NOSSAMAN LLP

ATTORNEYS AT LAW

50 California Street
34th Floor
San Francisco, CA 94111
T 415.398.3600
F 415.398.2438

Ashley K. Dunning
D 415.438.7228
adunning@nossaman.com

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Leroy Smith, Esq.
County Counsel
County of Ventura
County Government Center
800 South Victoria Avenue, L/C #1830
Ventura, CA 93009
Leroy.smith@ventura.org

David P. Mastagni, Esq.
Mastagni & Holstedt
1912 I Street
Sacramento, CA 95811
dmastagni@mastagni.com

Juhyung Harold Lee, Esq.
Rothner, Segall & Greenstone
510 S. Marengo Avenue
Pasadena, CA 91101
hlee@rsglabor.com

Re: October 8, 2020 Meeting Regarding Legal Parameters for VCERA Implementation of *Alameda* Decision

Dear Counsel:

On behalf of the Ventura County Employees' Retirement Association and its Board of Retirement ("Board") (collectively, "VCERA"), this letter is to provide each of you with an explanation of the legal parameters that govern VCERA in implementing the California Supreme Court's recent decision, *Alameda County Deputy Sheriff's Assoc. et al., v. Alameda County Employees' Retirement Assn., et al.* (2020) 9 Cal.5th 1032 ("*Alameda*") in advance of our scheduled meeting with you and your respective clients on October 8, 2020.

In particular, this letter addresses the following six (6) issues identified in the objection letters ("Objections") VCERA received either from County Counsel on behalf of the County of Ventura ("County") and/or from counsel for the Ventura County Deputy Sheriff's Association ("VCDSA") and the Ventura County Professional Firefighters Association ("VCPFA") (collectively, "Unions"), regarding VCERA's proposed implementation of *Alameda*, as discussed during open session at the September 14, 2020 VCERA Board meeting. As set forth below, the first four "issues presented" address points in both the County and Union Objections, while the last two issues presented address points the Unions' Objections raised separately.

In addition, this letter provides a comprehensive list of action items to implement *Alameda* that VCERA staff expect to propose to the VCERA Board for consideration at its regular meeting on October 12, 2020.

The VCERA Board considers its course of action in light of its fiduciary obligations to the entire membership of the system. In these difficult circumstances, VCERA is working hard to implement solutions that comply with the *Alameda* Court's admonition that it may not "evade" the law, that are fair and compassionate to its members and beneficiaries, and that recognize the interests of the participating employers of VCERA. At the same time, the VCERA Board recognizes that its primary "task … is not to design the [ACERA] pension plan but to implement the design enacted by the Legislature through CERL." *Alameda*, pp. 1066-1067. We hope that upon careful review of the proposed actions set forth below, you and your respective clients will ultimately agree that this course of action is both prudent and lawful.

Issues Presented and Conclusions

Issue No. 1: Does *Alameda* require that the portion of a cafeteria plan allowance that a VCERA member ***may not receive in cash*** ("non-cash flexible benefit") be excluded from compensation earnable?

Response to Issue No. 1: Yes, for the reasons summarized below, *Alameda*'s interpretation of the applicable statutes requires that VCERA exclude any non-cash flexible benefit from the compensation earnable determination of any VCERA member who retires on or after July 30, 2020.

In *Alameda*, the Supreme Court held that county retirement boards have no discretion to include the "monetary value of in-kind benefits" in compensation earnable. Specifically, the Court stated:

> The term "compensation," as used in section 31461[1] . . . is an employee's "remuneration paid in cash" and expressly excludes the "monetary value" of benefits paid in kind. (§ 31460.) Nothing in those definitions hints either that they are intended merely to establish a minimum, rather than to serve as a comprehensive definition, or that they may be implemented at the discretion of local retirement boards. There is no indication, for example, that a local board has the discretion to include the monetary value of in-kind benefits, which are expressly excluded by section 31461.

Alameda, p. 1070 (emphasis added). Under *Alameda*, a non-cash flexible benefit cannot qualify as compensation earnable because it is not "remuneration paid in cash," and it is thus not "compensation" under section 31460, and therefore it cannot be "compensation earnable" under section 31461.

