MEMORANDUM TO THE OPERATIONS COMMITTEE

DATE:	June 2, 2021
TO:	Members of the Operations Committee
FROM:	Jeff Rieger, Chief Counsel
SUBJECT:	Interested Party Submissions On Action Item No. 1

On May 21, 2021, I distributed my memorandum for Action Item No. 1 ("Straddling" and Related Issues) to the parties in the *ACDSA v. ACERA* litigation and I told them that I would supplement the public packet with any materials they provided to me by Friday May 28, 2021. In response, I received:

- A letter from David Mastagni on behalf of ACDSA and ACMEA, attached as Exhibit 1.
- A letter from Anthony O'Brien with the Attorney General's Office, attached as Exhibit 2.

I look forward to a thoughtful discussion of the issues addressed in my memorandum and the two attached letters at the June 2, 2021 Operations Committee meeting.

Exhibit 1

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May 25, 2021

Sent Via Email & U.S. Mail

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c/o Jaime Godfrey, Chair
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Re: ***ACDSA & ACMEA Position on Pensionability of Leave Cash-Outs***

Dear Gentlepersons:

This letter is on behalf of the Alameda County Deputy Sheriffs' Association ("ACDSA"), and the Alameda County Management Employees' Association ("ACMEA") (collectively, "Associations"). Our clients believe that ACERA's current practice of including multiple vacation cash-outs within a 12-month period so long as the amount cashed out does not exceed the amount of vacation earned during that 12-month period is lawful and required under PEPRA. Thus, the Associations urge the Board not to change this practice, either retroactively or into the future.

Additionally, the Associations disagree with the State of California's characterization of this practice as "straddling." So-called "straddling" has become a term of art in the pension context, wherein employees spike their pensionable compensation in excess of the amounts earned and payable in a 12-month period by spreading cash-outs of unused leave accrued across multiple years. Here, employees accrue leave increments each pay period on a rolling basis and possess a contractual right to cash out a portion of these accruals each fiscal year. Under ACERA's current practice, only the cashed-out vacation time that was *accrued during the employee's final compensation period* is considered compensation earnable for the purposes of calculating their pension. Thus, because ACERA members may only include payments for unused leave time in compensation earnable to the amount "earned and payable", ACERA's current practice is lawful.

A. Background

In 2012, the Legislature passed Assembly Bills 340 and 197 (collectively, "PEPRA"), effective January 1, 2013. Among other changes to public retirement systems, PEPRA amended Government Code section 31461's definition of "compensation earnable". Section 31461(b)(2)

now provides that pensionable compensation does not include payments for unused vacation/sick 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." PEPRA did not define the phrase "earned and payable".

In July of 2020, the California Supreme Court decided *Alameda*, upholding the legality of PEPRA. In discussing Section 31461(b)(2), the Court stated that, "such leave time is *earned* in the year in which it is awarded." (*Alameda County Deputy Sheriff's Association v. Alameda County Employees' Retirement Association* (2020) 9 Cal.5th 1032, 1062 (*Alameda*) [emphasis added].) However, it becomes compensable when the cash-value is paid/ received. (*Ibid.*) Under many employer's practices, this need not be the same year in which the surrendered time was earned. Thus, the Court reasoned that:

> Leave time earned prior to the final compensation period is, necessarily, *awarded in return for work performed prior to that period*. The receipt of cash-out payments for such leave time during the final compensation period therefore has the effect of *shifting compensation for that earlier work into the final compensation period*, thereby artificially inflating the days of compensation received during the final compensation period…. Limiting the inclusion of such payments in the compensation earnable calculation to the amount "earned and payable" during the final compensation period, as required by section 31461, subdivision (b)(2), reduces the potential for distortion from this type of compensation.

(*Id.* at p. 1096 [emphasis added].)

Consequently, the Supreme Court rejected the interpretation adopted by the appellate court that section 31461(b)(2) permitted the inclusion of "an unlimited amount of cashed out leave time" in compensation earnable, finding instead that "earned and payable" refers "to the amount of leave time *that can be accrued* during the final compensation period." (*Id.* at fn. 31.)

