

LOS ANGELES COUNTY  
*ECONOMY AND EFFICIENCY COMMISSION*

Gunther W. Buerk, *Chairperson*  
Betty Trotter, *Vice Chairperson*

July 21, 1992

Honorable Deane Dana, Chair  
Los Angeles County Board of Supervisors  
500 West Temple Street  
Room 822, Hall of Administration  
Los Angeles, CA 90012

Alfred P. Balderrama  
George E. Bodle  
Ann King Cooper  
Joe Crail  
Jack Drown  
Emma E. Fischbeck  
Louise Frankel  
Dr. Alfred J. Freitag  
Chun Y. Lee  
Robert J. Lowe  
Abraham M. Lurie  
Lauro J. Neri  
Arthur J. Peever  
Robert H. Philibosian  
Daniel M. Shapiro  
Randolph B. Stockwell  
Wally Thor  
Robert L. Williams  
Efram Zimbalist, III

Dear Chairman Dana:

In response to the Board of Supervisor's action of April 28, 1992, requesting the Economy and Efficiency Commission "to obtain an opinion from independent legal counsel on the question of what constitutes compensation for retirement purposes, as well as the same issue within SB 193", the Economy and Efficiency Commission has received this opinion. The Pension Task Force of our Commission has reviewed the opinion to insure that the assignment as stated in the Board motion was completely addressed, but has not made any changes to this opinion or directed the independent counsel to make any changes in his opinion.

Following direction independent counsel, Mr. Frank Smith, has provided a professional and complete opinion on the legal aspects of the issue requested in the Board motion. As such the Task Force is forwarding this opinion to your Board for consideration.

It is important to note that neither the Pension Task Force nor the Economy and Efficiency Commission has have reached any conclusions or recommendations regarding any policy issues at this time and by transmitting this opinion the Commission is not indicating agreement or disagreement with any conclusions or implications of the independent counsel's opinion.

Sincerely,



Gunther W. Buerk  
Chair

c: Each Supervisor  
Each Commissioner

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Wally Thor  
Robert L. Williams  
Erem Zimbalist, III

July 20, 1992

Mr. Gunther W. Buerk, Chair  
Economy and Efficiency Commission  
500 West Temple Street  
Room 163, Hall of Administration  
Los Angeles, CA 90012

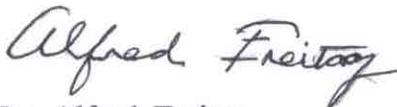
Dear Chairman Buerk:

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Following direction independent counsel, Mr. Frank Smith, has provided a professional and complete opinion on the legal aspects of the issue requested in the Board motion. As such the Task Force is forwarding this opinion to the full Commission for consideration to approve transfer to the Board of Supervisors.

It is important to note that the Task Force has not reached any conclusions or recommendations regarding any policy issues at this time and by transmitting this opinion the Task Force is not indicating agreement or disagreement with any conclusions or implications of the independent counsel's opinion.

Sincerely,



Dr. Alfred Freitag  
Pension Task Force Chair

c: All Commissioners

# MORGAN, LEWIS & BOCKIUS

PHILADELPHIA  
LOS ANGELES  
MIAMI  
LONDON  
FRANKFURT

COUNSELORS AT LAW  
801 SOUTH GRAND AVENUE  
TWENTY-SECOND FLOOR  
LOS ANGELES, CALIFORNIA 90017-4615  
TELEPHONE: (213) 612-2500  
FAX: (213) 612-2554

WASHINGTON  
NEW YORK  
HARRISBURG  
SAN DIEGO  
BRUSSELS  
TOKYO

FRANK H. SMITH, JR.  
DIAL DIRECT (213) 612-1016

July 15, 1992

Economy and Efficiency Commission  
163 Hall of Administration  
500 West Temple Street  
Los Angeles, California 90012

Re: Inclusion of Certain Items of Remuneration  
in Pensionable Compensation

Dear Commissioners:

The undersigned has been engaged as independent legal counsel to render an opinion regarding the treatment of certain items of Los Angeles County employees' remuneration for purposes of computing the employees' benefits under the retirement plan established pursuant to the County Employees Retirement Law of 1937. Specifically, this opinion will examine the legality of actions taken to date with respect to this issue and the degree of flexibility that the Board of Supervisors or Board of Retirement might have at this point to revoke or modify actions previously taken.

Whenever possible, an attempt has been made to reach as firm a legal conclusion as possible on the various aspects of this issue under existing precedents and authorities. However, an attempt has also been made to explore fully the basis for such conclusions and the support that might exist for contrary interpretations so as to provide maximum legal information for any future actions that might be contemplated with regard to these matters.

In conjunction with the preparation of this opinion, the County Counsel's opinion of June 10, 1992, rendered to the Board of Retirement has been carefully reviewed. While this opinion independently examines the various legal issues, because of the obvious importance of County Counsel's views, the opinion at times specifically comments on conclusions reached in the County Counsel's opinion. This is especially true where the conclusions reached in this opinion disagree with those reached by County Counsel. Furthermore, this opinion relies on

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certain factual matters as set forth in the County Counsel's opinion. Where the facts are of particular importance in reaching any legal conclusion, it will be so indicated by referencing the relevant page of such opinion.

### Issues

This matter involves the question of whether certain items of compensation received by employees of Los Angeles County are to be considered as pensionable compensation for purposes of computing the retirement and ancillary benefits of such employees under the plan established by the County pursuant to the County Employees Retirement Law of 1937. Specifically, the items of compensation are (1) certain transportation allowances, (2) benefits provided pursuant to elections made by employees under various flexible compensation plans, and (3) deferred compensation in the form of deferred salary and deferred merit increases. With respect to the deferred compensation, if such amounts are to be included as pensionable compensation, the additional issue arises as to whether they are to be so treated at the time of deferral or at the time of receipt. In addition, the question has arisen as to the ability of the Board of Supervisors or the Board of Retirement to now modify the existing treatment of such items of compensation under the plan.

In resolving these general questions, it will be necessary to explore a number of issues including: (1) the appropriateness of the interpretations of the statutory definitions of "compensation" and "compensation earnable" previously made by the Board of Retirement and/or others with respect to these items of compensation and the deference due to the decisions regarding such interpretations, (2) the effect of the enactment of Government Code Section 31460.1 and its repeal by SB 193 on the treatment of flexible benefits, (3) the effect of the failure to conduct a study of the actuarial impact of the treatment of the items of compensation pursuant to Section 7507 of the Government Code prior to the inclusion of such items in pensionable compensation, and (4) the extent to which current County employees are vested in certain rights as a result of actions already taken pertaining to the treatment of the specified items of compensation for retirement purposes.

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### Background

Transportation Allowances. Certain County elected officials and employees are entitled to specified transportation allowances. For some individuals, these transportation allowances are designated as a form of "security allowance." Except for a few individuals who are provided County automobiles, the transportation allowance is paid monthly as a form of cash remuneration. The amount received is not related to actual vehicle usage or actual vehicle expense and is intended to be reported as fully taxable income. For those individuals who are provided vehicles rather than allowances, neither the value of the use of the vehicle nor any other amount associated with the use of the vehicle is treated as pensionable compensation.

These transportation allowances have been included as pensionable compensation since early 1988. Although some individuals are entitled to certain security allowances that are designed to ensure personal safety, it has been indicated that no part of security allowances other than the transportation allowance is included in pensionable compensation.

Flexible Benefits. There are four County flexible benefit plans involved in this matter, all of which operate in substantially the same manner. The four plans are the Flexible Benefit Plan, Megaflex, Choices and Options.