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[1] All statutory references are to the California Government Code unless otherwise stated.

In County Counsel's comments to the Board during open session at the September 14, 2020, meeting, counsel stated that the topic of whether, under CERL, insurance payments made by employers were "in-kind" benefits has "never been litigated." That statement is incorrect. In fact, in a case to which VCERA was a party represented by the Office of Ventura County Counsel (Retirement Cases Coordinated Proceeding JCCP No. 4049), the trial court (Judge Pollak, presiding) considered that very question. As the reviewing court of appeal stated with respect to Judge Pollak's decision, "the [trial] court first considered whether CERL mandates inclusion of certain employment benefits in the calculations of retirement benefits. Plan members requested that the following items be included: . . . *insurance-related payments made by the employer*." *In re Retirement Cases* (2003) 110 Cal.App.4th 426, 436-437 (emphasis added). Thus, when the appellate court reviewed the trial court's decision, it articulated one of the three questions it was to address as follows: "Should items of remuneration that do not involve cash payments to the employee prior to his or her retirement be included in pension calculations?" *Id.* at p. 438. The court in *In re Retirement Cases* then held:

> Here, the employee is receiving an insurance premium, not a cash payment. ***Thus, it is an in-kind benefit, which is not "compensation" under section 31460***. . . . The employee receives insurance coverage, not cash, and therefore it is not "compensation" under CERL.

Id. at pp. 478-479 (emphasis added). Notably, the appellate court in *In re Retirement Cases* also directly refuted County Counsel's arguments regarding the import of section 31461.1, stating with respect to that statute, "contrary to plan members' assertions, the Legislature expressed its intent that it *never* considered the inclusion of flexible benefits to be mandatory under CERL." *Id.* at p. 480 (emphasis in original). Thus, the court held:

> We conclude that the Legislature has expressed its intent not to include employer payments into flexible benefits plans and payments of insurance carrier premiums as 'compensation' under CERL. . . . Accordingly, we conclude the trial court properly found that CERL did not require these payments to be included in the calculation of retirement benefits.

Id. at p. 481. *In re Retirement Cases* definitively establishes that employer payments toward flexible benefits plans, when those payments may not be received directly by the member in cash, are not "compensation" under section 31460.

Under *Alameda*, because those benefits are not "compensation," CERL retirement boards must not include them in compensation earnable. See *Alameda*, p. 1067 ("It is not within [a board's] authority to expand pension benefits beyond those afforded by the authorizing legislation.") (brackets in original, internal quotations omitted); see also, e.g., *Marin Assn. of Public Employees v. Marin County Employees' Retirement Assn.* (2016) 2 Cal.App.5th 674 ("*MAPE v. MarinCERA*") (court confirmed that flexible benefit plans constitute in-kind benefits and also upheld MarinCERA's exclusion of *conversions* of in-kind benefits in that case, which was newly permitted by PEPRA in section 31461(b)(1)(A)).

Issue No. 2: Does removing the non-cash flexible benefit violate vested contract rights of County employees who retire on or after *Alameda* was issued on July 30, 2020?

Response to Issue No. 2: No, the exclusion of benefits from compensation earnable that CERL does not include in compensation does not violated vested rights. VCERA members only have a vested right to statutorily authorized benefits. *Alameda*, p. 56, citing *International Assn. of Firefighters v. City of San Diego* (1983) 34 Cal.3d 292 (*Firefighters*). Specifically, the *Alameda* Court explained that in *Firefighters*:

> our court made explicit what was already implicit in the vested rights doctrine, namely, that the contract clause does not protect public employees against adverse changes in the manner in which a pension plan is implemented that are authorized by the existing terms of the plan, rather than as a result of legislative changes to those terms. (*Id*. at pp. 301–302 [holding that an increase in employee contribution rates pursuant to the existing terms of a pension plan does not violate vested rights].)

