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BOARD OF ADMINISTRATION
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

In the Matter of the Appeal Regarding Membership Exclusion of Foundation Employees by:

SANTA CLARA COUNTY HEALTH AUTHORITY,

Respondent,

and

KATHLEEN KING,

Respondent.

AGENCY CASE NO. 2014-1087
OAH Case No. 2015030359

RESPONDENT KATHLEEN KING'S REPLY BRIEF

INTRODUCTION

CalPERS apparently does not dispute that the facts here compel a finding of joint employment. Instead, it posits that, under the authority of *Metropolitan Water District of Southern California v. Superior Court* (2004) 32 Cal. 4th 491 ["*Cargill*"] and *City of Galt* (2008) PERB Precedential Decision 08-01, the concept of a joint employer simply cannot be encompassed within the PERL. It is submitted that CalPERS reads those two cases entirely too restrictively.

ARGUMENT

1. Neither the *Cargill* Case Nor the *City of Galt* Case Preclude a Joint Employer Theory

CalPERS reads the *Cargill* case as holding that when two employers are connected to the employment of a putative enrollee, one being the public agency and one being a private employer,

the only issue that CalPERS may determine is whether, under the common law, the public agency will be considered the employer of that individual.

The *Cargill* case came before the California Supreme Court without benefit of a trial on the facts. The facts assumed to be true, for purposes of the legal issue before the court, were that the plaintiffs worked under the direction of the public agency, were selected for employment by the public agency, were integrated into the public agency's workforce, had their rates of pay and schedules determined by the public agency, and were subject to discipline and termination by the public agency. At the same time, the plaintiffs were paid by "private labor suppliers" that contracted with the public agency. *Cargill* at 498-499. The court determined that the sole issue before it was whether, under the PERL, the public agency was required to enroll in CalPERS "all workers who would be considered [the agency's] employees under California common law". *Id.* at 496. The court noted that the PERL provides no useful definition of what it means by the term "employee". Thus, *Cargill* looked to various sources, beginning with federal cases interpreting federal law. *Id.* at 500.

Significantly, in entertaining the private labor suppliers' argument that the court should consider other statutes [workers compensation and unemployment insurance] which allow an allocation of responsibility between two employers---- a "co-employment" relationship---the *Cargill* court rejected that approach. The court drew a distinction between those other statute's definition of employment and how employment is defined "at common law", holding that "the court may not write such an omitted exception into the PERL statutes". *Id.* at 506. The court concluded its analysis as follows:

> In sum, we conclude the PERL's provision concerning employment by a contracting agency . . . incorporates a common law test for employment, and that nothing elsewhere in the PERL . . . or in statutes and regulations addressing joint employment and other contexts supports reading into the PERL an exception to mandatory enrollment for employees hired through private labor suppliers.

Cargill 32 Cal. 4th 491, 509.

The *Cargill* case simply cannot be read to *reject* the concept at common law of joint employment for purposes of determining who is an "employee" under the PERL. The only

discussion in *Cargill* regarding joint employment relates to specifics statutes which expressly address a joint employment relationship and allow liability to be allocated between one employer and another. *Cargill* distinguishes those statutes, holding that because they were specific to the statute in question, they had no relevance in determining who was an employee under the common law.

Cargill relied on numerous sources in discussing what comprises the common law, including federal law. *Id.* at 500-501. The whole import of the *Cargill* case is that because the PERL provides no definition of the term "employee" at all, to discern its meaning, the courts must turn to the common law. As argued in Respondent's Opening Brief, because the concept of joint employment is part of the fabric of the common law, it would be arbitrary and capricious to reject out of hand this doctrine if the facts lend themselves to it.

CalPERS approach--- that *Cargill* by implication rejects the joint employer theory without ever exploring it---is not even intimated anywhere in the case. In fact, the *Cargill* opinion, when dealing with the dissent's argument that a public agency should be provided more leeway in using "leased workers", actually characterizes the dissent's contention as "exploring common law issues neither decided by the lower courts nor briefed by the parties". *Cargill* 32 Cal.4th 491, 508. The court thus expressly chose not to visit any broader common law issues, amongst which the joint employer doctrine would be included. It did, however, state its holding as follows: "We conclude . . . that the PERL incorporates common law principles into its definition of a contracting agency employee". *Id* at 496. The case therefore cannot be read as supporting the notion that the concept of joint employment *per se* cannot be part of the PERL's definition of employee.

