

**BEFORE THE BOARD OF TRUSTEES  
TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS**

**In the Matter of:**                    )  
  )  
                          **JERRY F. ARTHUR,**            )  
  )  
                          **Petitioner.**                    )

**PROPOSED DECISION RECOMMENDED BY THE CLAIMS HEARING  
COMMITTEE IN THE ADMINISTRATIVE REVIEW OF  
JERRY F. ARTHUR**

**I.     Introduction**

Pursuant to 80 Ill. Admin. Code § 1650.610 *et seq.*, an administrative review hearing was held May 23, 1995, in Chicago, Illinois, to consider the appeal of Teachers' Retirement System (TRS) member Jerry Arthur, challenging the staff determination that the \$10,000 incentive payment Mr. Arthur received in the 1992-93 School Year, which was subject to forfeiture pursuant to the terms of Mr. Arthur's Incentive Agreement with Coal City Community District No. 1 (Coal City), was not reportable in that School Year. Rather, the \$10,000 payment was determined to be properly reportable as TRS creditable earnings in the 1993-94 School Year when the payment was no longer subject to forfeiture.

The TRS Board of Trustees (Board), the trier of fact in this matter as provided in TRS Rule 1650.620 (80 Ill. Admin. Code § 1650.620), was represented at hearing by its Claims Hearing Committee comprised of the following Board members: Judy Tucker, Chairperson, James Bruner and Ray Althoff. The Committee was advised in its deliberations by Ralph Loewenstein, Independent Counsel to the Board of Trustees.

Prior to hearing, it was agreed between the Parties that Mr. Arthur's administrative review would be submitted to the Claims Hearing Committee solely upon the briefs and that oral argument would be waived.

After reviewing the briefs of the Parties and the exhibits submitted therewith, it is the determination of the Claims Hearing Committee that, based

upon the recent decision in MacGregor v. Board of Trustees of the Teachers' Retirement System, 200 Ill. Dec. 892, 636 N.E.2d 83 (1994), the \$10,000 incentive payment in question was properly reportable in the 1993-94 School Year when the payment vested in Mr. Arthur's possession.

## **II. Relevant Statutes and Rules**

In the instant case, the Claims Hearing Committee and the Board must apply 40 ILCS 5/16-121, which defines salary for TRS reporting purposes and states:

“Salary”: The actual compensation received by a teacher during any school year and recognized by the system in accordance with rules of the board. For purposes of this Section, “school year” includes the regular school term plus any additional period for which a teacher is compensated and such compensation is recognized by the rules of the board.

## **III. Issue Statement**

The Parties agreed prior to hearing upon the following issue statement:

In what School Year (1992-93 or 1993-94) did the \$10,000, which was paid to Mr. Arthur in the 1992-93 School Year pursuant to his Incentive Agreement with Coal City Schools, vest in his possession and become reportable as creditable earnings to TRS?

The Claims Hearing Committee finds this to be an accurate statement of the issue to be resolved in this matter.

## **IV. Statement of Facts**

Prior to hearing, the Parties stipulated to the following facts:

1. Mr. Arthur is the former Superintendent of Coal City Community District No. 1 (Coal City).
2. On June 21, 1993, Mr. Arthur entered into an Incentive Agreement with Coal City.

3. The Incentive Agreement provided that in the event Mr. Arthur terminated his employment with the District prior to June 30, 1996, he would be obligated to return all payments made to date pursuant to the Agreement.
4. The Incentive Agreement was terminated by a Release Agreement entered April 30, 1994.
5. Pursuant to the Incentive Agreement, Mr. Arthur was paid \$10,000.00 in the 1992-93 School Year and \$20,000.00 in the 1993-94 School Year.
6. TRS included the \$10,000.00 paid to Mr. Arthur in the 1992-93 School Year in Mr. Arthur's 1993-94 School Year creditable earnings.

Based upon the arguments presented by the Parties and the above stipulations, the Claims Hearing Committee makes the additional factual finding that the forfeiture provision in Mr. Arthur's Incentive Agreement is a penalty clause rather than a liquidated damages clause as asserted by the Petitioner.