Because non-cash flexible benefits are not statutorily permitted to be included in compensation earnable because they are not "compensation," and because *Alameda* expressly disapproved the statement in *Guelfi* footnote 6 that county retirement boards have the statutory authority to include pay items in compensation earnable that are not compensation, no VCERA member has a vested contractual right to maintain its inclusion. Further, because *Alameda* stated, "it is the law in effect at the time of retirement that is used to calculate the amount of an employee's pension benefit," the *Alameda* Exclusions are to be implemented as to all VCERA members who retire on or after the Supreme Court's statement of that legal conclusion on July 30, 2020.

Issue No. 3: Does the VCERA's Board's 1989 resolution (providing that cafeteria plan allowances would be compensation earnable) provide other legal or equitable reasons that require the Board to include non-cash flexible benefit in compensation earnable of members who retire on or after July 30, 2020?

Response to Issue No. 3: No, *Alameda* confirms that previous county retirement board resolutions do not provide the legal or equitable bases that permit such boards to refuse to follow applicable statutes and case law. In fact, the Supreme Court's central focus in *Alameda* was on plaintiffs' contention that CERL provisions could not be applied according to their terms because of either "(1) agreements in effect when PEPRA was enacted or (2) application of the doctrine of equitable estoppel." (*Alameda*, p. 1052.) The Court rejected those contentions as follows:

> We conclude that neither argument authorizes the county retirement boards to administer CERL in a manner inconsistent with the governing statutory provisions by including items of compensation in compensation earnable that section 31461, as amended, excludes.

Alameda, p. 26. Furthermore, the Court went to great lengths to explain the authority, and the limits thereof, of county retirement boards with respect to the inclusion of particular benefits in retirement allowance determinations. The Court stated:

> The task of a county retirement board is not to design the county's pension plan but to implement the design enacted by the Legislature through CERL. . . . The boards do not have the authority to 'evade the law' that otherwise applies to their system. [Citing *Westly v. Bd. of Admin.* (2003) 105 Cal.App.4th 1095, 1100.) 'The granting of retirement benefits is a legislative action within the exclusive jurisdiction of the [relevant legislative body]. . . . [¶] It is not within [a board's] authority to expand pension benefits beyond those afforded by the authorizing legislation. . . . The scope of the board's power as to benefits is limited to administering the benefits set by the [legislative body]." (*City of San Diego v. San Diego City Employees' Retirement System* (2010) 186 Cal.App.4th 69, 79–80; see similarly *City of San Diego v. Haas* (2012) 207 Cal.App.4th 472, 495.)

For these reasons, under the Supreme Court's explicit conclusions in *Alameda*, the VCERA's Board's 1989 resolution providing that cafeteria plan allowances would be compensation earnable does not provide legal or equitable reasons that require, or authorize, the VCERA Board to include non-cash flexible benefit in compensation earnable of members who retire on or after July 30, 2020.

Issue No. 4: What contributions should be returned to VCERA members who retire on and after July 30, 2020 and do not have the non-cash flexible benefit included in the calculation of their compensation earnable?

Response to Issue No. 4: While the return of contributions question was not answered by *Alameda*, general principles of law and equity support returning all applicable member contributions (plus interest at a rates to be determined by the Board) to those members who retire from VCERA on and after July 30, 2020, to the extent that such contributions were paid on a non-cash flexible benefit.

Notably, California Supreme Court guidance provided in *Hittle v. Santa Barbara County Employees' Retirement System* (1985) 39 Cal.3d 374 ("*Hittle*"), as well as the discretionary authority of the VCERA Board, support making this correction in a manner which assumes, for purposes of the refund and for purposes of collecting future contributions, that the VCERA member will maximize his or her benefit that, under the participating employer's applicable rules at the time, may be received in cash. *Id.* [retirement system was required to permit a member to redeposit withdrawn contributions in order to be able to apply for disability retirement where retirement administrator was on notice of member's potential eligibility for disability retirement and did not inform member of waiver of rights upon withdrawal of contributions]. Point 8 of "Staff Recommended VCERA Board Actions" below provides language on this topic.