The first of these, the Flexible Benefit Plan, was established effective January 1, 1985 for nonrepresented employees of the County. Upon its establishment, the County offered eligible participants additional remuneration of a specified amount that could either be received in cash or, at the participant's election, be used to pay for certain benefits such as health, dental, life, or disability insurance. The County contribution to the plan has been increased three times since its inception.

Effective January 1, 1991, the Board of Supervisors adopted the Megaflex plan as an alternative to the Flexible Benefit Plan. This plan added additional options to those contained in the Flexible Benefit Plan and could only be elected during certain window periods open to the employees. Since the dollar amount of the County

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contribution to Megaflex is greater than that which is made to the Flexible Benefit Plan, employees electing to join Megaflex were required to voluntarily give up a number of benefits to which they would otherwise have been entitled such as certain vacation and sick leave benefits and rights to County paid life insurance and other benefits. The County contribution to Megaflex has increased once since its inception.

In 1989, the County established Choices, a flexible benefit plan for employees represented by the Coalition of County Unions. Finally, generally effective July 1, 1992, the County established Options (also known as the Local 660 Cafeteria Plan) which is available to employees represented by SEIU Local 660. As with the other flexible benefit plans, the employees in these plans are given a choice between cash or other benefits to be purchased with the cash that would otherwise be available.

All four of the flexible benefit plans are designed to meet the requirements of Section 125 of the Internal Revenue Code. Generally speaking, for tax purposes, when an employee is given a choice between cash or nontaxable benefits, such employee is deemed in constructive receipt of the cash that could have been received even if he or she elects the nontaxable benefit. This result is based on the theory that the employee could have elected the taxable cash and hence he or she constructively received it. However, if a plan meets the requirements of Section 125 of the Internal Revenue Code (and hence also qualifies under Section 17131 of the California Revenue and Taxation Code), the constructive receipt of income doctrine is not applicable. Thus, for such plans, any election of benefits is treated as pre-tax for the employees even though such employees had the option of receiving cash in lieu of benefits.

Commencing in January of 1991, amounts representing both cash elected in lieu of benefits and amounts otherwise receivable but used to purchase benefits have been treated as pensionable compensation for retirement plan purposes.

As indicated at page 36 of the County Counsel's opinion, employees have been consistently told through employee briefing sessions, in election materials and otherwise that County contributions made to purchase

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benefits pursuant to the flexible benefit plans would be treated as pensionable compensation.

Deferred Compensation. Pursuant to agreements with the County, some County officers and department heads have elected to delay receipt of up to 10% of one year's salary to be repaid without interest at a time chosen by the individual participating in the arrangement. Repayment is required to be over a six month period that must begin at least one year, but not more than ten years, after the deferral was made. In addition, certain employees who had previously been scheduled for an average 6% merit raise effective September 1, 1991, were given the option by the County of receiving an average 3% merit salary increase effective as of such date or a 6% raise to be delayed to at least September 1, 1992. If delayed, the raise is to be paid out in six monthly installments at the discretion of the employee beginning at least one year, but no more than ten years, after September 1, 1991. According to the County Counsel's opinion (page 32), employees who are deferring income or merit raises are being taxed on the income in the year in which it was initially earned rather than the year in which it is to be paid. Both of these types of arrangements are referred to as "deferred compensation" in this opinion.

As indicated in the County Counsel's opinion at page 30, each of the agreements between the County and the officers and employees involved contains the following language:

"County warrants that all amounts deferred pursuant to this Agreement shall constitute compensation earnable within the meaning of Government Code Section 31461 at the time the funds are paid to Employee."

Board of Retirement. The record is unclear as to the procedures that were followed in making the determination of whether transportation allowances and flexible benefits should be treated as pensionable compensation and on what precise basis these decisions were made. In particular, the role of the Board of Retirement itself in making these determinations is unclear.

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With respect to the transportation allowances, the County Counsel's opinion (page 1) indicates that the Board began including such allowances in pensionable compensation in "early" 1988 based on advice from County Counsel's office. Such advice was contained in a legal opinion of July 11, 1988 to the then Retirement Administrator. While this legal opinion was on the agenda for a Board meeting on August 3, 1988, and is listed without elaboration as "other communications" in the minutes of that meeting, there is no record of Board consideration of this issue nor of any formal action taken by the Board to resolve this question.

With respect to flexible benefits, County Counsel's opinion (page 1) indicates that the Board began including such benefits in pensionable compensation in January of 1991, based on similar advice from County Counsel's office. Upon inquiry, it appears that such advice was oral. Although there are minutes of a Board of Retirement meeting held on January 2, 1991, that reflect some discussion on the inclusion of Megaflex benefits in pensionable compensation, no action was taken or resolution adopted by the Board finding it appropriate to do so for Megaflex or for flexible benefits provided under any other County flexible benefits plan. Also, there is no record of subsequent Board involvement in this issue other than possible implicit ratification of actions taken by its staff to include these amounts (and the transportation allowances) in pensionable compensation.

The treatment of the deferred compensation as pensionable compensation and as pensionable compensation when it is to be paid rather than when deferred was not made pursuant to any determination of the Board of Retirement. Rather, the County Counsel's opinion of June 10, 1992 is, in part, meant to be advice to the Board of Retirement as to County Counsel's interpretation of the appropriate treatment of such compensation for retirement plan purposes. Apparently, the insertion of the above quoted language in the agreements with the employees who will receive the deferred compensation was done as part of the process of drafting the contracts by County Counsel's office.

Actuarial Impact. No actuarial study was made at any time prior to the inclusion of the transportation

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allowances and flexible benefit contributions in pensionable compensation or prior to the execution of the deferred compensation contracts. Of these elements of compensation, only the inclusion of flexible benefits in pensionable compensation has greater than a de minimis impact. Subsequently, the Board of Investments has obtained an interim actuarial evaluation that determined the total increase in the unfunded liability of the retirement system resulting from the inclusion of flexible benefit contributions and transportation allowances in pensionable compensation. Such interim actuarial evaluation was delivered on April 20, 1992, and was prepared as of June 30, 1991. The interim report reflects an increase in the unfunded liability from \$1.41 billion in June, 1990, to \$1.80 billion in June, 1991. \$265,000,000 of this increase results from including the flexible benefits in pensionable compensation beginning in 1991. There is no suggestion that the inclusion of flexible benefits in pensionable compensation affects the actuarial soundness of the system. On the contrary, according to the County Counsel's opinion, the system remains relatively well funded in comparison to other government plans having a "funded ratio" of 85.5% compared to a national average for such plans of 76%.

#### Appropriate Treatment of Elements of Compensation

##### Flexible Benefits/Transportation Allowances

###### (a) Board of Retirement

Benefits under the retirement system are based on "final compensation" as defined at Sections 31462 and 31462.1 of the Government Code. "Final compensation" is determined by reference to "compensation earnable" (Gov't. Code § 31461) which in turn is defined by reference to the definition of "compensation" set forth in Section 31460 of the Government Code. Thus, in order to be pensionable compensation, any amount paid to or on behalf of an employee must be both "compensation" and "compensation earnable."

Before turning to a more detailed analysis of whether flexible benefits should be treated as "compensation" or "compensation earnable," it is to be

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noted that Section 31461 provides that "compensation earnable" is defined to mean "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." (Emphasis added.) "Board" for this purpose means the Board of Retirement. Gov't. Code § 31459.1(c). Thus, Section 31461 appears to confer on the Board of Retirement the authority to, in effect, determine the scope of both the definitions of "compensation" (even though the Board is not referenced in Section 31460) and "compensation earnable" for retirement plan purposes. Guelfi v. Marin County Employees' Retirement Ass'n., 145 Cal.App.3d 297, 307 (1983); City of Fremont v. Board of Administration, 214 Cal.App.3d 1026, 1033 (1989). In addition, the Board of Retirement is vested with general powers in the administration and management of the retirement system. Gov't. Code § 31520.