In detailing the background of the case, the Court also repeated the argument made by intervenor the State of California:

> The State points to an additional function of section 31461, subdivision (b)(2) and (4). Prior to PEPRA's amendment, even in counties that limited the amount of leave time that could be cashed out in a calendar year, employees were able to double the amount of cashed out leave time received during a final compensation year by designating a final compensation year that straddles two calendar years, for example, July 1 through June 30. By cashing out leave time in the second half of the prior calendar year and the first half of the subsequent calendar year, a retiring employee could double the amount of cashed out leave time received in the final compensation year. By limiting the inclusion of cashed out leave time to that

> "earned and payable" in a "12-month period," subdivision (b)(2) and (4) prevent this practice.

(*Id.* at pp. 1062–1063.)

This paragraph reciting the State's argument is the only discussion of "straddling" in the Supreme Court's decision. The Court's restatement did not address straddled payments that do not exceed the amount of leave earned on rolling basis over the 12-month final compensation period, rather the description suggested a practice of including leave payments in excess of the amount earned in the final compensation period. Importantly, the Court did not discuss the factually distinct circumstances presented here, nor determine the general legality of straddling. Instead, the Court merely analyzed the broader constitutional and equitable estoppel questions surrounding PEPRA and remanded the case to the lower court to decide any outstanding issues in a matter consistent with the Supreme Court's ruling. Remand proceedings are ongoing, although issues relating to interpretation and application of PEPRA, such as the instant issue, are beyond the scope of that litigation.

B. ACERA's Current Practice is Lawful.

Under ACERA's current practice, members' cash-outs during their final compensation period cannot exceed the amount of vacation that they can earn in that period. Accordingly, they must be included as "compensation earnable" under section 31461. This is true even when multiple leave cash-outs are included in the final compensation period—so long as the total cashed out leave does not exceed that which could be earned and paid during the final compensation period, it must be considered pensionable.

By designating a final compensation period that "straddles" multiple fiscal years, a retiring employee could include multiple leave cash-outs in a 12-month final compensation period. This results directly from the fact that the final compensation period is not required to run concurrent with any fiscal year. For example, an ACERA member with a 12-month final compensation period[1] who retires January 1, 2022 could choose January 1, 2021 through December 31, 2021 as his or her final compensation period, and then execute two separate leave cash-outs on June 30, 2021 and December 31, 2021. Each cash-out would be permitted under the MOUs because they would occur in separate fiscal years. ACERA would then exclude these two cash-outs from "compensation earnable" only to the extent they exceeded the individual employee's annual vacation accrual rate.

The biweekly manner in which employees earn vacation on a rolling basis is dispositive as to the dispute over whether the leave payments are "earned" in the final compensation period. For

[1] The same analysis applies to an employee with a three-year final compensation period whose final compensation period encompasses four fiscal years.

example, ACDSA members who have been employed for 20 years earn 7.692 hours of vacation time each biweekly pay period, for a total of 200 hours in a 12-month period. These vacation increments are earned on a rolling basis. Per the MOU, employees can cash-out up to 120 hours each fiscal year. That employee would be able to make two cash-outs in their final year, and thus could cash-out 240 hours in their final compensation period. However, under ACERA's current practice, only 200 of those hours would be treated as pensionable compensation because that is the number of hours the employee could *earn* in that year.

The timing of the cash-outs in separate fiscal years does not make them any less "payable": employees are still able to be paid out unused vacation and other leaves, even when multiple cash-outs are exercised during a final compensation period that spans more than one fiscal year. This is the direct result of the employers' policies. The Associations' employers agreed to provide cash-outs at any time during the fiscal year—as CERL employers are permitted to do—even though this permits cash-outs to be exercised less than twelve months apart. Although they could have bargained for cash-outs to be separated by a year, or that cash-outs occur only on a specified date—e.g., July 1 of each year—they chose not to, making it possible to cash out leave multiple times during a final compensation period.