Note further that this application of *Hittle* to deem payments that ***may be*** *received by a member in cash*, rather than limiting them to those that ***are*** *received by a member in cash*, is consistent with section 31461 itself. Section 31461 includes such amounts in two specific contexts: (1) a leave of absence without pay, as to which compensation earnable is based on the "compensation of the position held by the member at the beginning of the absence," and (2) in the context of leave cash outs, as to which the "payable" rather than "paid" amount is included. In

both of these instances, a member may not actually *receive* the compensation *during* the final compensation period, but it is a cash benefit that the member *may* receive in the normal course under applicable labor agreements and other rules. Point 7 of Staff Recommended VCERA Board Actions below provides language on this topic.

Finally, if permitted by the member's participating employer and applicable tax law, a rollover of those contributions would be allowed should VCERA members so elect.

Issue No. 5: Is VCERA permitted to include mandatory on-call or standby pay that is not paid for services a VCERA member renders within "normal working hours" of members in the same grade or class as the member?

Response to Issue No. 5: No. Section 31461(b)(3) prohibits the inclusion in compensation earnable for those who retire on and after January 1, 2013, of any "pay for additional services rendered outside of normal working hours, whether paid in a lump sum or otherwise." Furthermore, the statutory framework for "compensation earnable" set forth in section 31461 looks to the days "ordinarily worked by persons in the same grade or class of positions during the period, and at the same rate of pay." Thus, "normal working hours" is to be determined by reference to the normal working hours of "members in the same grade or class of positions during the period, at the same rate of pay."

The *Alameda* Court determined that this mandatory exclusion from compensation earnable was a change in law. *Alameda*, p. 59 ("We conclude that the amendment of section 31461 to add subdivision (b)(1) through (3) constituted a change in the law because those provisions narrowed the expansive interpretation of compensation earnable adopted in *Ventura County*.") The Court also noted with respect to subdivision (b)(3):

> An often-cited example of such compensation is on-call duty pay, which is provided to employees in return for voluntarily making themselves available to be called to work outside their normal working hours. Because such pay is cash remuneration, it is "compensation" under section 31460. Yet because compensation earnable excludes overtime pay and is calculated on the basis of the days "ordinarily" worked by an employee's peers (§ 31461, subd. (a)), the inclusion of payment for services provided outside normal hours in compensation earnable is arguably inconsistent with the statutory concept.

Alameda, pp. 18-19. The Court held that section 31461, subdivision (b)(3) is constitutional and concluded that "the PEPRA amendment was enacted to maintain the integrity of the pension system and 'bear[s] some material relation to the theory of a pension system and its successful operation." *Alameda*, p. 76. While the Supreme Court focused its discussion of the restriction of employees who volunteer "during their final compensation period, to perform additional services outside normal working hours in order to artificially inflate their daily rate of pay," the Court also concluded that "subdivision (b)(3) therefore reinforces the portion of section 31461 that requires compensation earnable to be based on the same work year for all employees within a particular pay grade." (*Alameda*, p. 80.) As a result of its conclusion the PEPRA Exclusions are

constitutional as written and must be applied by county retirement boards consistent with the statutory language and without regard to any legal or equitable defenses that plaintiffs asserted, the Supreme Court reversed the decision of the Court of Appeal and remanded the matter to that court, "with directions to remand the matter to the trial court to vacate the judgments entered in each of the consolidated proceedings and to conduct further proceedings consistent with this decision."

While those "further proceedings" have not yet occurred, Merced County Employees' Retirement Association ("MercedCERA") excluded all standby and on-call pay from retirement allowance calculations as "outside normal working hours," and the County did not reverse that application of the PEPRA Exclusions. In addition, on September 23, 2020, the Supreme Court issued an order dismissing the petition for review that it previously had granted in *MAPE v. MarinCERA*, thus upholding that decision's ruling that MarinCERA was legally authorized to exclude all standby and on-call pay from retirement allowance calculations as outside normal working hours. The First District Court of Appeal subsequently issued a "remittitur" in the case awarding MarinCERA its costs. Thus, *MAPE v. MarinCERA* remains published, on-point, legal authority for the exclusion of all pay codes that reflect payments for services rendered outside normal working hours from compensation earnable.

