
SENATE COMMITTEE ON LABOR, PUBLIC EMPLOYMENT AND RETIREMENT

Senator Dave Cortese, Chair

2021 - 2022 Regular

Bill No:	AB 826	Hearing Date:	July 12, 2021
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Urgency:	No	Fiscal:	No
Consultant:	Glenn Miles		

SUBJECT: County Employees Retirement Law of 1937: compensation earnable

KEY ISSUE

Should the Legislature clarify the Public Employees' Pension Reform Act (PEPRA) as upheld by the California Supreme Court's *Alameda* decision¹ so that 37 Act County retirement systems can include specified compensation in legacy members' pension calculations?

ANALYSIS

Existing law:

- 1) Establishes the County Employees Retirement Law of 1937 Act (referred to as "37 Act" or "CERL") consisting of twenty county retirement systems to provide defined benefit pension benefits to public county or district employees, as specified. (Government Code § 31450 et seq.)
- 2) Provides that 37 Act retirement system members are entitled, upon retirement for service, to receive a retirement allowance consisting of their service retirement annuity, their current service pension, and their prior service pension, as specified. (GC § 31673)
- 3) Establishes benefit provisions for the general defined benefit plan that each member county can adopt by resolution. Existing law also provides specific plan elements by statute to particular systems, as specified. Thus, while 37 Act retirement systems have similar characteristics each has its own particular benefit structure and requirements. (e.g., GC § 31461.1)
- 4) Defines "compensation earnable" and "pensionable compensation" ², as specified, in the 37 Act, and as amended by PEPRA, which is the member's compensation that a pension system may include in calculating the member's pension benefit. Existing law also specifically excludes certain forms of compensation from pension benefit calculations in order to prevent manipulation of pension benefits in contravention of the theory and successful operation of a pension system. (GC § 31461 and GC § 7522.34)
- 5) Establishes PEPRA, a comprehensive reform of public pension law designed to stabilize public pension systems while preserving the objective of ensuring that public employees who

¹ *Alameda County Deputy Sheriff's Assn. v. Alameda County Employee Retirement Assn.*, S247095 (Cal. Jul. 30, 2020).

² Compensation earnable is the terminology used in the 37 Act and "pensionable compensation" is the terminology used in PEPRA.

dedicate a lifetime of service to California receive retirement security in their old age (GC § 7522 et seq.).

- 6) Excludes the following forms of compensation from compensation earnable:
- a) Any compensation determined by the board to have been paid to enhance a member's retirement benefit under that system, including:
 - (1) Compensation that had previously been provided in kind to the member by the employer or paid directly by the employer to a third party other than the retirement system for the benefit of the member, and which was converted to and received by the member in the form of a cash payment in the final average salary period.
 - (2) Any one-time or ad hoc payment made to a member, but not to all similarly situated members in the member's grade or class.
 - (3) Any payment that is made solely due to the termination of the member's employment, but is received by the member while employed, except those payments that do not exceed what is earned and payable in each 12-month period during the final average salary period regardless of when reported or paid.
 - b) Payments for unused vacation, annual leave, personal leave, sick leave, or compensatory time off, however denominated, whether paid in a lump sum or otherwise, in an amount that exceeds that which may be earned and payable in each 12-month period during the final average salary period, regardless of when reported or paid.
 - c) Payments for additional services rendered outside of normal working hours, whether paid in a lump sum or otherwise.
 - d) Payments made at the termination of employment, except those payments that do not exceed what is earned and payable in each 12-month period during the final average salary period, regardless of when reported or paid. (GC § 31461)

This bill:

1. Amends the definition of "compensation earnable" to include any form of remuneration, whether paid in cash or as in-kind benefits, if all of the following requirements are met:
 - a) The employer made the remuneration available to any person in the same grade or class of positions. "Grade or class of positions" means a number of employees considered together because they share similarities in job duties, work location, collective bargaining unit, or other logical, work-related grouping. The retirement system and employer shall not consider a single employee a grade or class of positions.
 - b) Existing law, as specified, does not *expressly* exclude the remuneration from compensation earnable.
 - c) With regard to remuneration paid between January 1, 2013, and July 30, 2020, the employer and system included the remuneration in compensation earnable, and the employer and employee paid contributions to the retirement system based on the remuneration.
 - d) The retirement system's board, on the bill's operative date, has not formally reversed a prior determination that a form of remuneration, to which this bill would otherwise apply, is compensation earnable.