In fact, because of how employers have agreed to structure the cash-out benefit, the only situation in which multiple leave cash-outs would not be permitted is if the employee chose a final compensation period that corresponded exactly with the fiscal year, running from July 1st to June 30th. But the final compensation period is chosen by the employee, not ACERA. In other words, the right to multiple cash-outs during a 12-month period is the norm, rather than a deviation or distortion. Thus, given the commonplace nature of the benefit and the statutory language, there is no basis for changing ACERA's current practice regarding the pensionability of leave cash-outs.

1. The Plain Language of the Statute and the Legislative Intent Allow Multiple Cash-Outs as Permitted Under ACERA's Policy.

The plain language of section 31461(b)(2) allows for this type of "straddling". If a member earns 200 hours of leave per year of service and is able to sell back 200 hours of leave in that same year, the amount was "earned and payable" in that "12-month period" under the plain meaning of "earned and payable." The fact that the member cashed-out 120 hours in one fiscal year and 80 hours in another makes no difference under the plain meaning of a statute that refers to each "12-month period" in the final compensation period. The statue does not refer to how much is "payable" in a fiscal year.

Further, if the Legislature intended to eliminate straddling, they could have done so. However, there is no evidence of any such intent, nor did the Legislature revise section 31461 to make such a change. Fundamentally, section 31461 continues to permit the employer to set the terms of employee compensation, including the ability to cash out leave, either through collective bargaining or unilaterally where there is no union. Neither AB 340 nor AB 197 dictate how often

employees could be allowed to cash out leave or set a specific numerical limit on how much leave could be pensionable, beyond saying that the pensionable amount is limited to what could be accrued and paid out in the relevant 12-month final compensation period.

In section 31461(b)(4), the Legislature demonstrated its ability to address the timing of leave payments. Tellingly, section 31461 does not prohibit the inclusion of multiple leave cash outs within a 12-month period, nor does the section even reference fiscal or calendar years. "Earned and payable" relates only to the "12-month period during the final average salary period, regardless of when reported or paid." There are numerous ways an employer could provide leave cash-outs. For example, in Sacramento, deputies may receive biweekly cash payments of their vacation accruals earned over that biweekly period. Section 31461 does not dictate how the employer may award these cash-outs, other than limiting the pensionable portion to what may be earned and payable in the final compensation period. Put differently, by choosing not to circumscribe or narrow the cash-out benefit provided by employers, the Legislature plainly stayed its hand and did not act to prohibit "straddling" or other forms of leave cash-outs.

2. *Alameda* Did Not Prohibit ACERA's Practice of Including Multiple Vacation Cash-outs Which Do Not Exceed Accruals Earned and Payable in a 12-Month Period.

ACERA's practice is also consistent with the Court's reasoning in *Alameda.* ACERA's practice avoids the concerns raised by the Supreme Court of preventing the "distortion" of pensions that occurred "when leave time awarded in a prior year [was] cashed out during the final compensation period." (*Id.* at p. 1096.) ACERA members are never receiving pensionable compensation that is "awarded in return for work performed prior to [the final compensation] period." (*Id.* at p. 1062.) Rather, employees accrue leave increments each pay period on a rolling basis and possess a contractual right to cash out a portion of these accruals each fiscal year. Employees' compensation earnable only includes what is accrued and cashable during that period. Thus, the Court's concern of "shifting compensation for [] earlier work into the final compensation period" does not apply to ACERA's practice. (*Id.* at p. 1096.)

The State's reliance on the discussion of "straddling" in *Alameda* is misplaced and circular; the Court merely recited the State's argument in the "background" section of the opinion. The issue of straddling was not before the Court, and therefore was not decided or analyzed by the Court. In granting review, the Supreme Court described the issue before the court as "Did statutory amendments to the County Employees' Retirement Law (Gov. Code, § 31450 et seq.) made by the Public Employees' Pension Reform Act of 2013 (Gov. Code, § 7522 et seq.) reduce the scope of the pre-existing definition of pensionable compensation and thereby impair employees' vested rights protected by the contracts clauses of the state and federal Constitutions?"