As indicated previously, however, the Board of Retirement's involvement in determining whether the transportation allowances and especially the flexible benefits were to be included in pensionable compensation was minimal. There is no record of the Board having deliberated on these questions or having reached any formal conclusions. For example, with reference to the flexible benefits, there is no record that the Board did such things as request a written opinion of County Counsel, determine at what point in time such benefits should begin to be considered as pensionable compensation, explore the interrelationship of its authority with the statutory language of Government Code Section 31460.1 (discussed below), or make an inquiry as to the practice of other county retirement systems in this regard. The most that can be said is that by not taking any action to countermand any actions taken by staff or others while being generally aware of the issues, the Board implicitly ratified the decisions.

It should also be noted, however, that even if the Board had become more fully involved in this matter, some courts have viewed the interpretation of a statute as primarily a legal question for which the normal deference should not be given to an administrative board or agency. In this regard, it has been stated as follows:

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"The policies which underlie judicial deference to administrative constructions of statutes are not served by deference to the opinions of legal counsel for an administrative agency which informed the agency that it is constrained by law to adopt a certain construction. In such a situation the agency has not selected between policies based upon its expertise or delegated political authority; it has merely adhered to a view of the general law advanced by counsel. As to such matters, the court, rather than the staff counsel for an agency, is the superior arbiter." California Trout, Inc. v. State Water Resources Control Board, 207 Cal.App.3d 585, 607 (1989).

But see, Guelfi, supra, at 307, note 6 (indicating wide latitude to a board of retirement without discussion of the legal question issue).

Arguably, the application of the statutory term "compensation" to benefits programs such as a flexible benefits plan is not purely a matter of legal interpretation, but also requires expertise in the field of compensation and benefits, such as that which the Board of Retirement is assumed to have. Nonetheless, given both the minimal activity on the part of the Board in this case and the possibility that a court would view the treatment of flexible benefits and transportation allowances under the statute as primarily a question of legal interpretation, it is likely that a court would not give the due deference normally accorded a board charged with administration of an act. Accordingly, the next sections of this opinion examine these issues as a matter of direct statutory interpretation.

(b) Compensation

Statutory and Judicial Background. Section 31460 of the Government Code defines compensation as follows:

"'Compensation' means the remuneration paid in cash out of county or district funds, plus any amount deducted from a member's wages for participation in a

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deferred compensation plan established pursuant to Chapter 8 (commencing with Section 18310) of Part 1 of Division 5 of Title 2 or pursuant to Article 1.1 (commencing with Section 53212) of Chapter 2 of Part 1 of Division 2 of Title 5, but does not include the monetary value of board, lodging, fuel, laundry, or other advantages furnished to a member."

The answer to the question of whether flexible benefits or transportation allowances are to be considered compensation is extremely difficult because the statute's meaning as applied to payments other than direct cash payments to an employee is not clear on its face, the statute was drafted at a time when flexible benefit plans of the type involved here were not in existence and the statute has been interpreted by only one case and that case reaches a dubious result.

The statute first requires that amounts be "paid in cash." It then excludes the "monetary value" of board, lodging, fuel, laundry or other advantages furnished to member. This would seem to mean that only amounts paid in cash are included in the definition (which would exclude remuneration paid to the employee in-kind) but amounts paid in cash to a third party to provide board, lodging, fuel, laundry or other advantages would be excluded (whether such cash was equal to the monetary value of the items furnished or not). The only other interpretation would be that in spite of the initial requirement that the remuneration be paid in cash, it nonetheless could include remuneration paid to the employee in-kind unless excluded under the clause excluding "the monetary value of board, lodging, fuel, laundry or other advantages." As is evident, the statutory provision is far from being a model of clarity.

The case interpreting the statute is Guelfi v. Marin County Employees' Retirement Ass'n., supra. The portion of Guelfi dealing with Section 31460 is primarily concerned with an interpretation of the exclusion. The item of remuneration considered in Guelfi most relevant to this analysis was a monthly uniform allowance. Although the facts are not set out in detail, it seems clear that such allowance was paid in cash and, while designated as a "uniform allowance," presumably such cash could have been

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spent by the employee in any manner he or she chose once it was received. Based on these facts, Guelfi held that the uniform allowance should be excluded from compensation as an "other advantage" because "the uniform substitutes for personal attire which the employee would otherwise be forced to acquire with personal resources." Guelfi reaches this result in spite of the fact that the exclusion applies to the "monetary value" of "other advantages" and it is illogical to speak of the monetary value of cash. Thus the decision seems to have the result that simply because a cash payment is designated as an allowance for a particular benefit to the employee, it is to be excluded from the definition of compensation even though if it had been paid in cash without any such designation, it would have clearly been included within the definition of compensation. It is impossible to divine any policy reason for such a result.

Since Guelfi must be considered as precedent for purposes of this opinion, but must also be viewed as a case that quite possibly would not be followed by another court, the interpretation of Section 31460 as applied to flexible benefit elections and, more importantly, to the transportation allowances should be done with and without the approach taken to the statute by Guelfi.

Flexible Benefits. In attempting to interpret the statute in the context of a flexible benefits plan, it is necessary to consider both the situation in which the employee elects cash in lieu of benefits and the situation in which the employee elects benefits in lieu of cash. As to an election to receive cash, since the statute includes in compensation amounts "paid in cash," there should be no question that such amounts should be considered to be compensation. Furthermore, although the Guelfi decision holds that certain cash payments can be excluded as an "other advantage," even the rationale of that case would appear inapplicable here because the cash ultimately elected under a flexible benefits plan is not designated as being for any specific purpose that might be deemed to be an "other advantage" to the employee. Thus, the receipt of cash pursuant to a flexible benefits election is clearly the receipt of "compensation."

The question is more difficult with respect to an election to receive benefits in lieu of cash. The first question is whether an expenditure to purchase benefits on behalf of the employee at his or her election

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is an amount paid in cash as required by the statute. Since there is no requirement under the statute that any cash be paid directly to the employee and since any expenditure of cash to a third party or fund (or other setting aside or earmarking of such amount) to provide benefits for the employee is nonetheless an amount that is paid in cash, this requirement is met.

The next question is whether the provision of benefits elected in lieu of cash should be excluded as the "monetary value of . . . other advantages furnished to a member." The answer to this question is unclear. If the benefits were provided to the employee unilaterally by the County, the monetary value of such benefits would seem to come clearly within the exclusion. However, when the benefits are instead purchased by cash that could otherwise have been received directly by an employee without any designation regarding its intended use, it is certainly possible that a contrary conclusion could be reached. In the first place, it should be noted that the language in question has been in the statute in its present form since 1959 (and, aside from the de facto amendment involved in the adoption of Section 31460.1, that the statute itself has not been amended since 1972) and probably contemplated a situation in which an employer chose to provide employees with in-kind benefits as additional remuneration and thus could be said to have "furnished" such benefits to the employees. Under such circumstances, the uncertainty (and possible abuse) in valuing such benefits could well have been a reason for the decision to exclude them statutorily from the definition.

It should also be noted that if the same benefits being purchased under the flexible benefits plan were purchased on an after-tax basis (as was the case before the establishment of the IRC Section 125 plans), the cash received would clearly be included in income. This raises a real question as to whether the determination of pensionable compensation under the retirement system should be different simply because the County chose to establish a plan with the same level of employee contributions that would have been required on an after-tax basis but established it in a manner designed to secure advantages available to its employees (and indirectly to the County itself) under Federal and State tax laws. Furthermore, if the statute is interpreted to include cash in lieu of benefits as a part of compensation but not benefits in lieu

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of cash, an employee could simply achieve maximum retirement benefits by electing to receive cash during the period in which final compensation is being determined. This is just another indication of the difficulty of applying a rather dated statute to a type of plan it never contemplated.