2. States that the bill's change to compensation earnable is "declarative of existing law", thereby immunizing the inclusion of otherwise prohibited remuneration paid between July 1, 2013, and July 30, 2020, from the requirements of PEPRa and the *Alameda* Supreme Court decision.

COMMENTS

1. Background

PEPRA limited the types of compensation that public employers can include for purposes of calculating their employees' pension allowance. PEPRA, as upheld by the California Supreme Court in its 2020 *Alameda* decision, excluded certain items of pay - to legacy employees as well as PEPRA employees - as part of efforts to end pension spiking (i.e., the practice of padding compensation at the end of the employee's career to inflate the life-long pension benefit the employee would get upon retirement). PEPRA provided express examples of remuneration that are excluded per se and also examples of remuneration that a retirement board may exclude if it determined the compensation was paid to enhance a member's pension benefit.³

After PEPRA became law in 2013, some 37 Act members and employers believed that its provisions regarding the kinds of remuneration excludable from compensation earnable for *legacy* members were constitutionally infirm. They pursued litigation while their systems waited for the outcome of the litigation before unwinding the contested remuneration from their members' pension benefit calculations, believing that PEPRA's provisions affecting legacy members violated those systems' previous contracts and settlement agreements with those members. However, the Supreme Court in *Alameda* upheld PEPRA's provisions. The court found, in part, that the pension systems' past practices and settlement agreements did not prevent the Legislature from revising the law to achieve the permissible purpose of conforming pension benefits to the theory underlying the 37 Act plans by closing loopholes and proscribing potentially abusive practices. Thus, those 37 Act systems that continued to include affected compensation practices from their legacy members' pension calculations now face the daunting task of reversing and recovering from retirees up to 8 years of pension overpayments and refunding contributions that those retirees and active members have paid on the contested compensation.

2. Need for this bill?

According to the author,

AB 826 will ensure specified public employees hired prior to January 1, 2013 do not have their pensions unfairly reduced by clarifying the definition of "compensation earnable", consistent with PEPRA and standing legal precedent.

³ Per se exclusions include, for example, payments for excess unused leave, payments for additional services outside normal work hours, and termination payments made at time of termination. Examples of potential exclusions for compensation to enhance pension benefits include conversions of third party cash or in-kind payments to direct cash payments to the member during the final compensation period, one-time or ad hoc payments made to individuals, and excess termination payments made prior to termination and during the final compensation period. (GC §31461)

The author and the sponsors inform the committee that they need this bill to clarify that certain compensation practices by Ventura County as applied to their legacy employees do qualify as compensation earnable despite PEPRA and *Alameda*.

The author names one particular form of remuneration (a Flexible Benefit Account in which employees are paid an amount which then they must use to purchase health care policies). However, the bill provides authorization to include *any form of cash or in-kind remuneration* in compensation earnable provided the employer paid it to groups of similarly situated employees, PEPRA did not expressly exclude it, the respective retirement board did not previously reject it as compensation earnable, and that the employer and member made conforming pension contributions on the compensation.

Committee Concerns

1. *Creates Inequitable Treatment Among 37 Act Systems that the Legislature Will Probably Have to Address Eventually*

A 37 Act pension board that has already formally reversed a prior determination that a form of remuneration is compensation earnable will not be able to avail themselves of this bill's provisions as currently drafted. This bill must be particularly galling to those 37 Act systems that actually complied with the Legislature's mandate in PEPRA from its implementation date or that promptly initiated the required pension and contribution adjustments immediately after *Alameda*. They may well face lawsuits by their membership to challenge their exclusion or may seek equitable treatment in this or subsequent legislation.

However, if the bill is amended to include them to grandfather the specified compensation for their legacy members, they face inevitable inequities and administrative complexities at the prospect of having to quickly decide whether to reverse their previous resolutions, recalculate their retirees' and members' respective pension benefits and pension contributions, and recalculate their actuarial assumptions regarding their unfunded liability. Some may well prefer to avoid that outcome but the pressures from their members and retirees are likely to be intense to obtain the same benefit. These challenges, though administrative, are not trivial nor free of cost. In the spirit of equity, the Legislature should consider providing funding to those specific 37 Act systems who incurred costs in timely and faithfully complying with and adjusting to PEPRA only to re-incur costs to reverse all that work should this bill eventually apply to them.