As with the *Cargill* case, CalPERS seems to argue that the *City of Galt* case requires CalPERS to utilize one test, and only one test, for determining the definition of an employee under the PERL. There is no doubt that CalPERS is bound to not arbitrarily stray from the holding in the *City of Galt* case once it adopted it as a precedential decision. But Respondent is not suggesting that CalPERS do that.

The holding in *Galt* is not nearly as broad as CalPERS portrays it. *The City of Galt* case examined whether the "Galt Services Authority", an entity created for the purpose of enhancing

retirement benefits for City's employees while circumventing the City's prior irrevocable decision to decline participation in social security benefits, was an employer of the City's employees under the PERL, as opposed to the City itself. The arrangement called for the employees to continue to function under the direction of the City, but the Galt Services Authority was obligated to maintain all personnel records for employees, recognize all City bargaining units and assume the associated labor relations duties to those units, and adopt all existing City rules, regulations, policies covering personnel matters. At the same time, the City was to provide the Galt Services Authority with office space, equipment and supplies, all at the City's expense, and was to reimburse the services agency for all of the salaries and benefits of the employees. In addition, all of the actions of the Authority were subject to City approval. Most significantly, the Services Authority was created for the purpose of being an "alternate employer" so that the City could avoid its social security obligations and increase CalPERS benefits for the employees even though the City had previously irrevocably opted into social security participation.

The *Galt* decision held that under the common law, the City remained the employer of the employees, not the Galt Services Authority. The *Galt* case reached its conclusion by analyzing the facts under the common law test for employment, as spoken of in *Cargill*. The case held that the service agency's right of control over the employees was "at best illusory" and that for all practical purposes, the employees would remain employees of the City.

As with *Cargill*, the *City of Galt* case did not consider whether a joint employer theory is part of the common law that is incorporated to the PERL. Therefore, simply because the case states that "CalPERS must apply the common law test for employment" does not mean that a joint employer theory is somehow excluded from the PERL's definition of employee. A joint employer theory was never a part of the case, and its holding therefore must be limited to the issue brought before it, which was, under *Cargill,* in the face of a contention that the individuals in question are solely employees of the Service Authority, would the common law actually deem them to be employees of the City? Because its holding is limited to that issue, CalPERS' reliance on the case for the proposition that the PERL cannot embrace the joint employer concept is, just as with the *Cargill* case, far too restrictive a reading of the case.

Moreover, CalPERS argument that only one employer can act as *the* employer, even if sustained, would still compel the conclusion that Respondent King was properly enrolled. After all, if one had to choose between the Authority and the Foundation, there is little doubt that the Authority holds all the earmarks of being *the* employer, as compared to the relative degree of control exercised by the Foundation. Because all of the factors supporting joint employment also support a finding that the Authority was the "true" employer, then even if CalPERS reading of *Cargill* is correct, the evidence supports a finding that Respondent King was covered anyway.

2. The Underlying Facts Demonstrate That The Authority's Exercise Of Control Over the Foundation Predominated

CalPERS points out what amounts to a smattering of evidence that the Foundation occasionally seemed to exert direct authority over its employees through its Board, as opposed to the Authority exercising such ultimate Authority. Based on these isolated instances, CalPERS argues that it was the Foundation, not the Authority that was "the employer".

The first instance CalPERS relies upon was a 2007 email indicating that the Foundation Board authorized an increase for Foundation CFO Emily Hennessey. Respondent agrees that the email does in fact seem to indicate that. However, there are far more numerous instances where the Authority controlled the rates of pay for Foundation employees, even including Ms. Hennessey's in another instance (*See* Respondent's Opening Brief p. 10, lines 3-22). Thus, although CalPERS points out a single instance where a pay rate may have been ratified by the Foundation Board, the Authority's control over Foundation employee pay increases and rates clearly predominated over any Foundation's exercise of such control.