Except to the extent necessary to determine the existence of an impairment, issues involving the interpretation and application of PEPRA were not raised in the complaint nor

addressed by the Court. Moreover, the permissibility of any particular straddling practice under section 31450 is an inherently fact intensive inquiry, which should be addressed in a separate proceeding, if at all. Even in restating the State's argument, the Court described a factually distinguishable "straddling" practice which permitted a "doubling" of the amount of cashed-out leave that an employee could receive in a year so as to spike their pensionable compensation in excess of the amounts earned in a 12-month period. ACERA's practice is entirely distinct from this classic idea of "straddling". Under ACERA's policy, leave is accrued each pay period and only that leave time which can be both 1) earned and 2) cashed-out in the final compensation period is included in compensation earnable. In short, nothing in *Alameda* regulates the number or timing of cash outs. "Analysis that is unnecessary to a decision's holding is dictum and lacks precedential force." (*Lockyer v. City and County of San Francisco* (2004) 33 Cal.4th 1055, 1085, fn. 17.) Thus, the dictum by the *Alameda* Court regarding a different "straddling" practice is irrelevant and inapposite.

C. The Board Has the Discretion to Continue the Current Practice.

The ACERA Board has board authority, consistent with the clear language of the CERL, to determine whether multiple vacation cash-outs within a 12-month period may be included in compensation earnable up to the maximum amount of leave earned in that 12-month period. The California Constitution vests the ACERA Board with "plenary authority" and "fiduciary responsibility" for the administration of ACERA. (Cal. Const., art. XVI, § 17.) In exercising these responsibilities, "[a]ny ambiguity or uncertainty in the meaning of pension legislation must be resolved in favor of the pensioner, but such construction must be consistent with the clear language and purpose of the statute." (*Ventura County Deputy Sheriffs' Assn. v. Board of Retirement* (1997) 16 Cal.4th 483, 490; *City of Oakland v. Oakland Police & Fire Retirement System* (2014) 224 Cal.App.4th 210, 226.)The stated purpose of CERL is "to recognize a public obligation to county and district employees who become incapacitated by age or long service" by providing them pension and disability benefits "as additional elements of compensation." (Gov. Code, § 31451; *Porter v. Bd. of Retirement* (2013) 222 Cal.App.4th 335, 349-350 [liberally construing pension legislation in favor of applicant, consistent with CERL's intent to provide pension and disability benefits].) A public retirement board's duty "to its participants and their beneficiaries shall take precedence over any other duty," including minimizing employer contributions and defraying administrative costs. (Cal. Const., art. XVI, § 17, subd. (b); *City of Oakland, supra*, at p. 226.)

While the *Alameda* decision made clear that retirement boards do not have open-ended discretion to grant benefits completely untethered to the provisions of CERL, the Board does have the discretion to make reasonable interpretations of ambiguous statutes contained in CERL. Thus, any ambiguity or uncertainty as to the permissibility of ACERA's straddling practice must be resolved in favor of the ACERA members. (*Ventura County Deputy Sheriffs' Assn. v. Board of Retirement* (1997) 16 Cal.4th 483, 490; *In re Retirement Cases* (2003) 110 Cal.App.4th 426, 439.)

ACERA's current practice is the proper interpretation bearing in minds these fiduciary duties while still remaining consistent with the plain meaning of the statute and the *Alameda* decision. For these reasons, the Associations urge ACERA to continue with their current practice of allowing multiple leave cash-outs.[2]

We look forward to continuing this discussion at the Operations Committee meeting on June 2nd. In the meantime, please contact me with any questions or concerns at davidm@mastagni.com or (916) 491-4298.

Sincerely,

MASTAGNI HOLSTEDT, APC

DAVID E. MASTAGNI
Attorney at Law

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[2] The Associations do not oppose the three (3) sub-recommendations outlined in "Summary of Recommendations" number two (2).

