

CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
BOARD OF RETIREMENT

**POLICY ON DETERMINING "COMPENSATION EARNABLE"
UNDER ASSEMBLY BILL 197
FOR PURPOSES OF CALCULATING RETIREMENT BENEFITS
FOR "LEGACY" (PRE-PEPRA) MEMBERS**

Adopted: 9/10/2014

I. INTRODUCTION

In 1997, the California Supreme Court held that "compensation earnable" used to determine a retiring member's retirement allowance ordinarily includes all cash payments received for services performed, with the exception of overtime pay. *Ventura Deputy Sheriffs' Assn. v. Board of Retirement*, 16 Cal.4th 483 (1997). In 2012, the California Legislature enacted and the Governor signed into law Assembly Bill 197, which changed the way the Board of Retirement must calculate "compensation earnable". The effective date of AB 197 was January 1, 2013, but that date was postponed until July 12, 2014 by an order of the Contra Costa County Superior Court.¹ AB 197 applies to the calculation of benefits for all active or deferred employees who first became CCCERA members before January 1, 2013 ("Legacy Members.") AB 197 does not apply to "New Members," generally those who became members of CCCERA for the first time on or after January 1, 2013. The retirement allowances of "New Members" will be calculated under the provisions of the California Public Employees' Pension Reform Act of 2013 ("PEPRA.")

On May 12, 2014, the Contra Costa County Superior Court issued a final Judgment and Writ interpreting AB 197 and concluding that it was consistent with prior law. The Court's Statement of Decision supporting the Judgment concluded that several of CCCERA's prior practices were not consistent with applicable law — primarily with reference to the inclusion of leave sell-backs and cash-outs for time not both earned and payable annually during the one- or three-year final average salary ("FAS") period. Although the litigation is now on appeal, the Judgment and Writ have not been stayed, and CCCERA is legally bound to apply them to all retirements occurring on or after July 12, 2014.

AB 197 and the Judgment and Writ changed the way CCCERA is obligated to calculate Legacy Members' retirement allowances, primarily by requiring CCCERA to exclude certain elements of compensation that previously were treated as "compensation earnable" if earned or received during the FAS period. AB 197 provides that these exclusions from "compensation earnable" are intended to be consistent with and not in conflict with the holdings in *Salus v. San Diego County Employees Retirement Association*, 117 Cal.App.4th 734 (2004) and *In re Retirement Cases*, 110 Cal.App.4th 426 (2003). (Gov. Code § 31461(c).) These two appellate court decisions held as follows: (1) Compensation that may only be received at termination and never

¹ *Contra Costa County Deputy Sheriffs Association, et al., v. CCCERA, et al.*, Contra Costa County Superior Court, Case No. N12-1870.

during service must be excluded from "compensation earnable"; and (2) Amounts received at the end of a career that "distort" the notion of "average annual compensation" must also be excluded. The Legislature intended that the Board's implementation of AB 197 be guided by these two principles, and the CCCERA Board intends to follow these principles in implementing the requirements of AB 197.

II. PURPOSE

The purpose of this Policy is to set forth what elements of pay constitute "compensation earnable" for Legacy Members under AB 197 and the Superior Court's Final Judgment and Writ.

III. POLICY

This Policy identifies what elements of compensation are now considered "compensation earnable" during the FAS period and sets forth the policies and practices CCCERA intends to follow in implementing the new law. A list of general pay items that are included in, and excluded from, "compensation earnable" by CCCERA effective on and after July 12, 2014 is attached hereto as Attachment A.

Where an item of remuneration is not excluded categorically from "compensation earnable," CCCERA's participating employers will need to collect and pay both employer and employee contributions on such amounts, if and when paid during service.

A. "Compensation Earnable" Is the Average Annual Compensation For the Period Under Consideration.

Applicable Law: *"Compensation earnable" by a member means the average compensation as determined by the board, for the period under consideration upon the basis of the average number of days ordinarily worked by persons in the same grade or class of positions during the period, and at the same rate of pay. The computation for any absence shall be based on the compensation of the position held by the member at the beginning of the absence. Compensation, as defined in Section 31460, that has been deferred shall be deemed "compensation earnable" when earned, rather than when paid. (Gov. Code Section 31461(a).)*

CCCERA Policies and Practices. This provision remains unchanged under AB 197. The section primarily defines what constitutes an ordinary work week, excluding compensation received for non-mandatory "overtime." Consistent with the Supreme Court decision in *Ventura Deputy Sheriffs' Assn. v. Board of Retirement*, 16 Cal.4th 483 (1997), "compensation earnable" ordinarily includes all cash payments received for services performed during normal working hours, and usually does not have to be earned or received by everybody else in the same grade or class. Thus, "compensation earnable" ordinarily includes regular salary, service and skill based differentials (e.g. POST, CPA, bilingual pay), holiday pay, allowances (uniform, automobile). "Compensation earnable" excludes overtime pay.