In connection with that 2007 pay increase, CalPERS rejects Respondent's contention that this pay increase evidenced control by the CEO's Authority because she was the one that instigated it. CalPERS asserts that such argument is disingenuous because the Authority CEO may have proposed the increase while wearing her Foundation Board-member hat. To the contrary, whether the Foundation Board approved the pay increase or not, the fact that it was instigated by the CEO of the Authority precisely demonstrates the relationship between the Foundation and the Authority. When the CEO of the Authority sits on the Foundation Board, and recommends a pay increase for a

Foundation employee, the dynamic of the relationship is such that the Foundation Board is not likely to reject such a recommendation. Moreover, the Authority CEO's retention of the two Board positions simultaneously aptly demonstrates the relationship between the two entities---that there is far less than an arms-length relationship, a factor that further supports joint employment.

CalPERS also relies upon a CalPERS questionnaire filled out by the Authority's VP for Human Resources in which she stated that Foundation CFO Emily Hennessy performed services on behalf of the Foundation, not the Authority, and that her hours of work and supervision of her work were conducted by the Foundation, not the Authority. But one would always expect that the Foundation CFO's work would be directly supervised by the Executive Director of the Foundation, not by the Authority. The Foundation functioned as if it were a department or division of the Authority, with its own internal reporting lines, just as any department within an employer would have. Thus, her reporting to the Foundation is simply not probative of an absence of ultimate control of employment conditions by the Authority. After all, she reported to the Executive Director of the Foundation, but at the same time, the Authority overruled the Foundation's attempt to get her a pay increase. That kind of power renders the significance of that particular reporting line inconsequential, especially in the context of the numerous other factors demonstrating ultimate control by the Authority.

Of course, in that same questionnaire relied upon by CalPERS, the question "can the agency [the Authority] terminate the relationship at any time?" was answered by the Authority VP "Yes". Similarly, to the question "in your opinion, is the individual an employee of the agency [the Authority]?", she also answered "Yes". (CalPERS Exhibit 16, pp. 2 and 3 within). These two responses---highly probative of a direct employment relationship--- were omitted from CalPERS argument.

CalPERS also relies upon a letter from the CFO of the Authority stating that Foundation employees "were not reporting, supervising, directed or evaluated by the Health Authority CEO". CalPERS chooses to rely on this single sentence in a letter, rather than exploring the underlying facts. There was no testimony from the letter's author to explain the meaning or context of that statement. In fact, the overwhelming weight of the evidence, as chronicled extensively in

Respondent's Opening Brief, was that Foundation employees were directed and evaluated by the Authority, that their terms and conditions of employment were all controlled by the Authority, and that the Authority issued their paychecks, provided their benefits, and regulated all their employment conditions. Those facts are abundantly clear. In the face of all that specific evidence, submitted under oath, and unrebutted, CalPERS argues that this unexplained single sentence in a letter is highly probative of the actual underlying facts. However, because the mountain of countervailing evidence contradicts it, the statement must be seen for what it is: simply an allegation, unverified by its author, and uncorroborated by any other evidence in the record.

3. The Existence Of Two Technically Separate Entities Does Not Preclude A Finding Of Either Joint Employment Or Common Law Control By The Authority

CalPERS stresses that the Foundation and the Authority are "separate and distinct" as entities. Respondent does not dispute that there were two separate entities with two separate sets of charter documents. In Respondent's view, however, this contention is irrelevant.

Whether considered as a joint employer or even in assessing whether Respondent could have been a "common law employee" of the Authority only, the existence of two separate legal entities is in fact a necessary predicate for even delving into either the joint employer or the "common law employee" inquiries. In the *Cargill* case, there was no question that the private labor suppliers were separate legal entities from the *Metropolitan Water District* (the contracting public agency). Having a distinctly separate legal form, however, merely gives rise to the question; it does not weigh against a finding of joint employment or common law employment.