We therefore conclude that section 31461(b)(3) requires the exclusion of all standby and on-call type of payments that are for services rendered outside the normal working hours of a particular class or grade, regardless of whether those services are characterized by the member or employer as voluntary or mandatory.

Issue No. 6: May VCERA include annual leave cash-outs that exceed amounts that a VCERA member is able to earn and receive in cash during each 12 month period, such as may occur through cashouts that straddle a calendar year or through the inclusion in compensation earnable of an annual leave donation that a VCERA member may choose to make to another VCERA member?

Response to Issue No. 6: No. Section 31461(b)(2) prohibits the inclusion in compensation earnable payments for leave "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." This provision thus prohibits, as discussed in detail in *Alameda* itself, the inclusion of cash outs in excess of that statutory maximum that VCERA members have received by "straddling" their leave redemptions. In addition, annual leave donations that a VCERA member may make to *others* do not constitute "compensation" the member receives directly from his or her employer each year that may be added to their compensation earnable. Such donations may not be received in cash by the member and, therefore, are akin to an "in-kind" benefit.

Next Steps

VCERA will take actions to implement *Alameda* that address both benefit payments and contribution collection applicable to PEPRA Exclusions and *Alameda* Exclusions. These actions will identify (i) to whom the action applies, (ii) as to what period of payments it applies; and (iii) the pay items to which it applies. Following is an 11-point list of staff's recommended high-level

directions for the Board to provide VCERA staff on these topics. Notably, as the *Alameda* Court made clear, both VCERA staff and its Board are required to follow the law, regardless of the manner in which VCERA sets forth its administrative actions from a procedural standpoint.

Staff Recommended VCERA Board Actions

(1) Comply with *Alameda*'s directives regarding mandatorily excluded pay items that are PEPRA Exclusions, and apply that directive to all retiree payroll for individuals who are legacy or PEPRA members who retired on or after January 1, 2013 (including those who will retire on or after the date of this Resolution), effective with the first retiree payroll occurring after *Alameda* becomes final, that is, the VCERA retiree payroll on August 31, 2020.

(2) Comply with *Alameda*'s directives regarding the Board's lack of authority to include the *Alameda* Exclusions in compensation and compensation earnable. To the extent, in contravention of *Alameda,* VCERA currently includes any benefits that members may not receive in cash and therefore that are not "compensation" under Government Code section 31460 (e.g., all portions of Flex Credit that *may not be provided to members in cash* under a participating employer's rules applicable during the pertinent time period) ("in-kind benefits" as described in *In re Retirement Cases* (2003) 110 Cal.App.4th 426), apply that directive to all retiree payroll for individuals who retire on or after July 30, 2020, when the Supreme Court overturned footnote 6 of *Guelfi v. Marin County Employees' Retirement Assn.* (1983) 145 Cal.App.3d 297 ("*Guelfi* footnote 6") and VCERA was thus on notice of that change in judicial law (including those who will retire on or after the date of the Board's Resolution).

(3) With respect to overpayments that occurred prior to the August 31, 2020 payroll, do not recoup those amounts related to PEPRA Exclusions from retirees unless directed to do so by the Internal Revenue Service and/or a final, non-appealable, order of a court of competent jurisdiction (any overpayments made on and after the August 31, 2020 payroll would be recouped).

(4) Make a corrective distribution (which may include interest) on the overpaid contributions reported on PEPRA Exclusions to retirees: (i) if such retirees were in active member service anytime on or after January 1, 2013; and (ii) to the extent that the member's contributions exceed any retirement benefit payments that were based on the PEPRA Exclusions. In the event no contributions associated with the PEPRA Exclusions remain for a retiree, no corrective distribution of contributions shall be made.

(5) Make a corrective distribution (which may include interest) to active and deferred members of member contributions that they made on pay codes for the *Alameda* Exclusions prior to July 30, 2020, provided such members did not retire by that date and therefore will not have the *Alameda* Exclusions included in the calculation of their retirement allowances from VCERA.

(6) Regarding VCERA active and deferred members, also implement a corrective distribution (which may include interest) to such members for employee contributions reported and or associated with PEPRA Exclusions while in active service from January 1, 2013 through the date of implementation of the corrective distribution.