For the above reasons, the statute is ambiguous in its application to a flexible benefit plan. Under these circumstances, it is appropriate to consider subsequent enactments of the Legislature in attempting to determine legislative intent with respect to the interpretation of an earlier statute. As has been said in a number of cases:

"[A]lthough construction of a statute is a judicial function, where a statute is unclear, a subsequent expression of the Legislature bearing upon the intent of the prior statute may be properly considered in determining the effect and meaning of the prior statute." Tyler v. California, 134 Cal.App.3d 973, 977 (1982).

See also Board of Social Welfare v. County of Los Angeles, 27 Cal.2d 90, 97 (1945); Escalante v. City of Hermosa Beach, 195 Cal.App.3d 1009, 1020 (1987); Friends of Lake Arrowhead v. Board of Supervisors, 38 Cal.App.3d 497, 506 (1974).

In 1990, the Legislature enacted Government Code Section 31460.1 which provided as follows:

"'Compensation' shall not include employer payments, including cash payments, made to, or on behalf of, their employees who have elected to participate in a flexible benefits program, where those payments reflect amounts that exceeds their employees' salaries.

This section shall not be operative in any county until the time the board of supervisors shall, by resolution adopted by

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a majority vote, makes (sic) this section applicable in that county."

This is a clear indication of legislative intent that Section 31460 be read to include flexible benefits as an item of compensation within the meaning of that section. By providing by its terms that it is not to be operative in any county until such time as a board of supervisors takes action to make it applicable in such county, the clear and unambiguous implication of Section 31460.1 is that flexible benefits are, in the absence of a resolution by a board of supervisors, included in compensation, at least if a board of retirement so includes them. Any other interpretation would make nonsense of the statute; after all, if flexible benefits are not part of compensation under Section 31460, an election under Section 31460.1 would have no effect.

As will be discussed below, it is noted that SB 193, in repealing Government Code Section 31460.1, contained a legislative finding that the prior section had been erroneously construed as implicitly requiring counties to include flexible benefits in compensation. While it is appropriate to consider subsequent enactments of the Legislature in attempting to determine the legislative intent with respect to the interpretation of an earlier statute when the meaning of such earlier statute is unclear, the ultimate interpretation of a statute is an exercise of the judicial power. Bodinson Manufacturing Company v. California E. Commission, 17 Cal.2d 321, 326 (1941); Henning v. Industrial Welfare Commission, 46 Cal.3d 1262, 1270 (1988). Thus legislative interpretations have no effect when the prior statute is clear and unambiguous. Honey Springs Homeowners Ass'n. v. Board of Supervisors, 157 Cal.App.3d 1122, 1137 (1984); People v. Martinez, 188 Cal.App.3d 1254, 1259 (1987). For the reasons discussed above, the inference of Section 31460.1 that flexible benefits be included in compensation was clear and unambiguous during the time it was in effect and the revisionist interpretation by SB 193 should be disregarded.

Thus, while it is an extremely close question, it would seem that upon consideration of all the above factors, the best interpretation of Section 31460 is that cash or flexible benefits elected in lieu of cash under flexible benefit plans such as those maintained by the County are included in the definition of "compensation"

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for purposes of the computation of benefits under the retirement system.

It is noted that there was a period of time prior to January of 1991 when flexible benefits were in effect and yet were not being treated as pensionable compensation because no administrative action had been taken to do so. It could be argued that action should now be taken to make retroactive adjustments to the retirement allowances of affected employees who have retired during this period and to collect retroactive contributions from them and any other employees who were participating in a flexible benefits plan during this period. There are two reasons why this should not be necessary. First, as discussed more fully below, the vesting of employees' benefits is based on their reasonable expectations and no such expectations could have arisen until administrative action was taken to include the benefits in compensation. Second, given the impracticality of collecting additional employee contributions in the event of any such retroactive application and the possible additional cost that might result to the system if additional retroactive benefits are produced without such corresponding employee contributions, it is appropriate to consider the fiscal effect of any such retroactive application. See Allen v. Board of Administration, 34 Cal.3d 114, 125 (1983).

Transportation Allowances. No court has ever specifically considered the question of whether transportation allowances should be taken into account as compensation within the meaning of Section 31460. However, if the question of whether transportation allowances constitute compensation is determined by application of Guelfi, they would be excluded. Since they are paid regardless of whether or how much the employee uses his or her car on County business, they would clearly be an "other advantage" under the approach of that case because they would be allowances paid for a personal expense that the employee would otherwise be forced to incur with his or her own resources and hence would be excluded from the definition.

As discussed earlier, the Guelfi approach is questionable. Nonetheless, for purposes of this opinion, it cannot be dismissed and, if applied, leads to the conclusion that the transportation allowances should not be included in pensionable compensation. However, it is quite

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possible that litigation on this issue would lead to a different result should Guelfi be challenged as a part of that litigation.

(c) Compensation Earnable

Flexible Benefits. Under the statutory framework, remuneration must not only be "compensation" but also "compensation earnable" to be taken into account for retirement plan purposes. Section 31461 defines "compensation earnable" as follows:

"'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 him at the beginning of the absence."

The phrase "for the period under consideration and on the basis of the average number of days ordinarily worked" has been interpreted to require a certain regularity of payment so as to exclude irregular, extraordinary amounts that would otherwise clearly meet the definition of "compensation." Thus overtime when not received regularly by all employees similarly situated has been excluded. See Guelfi v. Marin County Employees' Retirement Ass'n., supra. Likewise, lump sum payments for sick leave or unused vacation have also been excluded on the same basis. See Santa Monica Police Officers Ass'n. v. Board of Administration, 69 Cal.App.3d 96 (1977). However, the amounts used to purchase flexible benefits are derived from remuneration paid on a regular monthly basis and thus meet this requirement.

In addition, in order to be "compensation earnable," the compensation must be paid regularly to "persons in the same grade or class of positions" during the period under consideration. This is a highly factual matter and an analysis of strict compliance with this

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requirement throughout all the various classes and grades currently existing in the County is beyond the scope of this opinion. However, given the almost universal availability of the flexible benefit plans, it would appear highly likely that this requirement is met.

This question is discussed in the context of County pay classifications on pages 8-9 and 28-29 of the County Counsel's opinion and applies to transportation allowances and deferred compensation as well as flexible benefits. While final resolution of this question would entail a detailed examination of departmental organizations and individual job descriptions, it can be said that the approach outlined in the County Counsel's opinion for handling different rates of pay within various classes appears appropriate and, through the historical administration of the system, has become so well established as to be virtually beyond challenge.

Transportation Allowances. Since the transportation allowances are paid on a monthly basis, there is no difficulty in meeting the requirement that they be paid with regularity. As to the matter of whether the compensation is paid to "persons in the same grade or class of positions" during any period under consideration, the inquiry is again highly factual and would require a review of all of the individuals entitled to receive the allowance in view of their grade or class in order to reach a firm conclusion on the matter.

(d) Government Code Section 31460.1/SB 193

Normally, any conclusions on the treatment of flexible benefits such as those reached above would be the end of the examination of this question. However, it is now necessary to turn to the specific statutory provisions that have been enacted addressing the treatment of flexible benefits as a component of pensionable compensation in order to determine the impact, if any, that such provisions have on the normal process involved in making such determinations.