CalPERS also relies on the split of the Foundation from the Authority in 2013 as evidence that the Foundation had the power to be a distinctly separate entity, and because it possessed the power to terminate the relationship, this somehow precludes a finding of joint employment or common law employment.

In fact, the Foundation's severance of the relationship is not evidence that the Authority actually lacked control over the Foundation; it tends to show just the opposite. The weight of the evidence was that, given the extensive control the Authority had over the Foundation's activities, the Foundation could never function as a separate entity and get out from under the control of the

Authority unless it completely severed the relationship. After all, all of the Foundation's labor and employment policies and practices were controlled by the Authority. The Foundation's use of office space was controlled by the Authority, and was provided at close to no cost. The Authority appeared on the Foundation's employees paychecks, including Respondent King's. Given all these facts, in addition to the interrelationship between the operations of the two entities, it is clear that the Foundation was in a subordinate role to the Authority, and that was a dynamic that could not change unless the relationship was severed. As Ms. King explained in her testimony, the Foundation had to accept the actions that the Authority took over Foundation employees because it would be hard to buck the Authority and still continue with a good working relationship ("she could have made it very tough if I didn't do it" (T.R. 166:5-9)).

Consequently, CalPERS is incorrect when it states that when the administrative services agreement was terminated, that demonstrated that the Foundation always had the ability to buck the Authority, and that the only dynamic between the two organizations was a contract that governed some "administrative services". When an organization is receiving its rent at virtually no cost, when its office space is provided at the pleasure of the other organization, when all of its pay raises and employee personnel issues are controlled by the other organization, and when the organization's only purpose is to raise funding for the Authority, this is not simply an arm-length arrangement. Consequently, the severance of the relationship signaled the end of the Authority's control, but it does not demonstrate an absence of control before that point. After all, in *Cargill*, the private labor suppliers presumably were not bound for eternity to their contractual relationship with the Water District, but simply because they could have ended the relationship at some point is not indicative of an absence of control by the District while the relationship endured.

4. <u>CalPERS' Tax Qualification Status Is Not Implicated By Any Issue In This Case</u>

CalPERS seems to intimate that the *Cargill* and *City of Galt* cases require it to only consider whether a given employee is solely the employee of the public agency, and not whether that employee might be in a joint employment relationship, and that this determination somehow implicates tax issues. However, there is no tax issue raised by the instant case.

Respondent King received her paycheck and her W-2 from the Authority, not from the Foundation. The same is true for all other Foundation employees. For IRS purposes, it is clear that there is but one employer here, the Authority. Consequently, there is nothing inconsistent about Foundation employees being treated as employees of the Authority for purposes of CalPERS participation, just as they are employees of the Authority for payroll tax withholdings and payments. This is not a situation where the Authority merely provided payroll services for Foundation employees and held itself out as the sole employer for payroll tax withholdings, but at the same time that was the only activity that connected the two entities. In that situation, Respondent agrees that some tax issue might be implicated. However, where the facts clearly give rise to a joint employment relationship, and thus allow Foundation employees to be treated as employees of the Authority for many purposes, including those consistent with how the employees' taxes have been withheld and who has been identified to the IRS as the employer, then the Foundation employees *are* Authority employees for tax qualifications purposes, and no case law considering a joint employer theory suggests otherwise.

5. <u>There Is No Evidence That Any Of The Relevant Parties Have Attempted To Falsely Obtain Pension Benefits</u>

CalPERS portrays this case as one where Respondent Kathleen King was "being misreported as an employee of a CalPERS-contracting entity for the sole purpose of taking advantage of CalPERS pension benefits" (CalPERS post hearing brief at p. 1, 21-23). In fact, nothing can be further from the truth.

There is not a shred of evidence in the record that Respondent was "misreported" - as if this were some scienter-laden undertaking to reap pension benefits to which she is not entitled. It is clear from the record that the relationship between the Authority and the Foundation is at best unusual. For all employment-related purposes, the Authority held itself out as the employer of the Foundation employees. The entities were chartered as two distinct legal beings, but they also had a close working relationship in which the Authority dictated the amount of office space, the amount of compensation, and even the amount and terms of the employees' benefits the Foundation employees would have. The paychecks came from the Authority, the benefits are provided by the Authority,

and all other aspects of the employment were regulated by the Authority. As such, there is not a scintilla of evidence that either Respondent King or the Authority believed that she was being "misreported" or that some sort of scheme was undertaken "for the sole purpose of taking advantage of CalPERS pension benefits".