(7) For clarification with respect to all corrective distributions provided for in the Resolution regarding PEPRA Exclusions, to the extent a particular payment is permitted to be included in compensation earnable under section 31461 so long as the timing of the payment did not result in prohibited overpayments (e.g., "straddling" of years for leave cash outs), active member contributions will continue to be taken, and will not be refunded, on those leave cash outs because they properly contribute to the payment of the member's future VCERA retirement allowance's inclusion of leave cash outs 'in an amount that does not exceed that which may be earned and payable in each 12-month period during the final average compensation period, regardless of when reported or paid."

(8) For clarification with respect to corrective distributions provided for in the Resolution regarding Alameda Exclusions (e.g., return of contributions paid on Flex Credit and other in-kind benefits to members who retire on or after July 30, 2020), VCERA will assume for purposes of the refund, collection of future contributions, and determination of compensation earnable, that the VCERA member maximizes his or her benefit that may be received in cash directly by the member. See generally, *Hittle v. Santa Barbara County Employees' Retirement System* (1985) 39 Cal.3d 374.

(9) Any amounts that VCERA is unable to collect from VCERA's active, deferred, and retired members as a result of this corrective action shall be collected instead through participating employer payments on the unfunded actuarial liability in accordance with recommendations from VCERA's actuary.

(10) Present impacted pay codes as soon as practicable to the Board to ratify exclusions from compensation earnable and pensionable compensation in compliance with *Alameda*, and communicate to VCERA participating employers that member contributions are no longer to be taken on such pay codes; and

(11) Inform VCERA members of the foregoing actions through appropriate means.

VCERA Staff and Counsel, and an ad hoc committee of three VCERA Board members that the VCERA Board Chair appointed for purposes of participating in these discussions, look forward to hearing your thoughts on the above during our virtual meeting on October 8, 2020.

As noted, recommendations of both staff and the ad hoc committee will be made to the full Board during open session of the VCERA Board's regular meeting on October 12, 2020.

A few final comments are warranted here regarding the role of the VCERA Board as it implements PEPRA and *Alameda*, and as the County and Unions consider their respective next steps.

First, under section 31461(b), VCERA is not to include in compensation earnable "Any compensation determined by the board to have been paid to enhance a member's retirement benefit under that system." Accordingly, to the extent that the County and Unions take actions designed to increase pension benefits that are otherwise affected by implementation of *Alameda*, that action may not be taken in a manner that results in a new payment "to enhance a member's retirement benefit under that system." And consistent with this legislative directive, the VCERA Board will have a statutory obligation to exclude any such amounts from compensation earnable.

Second, while VCERA will of course consider the County's views on the topics discussed herein, under *Alameda* and other applicable law VCERA must implement the statutes that govern the retirement system, and the County may not give directives to VCERA that are contrary to those statutes. Therefore, the County's desires with respect to whether a particular benefit is pensionable or not is not the appropriate standard. Rather, the County must conform its reporting of compensation earnable to the applicable statutory standards, which of course the Legislature sets. (Section 31582, subd. (a).) Furthermore, as *Alameda* also makes clear, VCERA may not *grant* new statutory/vested benefits to its members, as a matter of law. The provision of compensation to VCERA's active members who are county employees of course remains within the domain of the County.

Third, as noted at the outset of this letter, the VCERA Board is mindful of its fiduciary responsibility to the overall best interest of its members and beneficiaries as well as of the limitations on its authority as an administrative agency that applies statutes that the Legislature has enacted. VCERA staff has now developed a plan to implement *Alameda* that is consistent with both the Board's fiduciary duties and the statutes under which VCERA operates. VCERA prefers to operate collaboratively with both the County and the Unions in terms of understanding the roles of each of us with respect to these topics, and we provide this letter in that spirit.

Sincerely,

Ashley K. Dunning

cc: VCERA Ad Hoc Committee re Potential Litigation over *Alameda* Implementation
Linda Webb, VCERA Retirement Administrator
Lori Nemiroff, VCERA General Counsel