As indicated above, now repealed Section 31460.1 provided as follows:

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"'Compensation' shall not include employer payments, including cash payments, made to, or on behalf of, their employees who have elected to participate in a flexible benefits program, where those payments reflect amounts that exceeds their employees' salaries.

"This section shall not be operative in any county until the time the board of supervisors shall, by resolution adopted by a majority vote, makes (sic) this section applicable in that county."

Legislative history surrounding the enactment of Government Code Section 31460.1 indicates that the provision was enacted primarily at the urging of the Kern County Board of Supervisors which wished to have the ability to exclude flexible benefits from pensionable compensation in its county.

The Board of Supervisors of Los Angeles County never took any action pursuant to the second paragraph of Section 31460.1. The legal conclusion to be drawn from this fact is to a large extent predetermined by the approach of Government Code Section 31460.1 that flexible benefits are only be excluded from pensionable compensation by an affirmative action. Thus, by the statute's express terms, it never became operative.

In April of this year, the Legislature passed Senate Bill 193 which was signed by the Governor on May 8, and subsequently filed with the Secretary of State on May 11. As urgency legislation, it became effective immediately. Senate Bill 193 repeals Government Code Section 31460.1 and sets forth various legislative findings and declarations. The key provisions of Senate Bill 193 as they affect the process pertaining to the treatment of flexible benefits as pensionable compensation in Los Angeles County are as follows:

SECTION 1. Section 31460.1 of the Government Code is repealed.

. . . .

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SECTION 2. Nothing in this act is intended to, or shall be construed to, affect the validity of any action taken by a county pursuant to Section 31460.1 of the Government Code, prior to the effective date of this act.

. . . .

SEC. 3. The Legislature hereby finds and declares that:

. . . .

(3) Section 31460.1 has been erroneously construed as implicitly requiring counties maintaining retirement systems under the 1937 act to include in "compensation" those flexible benefits payments until the board of supervisors elect pursuant to that section to exclude those flexible benefits payments from "compensation."

. . . .

(6) It was the intent of Assembly Bill 3146 (Gov. Code §31460.1) merely to accord to each county board of supervisors, at its option, the power either to preclude its county retirement board from including those flexible benefits payments in "compensation," if the county retirement board had not previously taken such action, or to supersede any previous decision of their county retirement board to include those flexible benefits payments in "compensation."

(7) In order that the source of misconstruction of legislative intent regarding the enactment of Section 31460.1 of the Government Code may be eliminated at the earliest possible time, and that any county actions taken on the basis of that misconstruction may be reversed or terminated at the earliest possible time, the Legislature finds that it is necessary to repeal Section 31460.1 of the Government Code.

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Section 3(8) of the legislation also contains important language pertaining to the vesting of employees' pension rights that will be discussed below in the portion of this opinion dealing with this subject.

Section 2 of the legislation, which provides that nothing in the Act is intended to affect the validity of any action previously taken by a county pursuant to Section 31460.1, has no impact on the Los Angeles County situation because the action contemplated by that statute (i.e., adoption of a resolution by the Board of Supervisors) was never taken by the County.

Sections 3(3), (6) and (7) read together suggest that Section 31460.1 had been erroneously construed as implicitly "requiring" counties to include flexible benefits in pensionable compensation where instead it was the intent of the repealed section merely to accord each county an option to either include or exclude such benefits and further that it is necessary to repeal the prior section in order to eliminate the source of such misconception. Unfortunately, due to the lack of documentation pertaining to the Board of Retirement decision to include flexible benefits in pensionable compensation and the lack of any contemporaneous written advice by County Counsel on the subject, it is not at all clear on what basis such a decision was made and whether it was in any part based on an inference that the enactment of Section 31460.1 somehow required such a decision in the absence of action by the Board of Supervisors. There is certainly no record that the Board of Retirement felt compelled to make such a determination. As noted above, the enactment of Section 31460.1 could appropriately have been taken as an indication of legislative intent on the correct interpretation of Section 31460 as applied to flexible benefits. On the other hand, as also discussed above, such decision could certainly have been based on other factors.

In any event, except as discussed above with respect to the inference it created, it is difficult to see how the enactment of Government Code Section 31460.1 and its repeal by SB 193 have any ultimate impact on the subject of the treatment of flexible benefits in Los Angeles County. This is simply because the earlier Act never became operative due to a lack of any action by the Board of Supervisors; hence the subsequent repeal of the

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earlier act has no impact. Furthermore, regardless of the basis on which any entity acted, the likely vested interests achieved by affected employees as a result of the decisions previously made, as discussed below, would invalidate any retroactive effect of SB 193.

#### Deferred Compensation

The deferral of existing salary and the deferred merit increases should both be considered forms of deferred compensation in that they both represent an arrangement whereby receipt of compensation that would otherwise have been received at one point in time is deferred to some future point in time. The Board of Retirement has not made any determination as to the appropriate treatment of the deferred compensation for retirement plan purposes.

Section 31460 of the Government Code specifically includes as compensation "any amount deducted from a member's wages for participation in a deferred compensation plan" established pursuant to certain other provisions of the Government Code. The only real question is whether such deferred compensation should be included as pensionable compensation when it is first deferred or when it is paid pursuant to the deferral arrangement.

By referring to amounts "deducted" from wages for participation in a plan as compensation, Section 31460 strongly implies that deferred compensation is to be taken into account at the time of deferral rather than at the time of payment. The County Counsel's opinion (pages 30-32) agrees with that conclusion, but indicates that this is an exception to the general rule that amounts are to be treated as compensation when received and that such exception should only apply to a "formal plan" and, in particular, to one established as a "tax advantaged" plan under Section 457 of the Internal Revenue Code. Since the contracts involved in this situation do not constitute such a plan, the County Counsel's opinion concludes that the general rule of taking amounts into account when they are received should apply.

This position regarding only certain types of plans being contemplated by Section 31460 is based on the language contained in the section referring to deferred

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compensation plans established pursuant to Government Code Section 18310 (now Government Code Section 19993, which deals with deferred compensation plans for state employees) and Section 53213 (deferred compensation plans for local government employees). The problem with this interpretation is that there is nothing in Section 53213 or Section 19993 (assuming Section 19993 has any relevance in the interpretation of Section 53213) that would indicate that such sections are limited only to the establishment of deferred compensation plans that are "formal" plans or plans meeting the requirements of IRC Section 457 for tax deferral of income. Both sections (and the corresponding reference to them in Section 31460) pre-date the enactment of Section 457 by six years. In Herrick v. State of California, 149 Cal.App.3d 156, 162 (1983), which is cited in the County Counsel's opinion on this point, it is indicated that Section 18310 was presumably enacted in response to a 1972 IRS Revenue Ruling which also predated Section 457 and which involved a consideration of a deferred compensation agreement entered into with a single taxpayer.

Thus, there is no reason to suppose that the strong implication of Section 31460 that compensation is to be taken into account when deferred is to be limited to only certain kinds of deferred compensation plans. In addition to such a conclusion being a fair reading of the statute on its face, such a conclusion would also appear to be consistent with a possible appropriate policy objective of the statute prohibiting the timing of receipt of deferred compensation to periods in which it would have the most impact for retirement plan purposes. However, as with the other elements of compensation, this conclusion must be examined in the light of actions already taken which, in this case, involves the execution of individual contracts providing for the deferred compensation to be treated as pensionable compensation at the time of its receipt.

#### Actuarial Study

Government Code Section 7507 provides as follows:

"The Legislature and local legislative bodies shall secure the services of an enrolled actuary to provide a statement of the actuarial

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impact upon future annual costs before authorizing increases in public retirement plan benefits. An 'enrolled actuary' means an actuary enrolled under subtitle C of Title III of the federal Employee Retirement Income Security Act of 1974 and "future annual costs" shall include, but not be limited to, annual dollar increases or the total dollar increases involved when available.