B. "Compensation Earnable" Excludes Payments For Unused Leave To The Extent They Exceed What Was Both Earned and Could Have Been Sold Back For Cash During Service During The FAS Period

Applicable Law: *"Compensation earnable" does not include, in any case, the following: 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. (G.C. § 31461(b)(2).)*

CCCERA Policies and Practices. Every CCCERA employer has policies and memoranda of understanding governing its employees' ability to earn vacation, sick, compensatory and other leave time, and to receive the value of some or all of those accruals in cash in lieu of time off, but not all such cash payment for unused leave can be included as "compensation earnable". Cash payment for unused leave will be included only to the extent it does not exceed that which may be earned and payable in each 12-month period during the final average salary period.

The CCCERA Board has determined that if a Legacy Member has an employment agreement that allows an annual "sell back" of a certain number of leave hours (*e.g.*, every calendar or fiscal year), then the payment to be included in the FAS period will be limited to that same number of hours per year, regardless of whether the member actually cashed out more during the selected one- or three-year FAS period. Thus, if a member earns 240 hours of vacation leave in a calendar year and is allowed to sell back 80 hours of unused leave each calendar year, the amount that can be counted as "earned and payable" during the FAS period will be 80 hours, even if the member chose a FAS period that "straddles" two calendar years and sells back 80 hours twice during that period. This avoids the distortion that could arise between comparable members solely due to the selection of the twelve (or thirty-six) month FAS period, and yields a true "average annual" compensation earnable.

In general, it does not matter whether the member actually received the cash in lieu of time while still employed or at termination. If it was both earned and payable during the FAS period and does not exceed the employment agreement annual sell back limits, it will be "compensation earnable," regardless of when actually paid.

CCCERA will not need to trace the origin of each hour of leave earned, accrued and/or sold during a member's career. CCCERA will look to the applicable employment agreement to determine how much a member may earn and receive in cash in each time period (*e.g.*, each calendar year or fiscal year) during the FAS period to determine how much is to be included in "compensation earnable."

(i) **Exception: "Estoppel Class" Members Are Entitled to Include Additional Leave Cash Out Amounts Beyond What AB 197 Allows.**

Applicable Law. The Judgment and Writ recognize that some Legacy Members of CCCERA may be entitled to include additional leave cash-out amounts in their "compensation earnable" beyond the amounts allowed by AB 197. The requirements are:

- Before Dec. 31, 2012, the member's employer allowed, during employment, a cash out of unused leave time in amounts in excess of the amount of leave time earned in the selected FAS period.
- On Dec. 31, 2012, the member had accrued ("banked") such excess leave time.
- At retirement, the member still has some or all of that banked leave time at commencement of his or her FAS period.
- The member cashes out some or all of that bank during service in the FAS period (not upon termination).

If all the foregoing requirements are met, CCCERA also will include in the Legacy Member's "compensation earnable" for the FAS period the lesser of (a) the accrued bank or (b) the amount of the bank actually cashed out during the FAS period.

The CCCERA Board has determined that the bank can be preserved entirely if the member never uses or sells back more than what the member earns and can sell after December 31, 2012. For example, assume that the member had a bank of 320 hours on December 31, 2012, and prior to the beginning of the final compensation period the member only uses or sells back hours that the member earned after December 31, 2012. If the employer allows the member to sell back 320 hours during the final compensation period, it will all count towards the retirement allowance.

C. **"Compensation Earnable" Excludes Termination Pay.**

Applicable Law: *"Compensation earnable" does not include, in any case, the following: 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.* (G.C. § 31461(b)(4).)

CCCERA Policies and Practices. AB 197 made clear, based on case law precedent, that payments that are not both earned and payable to the member during service, but only received because of termination of employment, may not be included in the calculation of the retirement allowance. For example, severance pay and termination pay are generally excluded from "compensation earnable." It is recognized, however, that some pay for unused leave that could have been received during service may not be received until termination, solely due to the member's choice not to take it during service. Taking the money in a "lump sum" at termination does not necessarily disqualify it from inclusion in "compensation earnable." So long as the total of leave cashouts received during the FAS period and at termination does not exceed the amount that was both earned and could have been paid in cash during the FAS period, it will be included in calculating the retirement allowance, subject to the annual "sell back" limitation described in

Section III.B. of this Policy. Amounts in excess of that amount will be excluded from "compensation earnable."

D. "Compensation Earnable" Excludes Payments For Additional Services Rendered Outside of Normal Working Hours.

Applicable Law: *"Compensation earnable" does not include, in any case, the following: Payments for additional services rendered outside of normal working hours, whether paid in a lump sum or otherwise.* (G.C. § 31461(b)(3).)

