alvarez's pension benefit should not be based on his annual compensation of \$228,000, Watermaster contends that, with respect to the period after the effective date of Section 570.5 and through May 2012 when Mr. Alvarez's employment terminated, Mr. Alvarez's pension benefit should be based on the maximum monthly payrate on the salary matrix for the General Manager position, \$18,191 per month. Use of this pay rate is consistent with the illustrative list of information in subsection (b) of Section 570.5 that the Board is permitted to take into account in determining a payrate and is more relevant than looking back to the payrate applicable to Mr. Alvarez's prior employment.

**CONCLUSION**

For the reasons set forth above, Watermaster appeals the decision reached in the Letter and respectfully requests that the Board conclude that the applicable payrate is Mr. Alvarez's annual compensation of \$228,000 while employed by Watermaster. In the alternative, if the Board determines that, based on the relevant information provided to the Board, including the facts as set forth herein, the Board cannot find that the applicable payrate is Mr. Alvarez's annual compensation of \$228,000 while employed by Watermaster, Watermaster respectfully requests that the Board find that (i) the payrate be \$19,000 per month (based on Mr. Alvarez's annual compensation of \$228,000) for the period of May 2011 through August 2011 (the period prior to the effective date of the Section 570.5) and (ii) the payrate be \$18,191 per month for the period from September 2011 through May 2012 (when Mr. Alvarez's employment terminated) based on the maximum monthly payrate on the Watermaster salary matrix for the General Manager position.

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Once you have had a chance to review this letter, please let me know if you have any questions or if you need any additional information.

Sincerely,



Bradley J. Herrema

cc: John Michael Jensen, Esq.  
Peter Kavounas, Chino Basin Watermaster (without attachments)  
Joseph Joswiak, Chino Basin Watermaster (without attachments)

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