The future annual costs as determined by the actuary shall be made public at a public meeting at least two weeks prior to the adoption of any increases in public retirement plan benefits."

The principal question involved here is whether a decision to include the various elements of compensation as pensionable compensation by an interpretation of "compensation" and "compensation earnable" are "increases in public retirement plan benefits." Aside from the lack of any definition of such term in the statute, the answer to such question is made more difficult because there are no judicial or other authorities interpreting this statutory provision, nor is there any helpful legislative history on point.

In the County Counsel's opinion, it is stated that when Section 7507 uses the words, "increases in public retirement plan benefits," it is meant to indicate changes in the benefit structure of the retirement plan itself rather than increases or other modifications in compensation that would affect the computation of benefits under a particular benefit structure. Such changes in benefit structure would include such things as a modification of the retirement plan formula, the use of a member's one-year average compensation to compute benefits rather than his or her highest three-year average compensation, the addition or improvement of early retirement provisions and so forth. While this is a more likely interpretation of the words employed, it is certainly not clear that such is the case.

The County Counsel's opinion also refers to Government Code Section 7507.5, the section immediately following Section 7507, which requires the regents of the University of California to provide written notice to the

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Legislature of any proposed changes to "retirement plan benefits" along with a description and explanation of each specific proposed change to the "benefit structure," as support for its position on the interpretation of "plan benefits" in Section 7507. It is difficult, however, to put much weight on Section 7507.5 in the interpretation of Section 7507 because (1) the language pertaining to changes in retirement plan benefits and benefit structure in Section 7507.5 is not much clearer than the language employed in Section 7507 and, more importantly, (2) there is no reason why the Legislature could not have chosen to impose different requirements on the plan subject to Section 7507.5 than for plans subject to Section 7507.

It is to be noted, however, that the actuarial impact requirement is imposed on local "legislative bodies" that authorize increases in public retirement plan benefits. This may be a further indication that such requirement is only imposed on the Board of Supervisors in acting in areas in which it has responsibility such as making basic changes in the benefits structure of the plan rather than on interpretations in the administration of the plan such as here where the meaning of the terms compensation and compensation earnable is determined. Thus, given the difficulty of rendering a legal opinion in the absence of any authorities, it would seem that the actuarial impact requirement does only apply to basic changes in benefit provisions of a plan itself where such changes may only be made by the Board of Supervisors.

Finally, it is noted that there are no prescribed consequences for failure to comply with Section 7507. There is no indication in the statute that compliance with Section 7507 is a condition precedent to the validity of any increase in benefits. Since the statute has no other specific sanction for violation of its requirements, it is possible that a court would conclude that such a sanction is appropriate. Any such conclusion, however, would need to be examined in the light of possible vesting rights of the employees with respect to the increases adopted.

#### Vesting/Contractual Rights

Perhaps the most important aspect of this analysis is the extent to which employees currently employed by the County have achieved vested or contractual

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rights as a result of decisions and actions already taken with regard to the determination of their pensionable compensation. Since the facts involving the flexible benefits and the transportation allowances are different from those involved in the deferred compensation, these elements of compensation will be examined separately.

In California, vesting in public sector plans is based on both the United States Constitution's prohibition against any state passing a law "impairing the obligation of contracts" (U.S. Const., Art. I, §10) and a parallel proscription contained in the California Constitution (Art. I, §9). See Allen v. Board of Administration, 34 Cal.3d 114, 119 (1983). As discussed below, the contract clauses have been interpreted to protect reasonable pension expectations to be derived from future service as well as benefits accrued through any date in time. As such, the vesting accorded to employees covered by government plans is much broader than is the case in the private sector where plan participants are only protected against any reduction in accrued benefits through the point of any modification of a plan's benefit provisions. See, e.g., IRC §411(d)(6).

The vesting concept has been developed and firmly embedded in California law through a long line of cases starting with Kern v. City of Long Beach, 29 Cal.2d 848 (1947), with two of the more important of such cases being Allen v. City of Long Beach, 45 Cal.2d 128 (1955) and Betts v. Board of Administration, 21 Cal.3d 859 (1978).

In Kern, it was decided that a public employee's pension constitutes an element of compensation, that a vested contractual right to pension benefits accrues upon acceptance of employment and that such a pension right may not be destroyed once vested without impairing a contractual obligation of the employing public entity. Kern, supra, at 852-853.

In Allen v. City of Long Beach, which is considered to be the landmark case in this area, the vesting concept was described as follows:

"An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at

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the same time maintain the integrity of the system. [Citations.] Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. To be sustainable as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages. [Citations]. . ." Allen, supra, at 131.

See also Carman v. Alvord, 31 Cal.3d 318 (1982) and Miller v. State of California, 18 Cal.3d 808 (1977).

In Betts, it was affirmed that vesting applies not only to benefits that are in effect when an employee's employment commences but also to improvements in benefits that occur during his or her service. Betts, supra, at 866. Betts also reaffirmed the holding in Abbott v. City of Los Angeles, 50 Cal.2d 438 (1958), that the comparative analysis of disadvantages and compensating advantages in any modifications to a plan must focus on the particular employee or employees whose vested pension rights are involved. Betts, supra at 864. See also Olson v. Cory, 27 Cal.3d 532 (1980).

Thus the law as developed in California as applicable to public employees' rights in their pensions provides that an employee becomes vested in the particular level of benefits provided during his or her term of employment (conditioned upon fulfilling any service conditions to be eligible for such benefit) and that while such benefits can be modified in accord with changing conditions in a manner consistent with maintaining the integrity of the system, any such changes that result in a disadvantage to employees must be accompanied by a comparable new advantage to the same employees.

These principles were most recently examined by the California Supreme Court in Legislature v. Eu, 54 Cal.3d 492 (1991). Eu, the case which upheld the constitutionality of term limits as enacted as part of Proposition 140 in 1990, examined the legality of a specific provision in Proposition 140 to the effect that no pension or retirement benefits were to accrue as a result

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of service in the State Legislature for legislators serving new terms in the Legislature on or after November 1, 1990. The provision further provided that "[t]his Section shall not be construed to abrogate or diminish any vested pension or retirement benefit which may have accrued under an existing law . . . , but upon adoption of this Act no further entitlement to nor vesting in any existing program shall accrue to any such person, other than Social Security. . . ." Incumbent legislators challenged the constitutionality of this provision in Proposition 140 as being an improper impairment of their vested right to continued future participation in the pension program that was in place for their benefit at the time Proposition 140 was passed. Based on the long line of California cases alluded to above, the court held that the incumbent legislators had acquired a vested right to earn additional pension benefits under the plan in existence at the time of the passage of Proposition 140 through continued service in future terms and that prospective cessation of that right was an unconstitutional impairment of contract. The court also held that purported comparable advantages in the form of participation in Social Security were in fact illusory and not sufficient to support the prospective cessation of benefits.

Two other court cases are also particularly instructive on the question of modification of a particular provision in a pension plan under which public employees have already rendered service. The first, Pasadena Police Officers Ass'n. v. City of Pasadena, 147 Cal.App.3d 695 (1983), involved a plan amendment that for the first time put a limit on the amount of increases that could accrue under a post retirement cost of living adjustment. Against a claim that the amendment did not impair the vested contract rights of active employees because it was to apply only to that portion of the employees' pensions that would accrue by rendering years of service after its effective date, the court held that such an interpretation was inconsistent with California case law and unacceptable because it involved a substantial reduction in the pensions that could have been earned after the amendment without any comparable new advantages. Likewise, in United Firefighters of Los Angeles City v. City of Los Angeles, 210 Cal.App.3d 1095 (1989), the court held that Charter Amendment H, placing a 3% cap on previously unlimited cost of living adjustments available to certain public employees, was an illegal impairment of the employees'

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vesting rights even though it applied only prospectively to future years of service credited toward retirement after the date of the amendment.