Exhibit 2

ROB BONTA
Attorney General

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May 28, 2021

Sent via e-mail (jrieger@acera.org) and U.S. Mail
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Chief Counsel
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RE: *Alameda County Deputy Sheriffs Assn., et al. v. Alameda County Employees' Retirement Assn., et al.*
Superior Court of California, County of Contra Costa, Case No. MSN12-1870

Dear Jeff:

Thank you for inviting our office to attend the Alameda County Employees' Retirement Association (ACERA) Operations Committee meeting on Wednesday June 2, 2021. Our office does not plan on attending the meeting. However, we request that you please circulate the attached letter—originally sent to you on March 18, 2021—to the Operations Committee members to underscore the State's position that ACERA's practice of straddling violates Assembly Bill No. 197 (2011-2012 Reg. Sess.), and that the Supreme Court recognized straddling is prohibited in *Alameda County Deputy Sheriff's Association v. Alameda County Employees' Retirement Association* (2020) 9 Cal.5th 1032, 1062-1063.

Thank you again for your professional courtesy in this matter. I look forward to hearing how the Operations Committee and ACERA Board proceed on this issue.

Sincerely,

Tony O'Brien

ANTHONY P. O'BRIEN
Deputy Attorney General

For ROB BONTA
Attorney General

cc: Harvey L. Leiderman, Reed Smith LLP
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March 18, 2021

Sent via e-mail (jrieger@acera.org) and U.S. Mail
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Chief Counsel
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RE: *Alameda County Deputy Sheriffs Assn., et al. v. Alameda County Employees' Retirement Assn., et al.*
Superior Court of California, County of Contra Costa, Case No. MSN12-1870

Dear Jeff:

This letter further responds to the question you raised regarding whether the Public Employees' Pension Reform Act of 2013 (PEPRA), as amended by Assembly Bill No. 197 (2011-2012 Reg. Sess.), allows for "straddling" an employee's final compensation period over two separate 12-month periods and then including cashouts of unused leave from both 12-month periods in an employee's final compensation. As we discussed last week, and as recognized by the Supreme Court in *Alameda County Deputy Sheriff's Association v. Alameda County Employees' Retirement Association* (2020) 9 Cal.5th 1032, AB 197 strictly prohibits such a practice.

In *Alameda County*, the Supreme Court noted that AB 197 "was designed to limit pension spiking, the manipulation of compensation to artificially increase a pension benefit." (*Alameda County*, *supra*, 9 Cal.5th at p. 1098.) The Court noted in particular that Government Code section 31461, subdivision (b), "is intended to prevent various forms of manipulation of the compensation earnable calculation," including "the alteration of the normal pattern of an employee's compensation for the purpose of increasing the compensation received during the final compensation period." (*Id.* at pp. 1097-98.) In analyzing the different provisions of section 31461, the Court left no doubt that section 31461, subdivision (b), does not permit straddling:

> The State points to an additional function of section 31461, subdivision (b)(2) and (4). Prior to PEPRA's amendment, even in counties that limited the amount of leave time that could be cashed out in a calendar year, employees were able to double the amount of cashed out leave time received during a final compensation year by designating a final compensation year that straddles two calendar years, for example, July 1 through June 30. By cashing out leave time in the second half

> of the prior calendar year and the first half of the subsequent calendar year, a retiring employee could double the amount of cashed out leave time received in the final compensation year. By limiting the inclusion of cashed out leave time to that "earned and payable" in a "12-month period," *subdivision (b)(2) and (4) prevent this practice.*

(*Id.* at pp. 1062-1063, italics added.)

In light of AB 197 and the Supreme Court's decision in *Alameda County*, most CERL retirement systems have interpreted PEPRA as prohibiting straddling, and have eliminated the practice in its entirety. Indeed, in the immediate aftermath of the *Alameda County* decision, at least four retirement systems adopted resolutions stopping the practice of permitting cashouts of leave in excess of what can be earned and cashed out for each 12-month period. Many CERL systems did not allow straddling even prior to PEPRA. We are not aware of any CERL system other than Alameda County that still permits inclusion of straddled leave payments in pensionable compensation. This abusive practice must finally end.

Please let me know how the ACERA Board decides to proceed in this matter.

Sincerely,

Tony O'Brien

ANTHONY P. O'BRIEN
Deputy Attorney General

For XAVIER BECERRA
Attorney General

APO:

cc: Harvey L. Leiderman, Reed Smith LLP
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