2. *Ambiguity in the Language Regarding Post –July 30, 2020, Compensation and Contributions*

The bill's current language regarding the criteria for remuneration that may be included in compensation earnable is ambiguous and could result in the inclusion of cash/in-kind compensation going forward beyond July 30, 2020, and possibly without requiring conforming employer and employee pension contributions.

The ambiguity stems from the phrase "With regard to..." in Section 31461(c) (1) (C) in the context of Section 31461 (c) (1)'s list of requirements that must be met to qualify for inclusion in compensation earnable.

(c) (1) Notwithstanding subdivision (b) and Section 31460, “compensation earnable” means any form of remuneration, whether paid in cash or as in-kind benefits, if *all of the following requirements* are met:

... (C) *With regard* to remuneration paid between January 1, 2013, and July 30, 2020, the remuneration was included in compensation earnable, and the employer and employee paid contributions to the retirement system based on the remuneration.

What about compensation paid after July 30, 2020? Is that included? If not, there is no need to say “with regard” and the reference should be clearer. If post- July 30, 2020 compensation is included, do the members and employers have to pay contributions on that compensation? The existing wording makes it seem like the link to contributions only applies to the 2013-2020 period.

Option 1: Grandfather 2013-2020 Cash / In-kind Compensation (Grandfather Ventura- type systems for 2013-2020)

To eliminate this ambiguity and clarify that the bill authorizes only compensation for the 2013-2020 period (when 37 Act systems presumably were confused about the state of the law) the committee recommends the following amendments:

(C) ~~With regard to remuneration~~ **The remuneration was** paid between January 1, 2013, and July 30, 2020, the remuneration was included in compensation earnable, and the employer and employee paid contributions to the retirement system based on the remuneration.

Option 2: Allow Permanent Cash/ In-Kind Compensation Inclusion but clarify that Post-July 30, 2020 Compensation Also Requires Employer and Employees to Pay Pension Contributions (Clarify that Ventura- type cash and in-kind benefits are permissible under PEPR/ Alameda as specified)

To clarify that Ventura-type systems may continue to permanently include Cash / In-Kind Compensation in compensation earnable for legacy employees but that employers and employees must pay pension contributions on that compensation the committee recommends the following:

(C) ~~With regard to remuneration~~ **The remuneration is** paid ~~between~~ **on or after** January 1, 2013, ~~and July 30, 2020~~, the remuneration ~~was~~ **is** included in compensation earnable, and the employer and employee paid contributions to the retirement system based on the remuneration.

2. Proponent Arguments

According to the sponsors,

The *Alameda* decision created confusion among county retirement systems governed by CERL about how to correctly apply the PEPRA definitions to long-standing compensation practices, including the Flexible Benefit Allowance in Ventura County. The *Alameda* decision did not specifically address compensation, like Ventura's Flexible Benefit Allowance, but some have argued that these payments could fall outside the allowed compensation under CERL. In Ventura's case, however, the County has included the Flexible Benefit Allowance in the pension calculation for legacy employees because employees receive the full cash value and it is a regular, set amount paid every pay period; it is not subject to pension spiking or any other manipulation.

AB 826 has been narrowly crafted to clarify the definition of compensation earnable under CERL to include any form of compensation, whether paid in cash or as in-kind benefits, so long as the compensation is made available to any person in the same grade or class of positions. In addition, both the employer and employee must have paid contributions to the retirement system between January 1, 2013 and July 30, 2020 and the board of retirement must not have taken a formal action to reverse a prior determination regarding such forms of compensation. Importantly, AB 826 does not impact any benefit specifically excluded by PEPRA.

3. Opponent Arguments:

None received.

4. Prior Legislation:

Chapter 296, Statutes of 2012 (AB 340, Furutani), created PEPRA whose key provisions included restrictions on the types of compensation that could be included in determining pension benefits.

SUPPORT

County of Ventura (Co-Sponsor)
Service Employees International Union, California (Co-Sponsor)
Orange County Employees Association

OPPOSITION

None on file.

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