CCCERA Policies and Practices. Pay received for "overtime" is not included in "compensation earnable." To be included, the time for which compensation is received (1) must be the normal working hours set forth in the applicable employment agreement, (2) must be required by the employer to be worked by the employee (as distinguished from voluntarily worked), and (3) must be ordinarily worked by all others in the same grade or classification at the same rate of pay during the FAS period. Pay that will be reviewed under these conditions is often described as "standby" and "on-call." Employers must report to CCCERA as pensionable only that pay for work that is required of and ordinarily served by everyone in the same grade or classification, at the same rate of pay.

E. "Compensation Earnable" Excludes Compensation Determined By the Board To Have Been Paid To Enhance A Member's Retirement Benefits.

Applicable Law: *"Compensation earnable" does not include, in any case, the following: Any compensation determined by the board to have been paid to enhance a member's retirement benefit under that system. That compensation may include:*

(A) 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.

(B) 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.

(C) 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.

(G.C. § 31461(b)(1).)

CCCERA Policies and Practices. AB 197 gives the Board authority to review employer pay practices generally, and compensation received individually, to determine if any element of compensation being considered as "compensation earnable" during the FAS period was paid to "enhance" the member's retirement benefit. Examples would include converting from the use of an automobile for many years during service to the sudden receipt of an auto allowance in the year before retirement; converting from employer payments to third-party insurance providers

during a member's career to making direct cash payments to the member instead, and having the member separately purchase insurance coverage with the cash; a bonus received at the end of career solely for announcing one's retirement; retroactive grants of cashable leave time; pay received for voluntary after-hours "on-call" service substantially exceeding the member's practice during his or her career; "termination pay" that could not have been received during service; departmental transfers to higher paying positions in a member's final year after it is known the member is retiring; and similar examples of activities that appear to distort the "average annual" compensation earnable the member would have received had he or she not been nearing retirement.

Before the Board makes a determination under this provision, it will afford the member appropriate due process, including an opportunity to appear before the Board and present evidence to support the inclusion of the pay item in calculating the member's retirement allowance, as set forth in the Policy Regarding Assessment and Determination of Compensation Enhancements.

IV. IMPLEMENTATION BY CCCERA

The Retirement Chief Executive Officer, with assistance from legal counsel, is responsible for implementing the Board's determination related to "compensation earnable." The CEO is authorized to examine new pay codes and determine their pensionability as follows: If new pay codes are substantially similar to ones addressed in this Policy, the CEO is authorized to notify the employer of the pay item's pensionability without taking the item to the Board. If new pay codes are unusual or unique, the CEO will present the pay code to the Board for the Board's determination on pensionability. In all cases, the CEO will keep the Board informed regarding significant ongoing issues and challenges, as appropriate.

This Policy was adopted by the Board of Retirement on September 10, 2014 and supersedes the predecessor "Determining Which Pay Items are 'Compensation' for Retirement Purposes," as amended, and the Addendum thereto.

Attachment A

CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
BOARD OF RETIREMENT

**CHART OF GENERAL PAY ITEMS THAT ARE INCLUDED IN AND EXCLUDED
FROM "COMPENSATION EARNABLE" EFFECTIVE JULY 12, 2014 UNDER
ASSEMBLY BILL 197 AND THE SUPERIOR COURT'S JUDGMENT AND WRIT
FOR "LEGACY" (PRE-PEPRA) MEMBERS**

The following list applies to the calculation of benefits for all active or deferred employees who first became CCCERA members before January 1, 2013 ("Legacy Members.") New members after that date will have their retirement allowances calculated under the provisions of the California Public Employees' Pension Reform Act of 2013 ("PEPRA.")

"Compensation earnable" ordinarily includes:

- Regular base salary
- FLSA premium pay for regularly scheduled work assignment (fire and law enforcement)
- Longevity pay
- Cash payments for special skills and qualifications and unique services, such as:
 - bilingual pay
 - shift differential
 - special assignment differential
 - holiday pay
- Educational incentive pay (e.g. POST, CPA)
- In-service leave cash outs (earned and payable each year, regardless of when actually paid)
- Allowances (e.g. uniform, automobile)
- Standby or on-call pay (for work during normal working hours, required by the employer and not voluntary, and ordinarily worked by all others in the same grade or classification at the same rate of pay during the FAS period)

"Compensation earnable" ordinarily excludes:

- Overtime pay
- Expense reimbursements
- The monetary value of advantages received in kind, such as:
 - uniforms
 - employer payments to third-party insurers
 - lodging
 - transportation
 - the use of an automobile.
- Employer contributions to deferred compensation plans
- Lump sum at termination for accrued unused leave that could not be cashed out annually during service
- Severance pay