#### **V. Positions of the Parties**

It is Mr. Arthur's position that: the \$10,000 Incentive Agreement payment to Mr. Arthur was salary at the time it was paid; the Incentive Agreement payments did not constitute a contingent interest, and the right to such payments vested at the time they were received; the refund provision of the contract was merely a liquidated damages clause setting forth the damages to be paid in the event of Mr. Arthur's breach; and the \$10,000 Incentive Agreement payment was not subject to a substantial risk of forfeiture.

It is TRS' position that: Mr. Arthur's \$10,000 Incentive Agreement payment was not reportable as salary until the release agreement with Coal City vested the \$10,000 in Mr. Arthur's possession; the payment was subject to a substantial risk of forfeiture until the release agreement was executed; and the forfeiture clause in the Incentive Agreement was a penalty clause and not a liquidated damages clause.

#### **VI. Discussion and Analysis**

Mr. Arthur asks the Committee to look strictly to when he received his incentive payments to determine when they are reportable as salary to TRS.

However, when the incentive payments were made is not determinative as to when the payments would be reportable as creditable earnings to TRS. Only when the \$10,000 payment was no longer subject to forfeiture in the 1993-94 School Year was it reportable. The staff determination is clearly supported by statute and case law. Article 16 of the Illinois Pension Code defines salary as:

The actual compensation received by a teacher during any school year and recognized by the system in accordance with rules of the board. For purposes of this Section, "school year" includes the regular school term plus any additional period for which a teacher is compensated and such compensation is recognized by the rules of the board. (40 ILCS 5/16-121).

The Fourth Appellate Court has recently dealt with the issue of when "salary" is reportable to TRS as creditable earnings. In MacGregor v. Board of Trustees of the Teachers' Retirement System, 200 Ill. Dec. 892, 636 N.E.2d 83 (1994), the Court stated:

The Pension Code, however, prohibits the recognition of, as creditable earnings, compensation to which an employee does not have a vested right. Section 16-121 defines salary as "actual compensation received" during a school year (Ill. Rev. Stat. 1991, ch. 108 1/2, par. 16-121), but contributions made to plaintiffs' rabbi trusts should not be considered received or vested when made as they were subject to a "substantial risk of forfeiture" because they were contingent on the future performance of substantial services. Where a beneficiary's right is contingent on the occurrence of certain events, the right does not vest until the occurrence of the events. Galvin v. Jackson Park Hospital (1989), 187 Ill. App. 3d 774, 777, 543 N.E.2d 822, 824, 135 Ill. Dec. 254. (MacGregor at p. 894).

The Appellate Court went on to state:

. . . The sole determinant for purposes of creditable earnings is whether the beneficiary's right is vested or contingent and, because plaintiffs' contributions are contingent, they do not fall under the statutory definition of salary. (Id. at p. 894).

The Committee finds that the \$10,000 payment made in the 1992-93 School Year was subject to a substantial risk of forfeiture. Mr. Arthur contractually agreed that he would forfeit the \$10,000 and any other monies paid pursuant to the Incentive Agreement if he failed to serve as Superintendent until the 1995-96 School Year. Mr. Arthur's keeping the incentive rested on his performance of substantial services. (i.e., serving as Superintendent until June of 1996). His absolute unfettered right to the incentive did not vest until that time. In other words, incentive payments were being contingently held by Mr. Arthur until he met the terms of the Incentive Agreement.

In his letter of July 29, 1994 (Exhibit 8), Petitioner argues that MacGregor does not apply because in MacGregor, payments were made to a Rabbi Trust as opposed to the administrators themselves. However, the MacGregor Court did not look to where the money in question was paid in reaching its decision. Rather, the Court relied strictly on whether a right to the earnings in question was vested or contingent. If the right is contingent, as it is in Mr. Arthur's case, the money is not reportable to the System until the right to it is no longer contingent (i.e., the 1993-94 School Year in Mr. Arthur's case).