Based on the above case law, unless some exception applies, the employees currently employed by Los Angeles County have achieved a vested interest in the continued inclusion of flexible benefits and transportation allowances in pensionable compensation for purposes of computing their retirement benefits. It is now necessary to consider possible exceptions that might apply in this case:

(1) The benefits are not vested because they constitute unexpected "windfalls" -- It has been suggested that reversal of the treatment of flexible benefits as pensionable compensation would not be a prohibited impairment of contract because of the holding in Allen v. Board of Administration, *supra*. For example, section 3(8) of SB 193 provides as follows:

"Any reversal or termination, on or after the effective date of this act, of county actions taken on the basis of misconstruction of the intent and meaning of Section 31460.1 of the Government Code would merely restrict county employees to those gains reasonably to be expected from their county retirement contracts and withhold unforeseen and windfall advantages which bear no relation to the fundamental theory and objective of the county retirement systems maintained pursuant to the County Employees Retirement Law of 1937 and would, therefore, not constitute an unconstitutional impairment of the county retirement contract (see Allen v. Board of Administration, 34 Cal.3d 114, at pages 119-120, 122, and 124)."

Hence, Allen must be closely examined for possible application to this situation.

Allen involved the question of whether certain former State legislators were entitled to cost of living adjustments in their post retirement benefits due to the fact that they had rendered service under two separate

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provisions providing for such adjustments, one of which was related to salaries being received by current legislators and the other of which was a direct adjustment of retirement allowances to reflect increases in a cost of living index. Both of these provisions were in effect when the legislators were in office and they contended that they were entitled to the benefit of both provisions and that an attempt to limit their cost of living adjustments to only the latter provision was a violation of their vested rights.

Allen made it clear that not every change in a retirement law constitutes an impermissible impairment of the contract. Quoting from U.S. Supreme Court decisions, the court noted that the "constitutional prohibition against contract impairment does not exact a rigidly literal fulfillment; rather it demands that contracts be enforced according to their 'just and reasonable purport'" and that "the impairment provision does not prevent laws which restrict a party to the gains 'reasonably to be expected from the contract.'" Allen, supra, at 122. Further quoting from Lyon v. Flournoy, 271 Cal.App.2d 774, 787 (1969), an appellate court decision that had considered basically the same factual situation, the Allen court agreed with the following observation:

"The law-making power chose to confine beneficiaries to the gains 'reasonably to be expected from the contract' and to withhold 'unforeseen advantages' which had no relation to the real theory and objective of the fluctuation provision. Such a choice is not the repudiation of a debt, not an impairment of the contract." Allen, supra, at 122.

As interpreted by SB 193 and others, Allen is thus meant to preclude unintended "windfall" advantages under a retirement system.

Applying the principle of reasonable contractual expectations to the facts before it, the Allen court held that the legislators had no reasonable expectation to the cost of living adjustments based on current legislators' salaries because of the long period of time during which such salaries were in fact not adjusted. As such, the finding in Allen is very dependent on the unique facts involved in that case. This is emphasized by

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comparison of this case with Betts, supra, where a retiree was allowed to receive adjustments under both methods of adjustment considered in the Allen case.

Even though Betts involved the same exact double increment of increase as did Allen, the different result was attributable to the fact that Betts was a former state executive employee rather than a legislator and, unlike the legislators, salary adjustments were in fact periodically made for Betts' former position. Thus, he could have had reasonable expectations that such a method of adjustment of his retirement benefit would in fact result in increases. This is explained in Allen as follows:

"The primary basis for our determination that Betts reasonably was entitled to expect the benefit of both the fluctuating and cost-of-living provisions was the absence in his case of any factors militating against the reasonableness of that expectation such as were present in Lyon and are present here. There was no suggestion in Betts, for example, that the statutory scheme for pension enhancement of constitutional officers, like Betts, was not operating as originally designed. Lyon and the present case, on the other hand, are premised upon the discrepancy between the theoretical objective and the actual operation of the legislators' statutory pension scheme.

Thus, respondents' argument that they, like Betts, served while both the fluctuating provision of section 9359.1, subdivision (a), and the cost-of-living provision of section 9360.9 were 'in effect,' misses the point. Such a claim misapprehends the true character of the LRL as it actually operated on legislators' retirement benefits during respondents' incumbency. Indeed, in Betts we stressed the 'historically unique' context in which the legislative salary/retirement scheme operated during the period here in question and which gave rise to the constitutional revision of 1966. (21 Cal.3d at pp. 865-866.) Distinguishing Lyon, we noted that because of those unique circumstances, the

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retiree there, unlike Betts, "had no 'reasonable expectation' while in office that he would enjoy a double cost-of-living formula . . . ." Allen, supra, at 123-24.

Thus, even though Betts involved the same "windfall" as Allen, the vesting was upheld in Betts because Betts had rendered service under circumstances where he could reasonably expect to be entitled to both adjustments.

Applying the Allen finding to the facts involved in this situation, it should first be noted that while there are certainly questions as to whether flexible benefits and transportation allowances are properly "compensation" within the meaning of Section 31460 of the Government Code, it can hardly be said that a decision to so treat them results in the type of "windfall" brought about by the possible "double dipping" that was involved in Allen. More importantly, however, Allen, when read in conjunction with Betts, primarily requires that this situation be examined from the perspective of whether the inclusion of flexible benefits and transportation allowances in pensionable compensation would in fact create a reasonable expectation on the part of the employees that these elements of compensation are entitled to such treatment. Since the employees would have no reason to suspect that such a determination would be an unreasonable interpretation of existing statutes, they would have a reasonable expectation that this would be the case. In no way could this be equated to the "windfall profit" beyond reasonable expectations that was found to be the case in Allen. As was said in United Firefighters of Los Angeles City, supra, at 1107-1108:

"Accordingly, those system members who accepted public employment prior to 1971 have not received a "windfall profit" from the uncapping of the cost of living adjustment in 1971, but only their due. While it is true reasonable contractual expectations generally are to be measured as of the date the contractual relationship began (Allen v. Board of Administration, supra, 34 Cal.3d at pp. 124-125), the contractual relationship at issue here was modified by uncapping of the cost of living adjustment in 1971. Thus, in accord with Betts, supra, the reasonable expectations of plaintiffs

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in the instant matter must be measured as of that date."

(2) The benefits are not vested because the interpretation of the law giving rise to the benefits was incorrect -- The next issue that must be considered is whether vested rights in benefits that might otherwise accrue are defeated due to an incorrect interpretation of the law that gave rise to the benefits in the first place. It is possible, for example, that a court might ultimately find that flexible benefits and transportation allowances do not fit the definition of compensation and compensation earnable. The question is thus presented as to what effect, if any, any such conclusion would have on the vested rights of employees employed on or after the date such determinations were originally made and put into effect.

This question has not been considered directly by the California courts. However, given the consistent protection that the courts have given employees under the vesting doctrine, it is quite unlikely that a court would use such a basis to not recognize rights otherwise vested. As explained in Allen v. Board of Administration, supra, under California law vesting arises as a result of reasonable contractual expectations that cannot be subsequently impaired. It should not be incumbent on the employees to inquire as to whether such expectations are reasonable from the standpoint of whether their employer correctly interpreted the law. This is especially true under the well established approach that in the event of uncertainty a public pension plan should be construed liberally in favor of plan members. See, e.g., Eichelberger v. City of Berkeley, 46 Cal.2d 182, 188 (1956); City of Sacramento v. Public Employees Retirement System, 229 Cal.App.3d 1470, 1488 (1991).

