THE PUBLIC SECTOR

Concealment of rate of pay invalidates pension 'spiking' effort

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Under California's Public Employees Retirement Law (PERL), retiring employees' pension benefits are determined partly by the amount of their final salary. Overseeing one of the world's largest public pension systems, the California Public Employees Retirement System's (CalPERS) administration and legal operations are vigilant in their efforts to prevent employees and their employers from "spiking" pension benefits through artificial inflation of employees' final salary. This case is a textbook example.

In 2007, Joe Tanner was a candidate for city manager of Vallejo. To maximize his pension benefits, he proposed an employment contract that made every aspect of his compensation package count as "salary." By "converting" an automobile allowance, deferred compensation, and the employer's payment of his retirement contribution to salary, the proposed contract would have increased his "PERSable" salary from $216,000 to about $305,000—almost double the salary of his previous city manager position.

CalPERS disapproved designating any amount above $216,000 as salary. Tanner and Vallejo then revised the contract to provide for a salary of approximately $305,000, without listing the components that were part of the compensation package. However, the city's HR department confirmed that the $305,000 figure included the same components of compensation CalPERS had previously disqualified from the salary.

When Tanner applied for retirement, CalPERS again rejected the contention that his salary for retirement purposes was $305,000, instead limiting his final salary to $216,000. Tanner challenged this determination, but his arguments were rejected by an administrative law judge, the CalPERS board, and the superior court. Ducking whether the conduct constituted impermissible "spiking," the superior court based its finding on the limited grounds that Tanner's claimed $305,000 salary, or "pay rate," didn't appear on a publicly available pay schedule.

Tanner's appeal of the superior court decision relied on a highly technical argument. He asserted that the original version of the contract was based on a "mistake of law." Because of this "error," he argued, CalPERS and the superior court should have ignored the initial version of the contract and shouldn't have taken it into account in determining whether the ultimate agreement for $305,000 in total salary reflected "spiking."

Like the superior court, the court of appeal ignored Tanner's technical argument, focusing instead on the issue of whether his alleged $305,000 salary had been recorded on a publicly available pay schedule, as required by the PERL. Tanner claimed that his employment agreement and the city's HR department's analysis were the functional equivalents of a pay schedule. The appellate court disagreed.

Applying the plain meaning of "schedule," the appellate court concluded that neither the employment agreement nor the analysis came close to being a "list, catalog, or inventory" of the "rate of pay or base pay of one or more employees." Rather, the court noted that the key information about Tanner's salary was buried within a slew of figures, making a member of the public hard-pressed to locate his claimed base salary.

The court considered this flaw to be critical. Under the PERL, salaries of CalPERS members must be reflected in pay schedules that isolate their pay from other employment information and other figures. Ensuring that such information is readily available meets the important purpose of informing the public of the pay rate used in determining the amount of an employee's retirement benefits. It also helps to address concerns about pension "spiking."

The failure to comply with the "schedule" requirement cost Tanner over $1 million in potential retirement benefits over his lifetime. *Tanner v. California Public Employees Retirement System et al.* (California Court of Appeal, 3rd Appellate District, 6/28/16).

Bottom line

Neither CalPERS nor the courts had to go that far in disqualifying about one-third of Tanner's "salary" from his pension calculation. But public disclosure alone doesn't shield salary arrangements from being scrutinized for impermissible "spiking." Employers therefore should be on the lookout for other potential "red flags" that might cause CalPERS to reduce an employee's final compensation amount.

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