Furthermore, Mr. Arthur as a Superintendent (i.e., employer) should have been well aware that incentive payments were not reportable as creditable earnings until they were no longer contingently held. Starting in 1991, prior to Mr. Arthur's Agreement, the TRS Employer Guide, on which the Fourth Appellate Court relied for support in MacGregor, clearly stated:

### **Prepayment of Bonus**

Payments prior to termination which are contingent upon retirement are not reportable until retirement. For example, a teacher receives a \$2,000 bonus or retirement incentive two years prior to retirement. If the teacher does not retire, the bonus must be repaid to the employer. The bonus is not reportable until the year in which the teacher retires. (Exhibit C).

It is clear from the Employer Guide that TRS' position regarding reportability would be no different with regard to Mr. Arthur's Incentive Agreement. The Committee finds that Mr. Arthur and Coal City were clearly on notice from the Employer Guide as to TRS' position on the reporting of contingent incentives and bonuses paid directly to an employee.

When an administrative agency has construed a particular statute consistently over a period of years as TRS has done in this case, as evidenced by past Employer Guides, it is presumed that the General Assembly concurred in that interpretation. As stated in Freeman Coal v. Ruff, 228 N.E.2d 279 (1967):

Rules of statutory construction are tools or aids for ascertaining legislative intention and the application of a particular rule is not in and of itself determinative of legislative intention. It is, of course, axiomatic that longstanding contemporaneous construction by ones charged with the administration of a particular statute is entitled to great weight in construing the statute. This doctrine of contemporaneous construction becomes even more persuasive when it has been of longstanding and the legislature, presumably aware of the administrative interpretation, has amended other sections of the act during the period involved but left untouched the sections subject to the seemingly approved administrative interpretation. Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 414 Ill. 275, 111 N.E.2d 329 (1953). Bell v. South Cook Co. Mosquito Abatement Dist., 3 Ill.2d 329 (1954). Mississippi River Fuel Corp. v. Illinois Commerce Comm'n, 1 Ill.2d 509, 116 N.E.2d 394 (1953). (Emphasis added). (Ruff at p. 282).

Since 1991, there have been numerous changes to Article 16 of the Pension Code and, yet the legislature has not seen fit to enact legislation to change TRS' interpretation of 40 ILCS 5/16-121 regarding when contingent payments are reportable. Accordingly, the Committee finds that TRS' interpretation must stand.

Lastly, the Committee finds that the forfeiture provision in Mr. Arthur's contract is not a liquidated damages clause as asserted. Rather, it is a penalty clause. As stated in Stride v. 120 West Madison Bldg. Corp., 87 Ill. Dec. 790, 477 N.E.2d 790 (1985):

. . . However, if the clause fixing damages is merely to secure performance of the agreement, it will be treated as a penalty and only actual damages proved can be recovered. (*Scofield v. Tomkins* (1880), 95 Ill. 190.) In doubtful cases, we are inclined to construe the stipulated sum as a penalty. *Beuttas v. Garvey* (1933), 270 Ill.App. 310. (Stride at p. 793).

The in terrorem clause in Mr. Arthur's Incentive Agreement was obviously placed there to secure performance. As such, it must be construed as a penalty. The significance of this distinction is that it demonstrates that the District expected performance. If Mr. Arthur did not perform, the money was not his to keep. Therefore, the incentive was subject to substantial forfeiture and not reportable until that risk was eliminated as held by the MacGregor court.

## **VII. Conclusion**

Based upon the foregoing, it is the Claims Hearing Committee's recommendation that the staff determination that Mr. Arthur's \$10,000 Incentive Agreement payment was not reportable until the 1993-94 School Year be upheld.

## **VIII. Notice of Right to File Exceptions**

Exceptions to the Claims Hearing Committee's Proposed Decision must be filed within fifteen (15) days of receipt by the Petitioner. A Final Decision will be issued by the Board of Trustees after it has considered the Claims Hearing Committee's Proposed Decision and any exceptions filed by the Petitioner.