(3) The benefits are not vested because an interpretation of what is pensionable compensation is not a "benefit" protected by vesting -- Another question that arises is whether an interpretation of a statute such as was made here defining pensionable compensation is a "benefit" protected by the concept of vested rights in the same manner as cost-of-living provisions, the rate of employee contributions and other essential parts of the plan benefit structure itself. Again, there are no cases

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or other authorities on point, but it is likely that a court would conclude that such an interpretation does give rise to a vested right because the interpretation is an integral part of the benefit calculation. This question is also in part related to the analysis of Government Code Section 7507 in the sense that the further question can arise whether amounts that may not be deemed to be an increase in "benefits" for purposes of the actuarial impact requirement of Section 7507 may nonetheless be considered to be "benefits" for purposes of the vesting doctrine. This is a closer question and while it is always difficult to predict a result in the absence of any authority, the strong protection given to employees under the vesting doctrine would very possibly tip the scales in the favor of vesting. Again, the presumption that the courts apply in favor of plan members may be the deciding factor.

(4) Any vesting that otherwise occurs may be disregarded or modified due to fiscal concerns -- In extremely limited circumstances, the employees' right to a comparative advantage in the event of a reduction in benefits may be lost due to a consideration of fiscal factors. For example, in one case, this was found to be the result under circumstances where the underlying pension system had become completely insolvent. See Houghton v. City of Long Beach, 164 Cal.App.2d 298 (1958). However, in the absence of a clear showing that the pension system is actuarially unsound or will almost inevitably become so due to the governmental entity's inability to meet future funding obligations, this exception to the normal vesting rules will not be allowed. See Association of Blue Collar Workers v. Wills, 187 Cal.App.3d 780 (1986). See also Pasadena Police Officers Ass'n. v. City of Pasadena, supra, and the cases cited therein at 704, note 3. Since the Los Angeles County plan is relatively well funded and the additional unfunded liability brought about by the inclusion of the various elements of compensation in pensionable compensation results in relatively small additional unfunded liability, it is highly unlikely that this exception would apply in this situation but, of course, the final judgment on fiscal matters is not within the scope of this opinion.

Deferred Compensation. The situation with respect to deferred compensation is somewhat different from that of flexible benefits and transportation allowances

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because the treatment of deferred compensation was never considered by the Board of Retirement and there are in existence individual contracts containing language as to how deferred compensation is to be treated for retirement plan purposes.

Since the Board of Retirement is charged with the administration of the 1937 Act in general and determination of pensionable compensation in particular, it would seem clear that the retirement system cannot be bound as to interpretations of the Act without any participation whatsoever by the Board of Retirement in such interpretation. The Board of Retirement can now ratify interpretations made by others on this subject, but for the reasons suggested above, it is believed that the treatment of the deferred compensation in the contracts is an incorrect interpretation of the law.

Even if the retirement system is not bound by the treatment of deferred compensation set forth in the contracts, the existence of the contracts themselves would generally bind the County to the representations made therein, including the obligation to make a contracting employee whole with respect to any amounts not actually received under the retirement system. Under a contract law analysis, it is clear that the employees entering into the contracts gave sufficient consideration to bind the County to its representations and since the contracts were executed on behalf of the County by its Chief Administrative Officer, there can be no question as to whether the agreements were executed by an individual having the capacity to bind the County. Thus, absent special circumstances, the County would be estopped from asserting that it has no obligation with respect to the representations it has already made as to the treatment of deferred compensation. See, e.g., Baillargeon v. Department of Water & Power, 69 Cal.App.3d 670 (1977); Crumpler v. Board of Administration, 32 Cal.App.3d 567 (1973). However, it is possible that facts may show that individual employees entering into such contracts knew, or should have known, that the representations as to the treatment of deferred compensation had not been considered by the Board of Retirement and that the interpretation of the statute in that regard was uncertain. If this is so, this could preclude such employees from taking the position that the County is so estopped. See, e.g., Strong v. County of Santa Cruz, 15 Cal.3d 720 (1975); Lee v. Board of

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Administration, 130 Cal.App.3d 122 (1982). Furthermore, under such circumstances, it would be possible to argue that from a vesting standpoint any such employee should not have had a "reasonable expectation" that the deferred compensation would be treated as indicated in the contracts. Ultimate resolution of these issues could only be decided on a case-by-case basis.

### Conclusions

The principal conclusions of this opinion are as follows:

(1) Since the Board of Retirement did not fully deliberate on the question of whether to include the flexible benefits and transportation allowances within pensionable compensation and since, in the view of some courts, such matters are treated as questions of law that are completely reviewable, judicial deference would probably not be given to the administrative decision to include these items in pensionable compensation. Rather, the appropriate treatment of such items of compensation would likely be determined by direct statutory interpretation. This is certainly true with respect to the appropriate treatment of deferred compensation, which has as yet to be considered by the Board of Retirement.

(2) Although it is an extremely close question, the better interpretation of Government Code Sections 31460 and 31461 is that cash paid to an employee under a flexible benefits program and cash used under such a program to purchase benefits for an employee are pensionable compensation.

(3) Under the rationale of the one California appellate court case interpreting Section 31460, transportation allowances would not constitute pensionable compensation. However, the rationale of the case is not entirely sound and could well be dismissed or overturned by another court.

(4) Deferred compensation in the form of delayed salary and delayed merit increases is pensionable compensation, but is pensionable compensation when deferred, not when received.

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(5) In the absence of any authority on the point, it is unclear whether an interpretation of what is pensionable compensation is an increase in benefits within the meaning of Government Code Section 7507 so as to require an actuarial impact statement. The more likely interpretation of this section, however, is that the language in the statute is meant to indicate changes in the benefit structure of a retirement plan itself rather than increases or other modifications in compensation. If, on the other hand, the interpretation of pensionable compensation is deemed to be an increase in benefits, there is no indication in the statute that compliance with Section 7507 is a condition precedent to the validity of any increase in benefits. Since the statute has no other specific sanction for violation of its requirements, however, a court might fashion such a judicial remedy although this would need to be weighed against the consistent protection given by California courts to employees' vested pension rights.

(6) In the absence of one of the possible exceptions discussed below, California's vesting doctrine protects current employees' reasonable expectations to have flexible benefits and transportation allowances considered as part of pensionable compensation during the terms of their employment. Such treatment of these items of compensation is not an unforeseen windfall within the meaning of Allen v. Board of Administration. In the event conclusions are ultimately reached that are generally contrary to those contained in this opinion, an exception to the general rule of full vesting could be based on an argument that (i) the law was misinterpreted in the first place, (ii) proper procedures were not followed (such as the obtaining of an actuarial impact statement pursuant to Section 7507) or (iii) an interpretation of what is pensionable compensation is not the type of "benefit" protected under the vesting doctrine, but no California court has as of yet found lack of vesting based on any one of these reasons. Given the strong protection that the California courts have consistently given to public employees' pension rights, a finding of lack of vesting on the basis of any of these reasons is not likely.

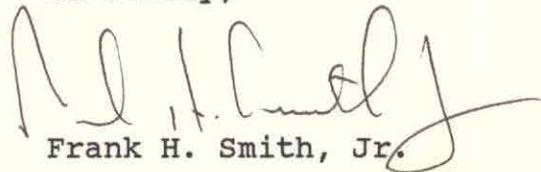
(7) Employees who have written contracts including a clause stating that the deferred compensation

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is to be treated as pensionable compensation when received generally have a right to enforce such contracts against the County if not the retirement system.

Sincerely,



Frank H. Smith, Jr.