While the state of mind of Respondent King, or even of the collective state of mind of both organizations, does not directly appear in the case law as an enumerated factor to be considered, there is no question that the element of contrivance had some bearing on the holdings in both *Cargill* and *City of Galt*. In the *City of Galt* case, that decision specifically found that the only reason the Galt Services Authority was created was to enhance pension benefits for the participating employees. If an organizational structure is manufactured for the dual purpose of reneging on the City's commitment to provide social security benefits while at the same time exploiting what benefits CalPERS had to offer, that presents an entirely different scenario than an organizational arrangement that has nothing to do with pension or other employee benefits.

Somewhat similarly, in the *Cargill* case, the Water District was able to take great advantage of the private labor suppliers' position as a non-public entity by avoiding the Water District's required Merit Selection System for hiring employees, by avoiding the District's restrictions for its own employees on long-term temporary hires, by avoiding paying for other non-CalPERS benefits for those hires, as well as avoiding paying all the CalPERS contributions. *Cargil* 32 Cal.4th 491, 497-498, 503-504. The *Cargill* court recognized that employees of the private labor suppliers may have received their paychecks from those private employers, but that factor can only go so far when the public agency appears to have manipulated the terms of employment in part to avoid the obligation to fund CalPERS benefits.

This case involves the opposite situation. Here, the contributions on behalf of Respondent have all been made. Those contributions were made in good faith. There is no evidence that there was ever any attempt to mislead CalPERS. Instead, the Foundation and the Authority developed their own relationship and their own system with dealing with employees in myriad ways that in no way were motivated by who would be a CalPERS participant. All employees were paid with Authority paychecks, and all employees received the same employee benefits package, whether they

worked for the Foundation or whether they worked for the Authority. Consequently, the notion that there was some kind of subterfuge going on is completely unsupported.

In one sense, the innocent character of Ms. King's participation, along with her fellow Foundation employees, does factor into the overall ramifications of this case. The evidence was unrebutted that there are at least two former Foundation employees who are currently drawing a CalPERS pension. If the decision is made that Ms. King was being "misreported", it may very well follow that CalPERS will question the current drawing of CalPERS benefits by those other former employees. Respondent does not contend that a party that is not entitled to CalPERS benefits should receive them anyway. However, given the complex set of facts here and the unusual circumstances of the relationship between these two entities, Ms. King's enrollment in CalPERS, as well as the two retirees who are currently drawing benefits, must be distinguished from *Cargill* and the *City of Galt* where there was an attempt to manipulate the employment conditions around CalPERS rules.

CONCLUSION

Respondent and CalPERS have a substantial disagreement over how restrictive the *Cargill* and *City of Galt* cases should be read. CalPERS position in essence is that under what it terms the "common law employment test", if there are dual employers involved, then one employer's role as *the* employer must predominate over the other. If the two employers share employment responsibilities, then, according to CalPERS, the joint employer concept, even though it exists in the common law, is not to be incorporated into the PERL. This contention is made in the face of the *Cargill* court's statement that "we conclude . . . . that the PERL incorporates common law principles into its definition of the contracting agency employee and that the PERL requires contracting public agencies to enroll in CalPERS all common law employees except those excluded under a statutory or contractual provision". 32 Cal. 4th 491, 496.

This notion that even if the joint employer concept fits like a glove, CalPERS is prohibited from recognizing it, reads into the PERL and the case law an artificial restriction. *Cargill* tells us that the common law must be controlling in determining who is an employee of the public agency. *Cargill* further tells us that those properly excluded from coverage are "those excluded under a statutory or contractual provision". *Cargill* at 496. There is no such statutory or contractual

exclusion that applies here. Consequently, those who would be considered employees of the contracting agency as part of a joint employment relationship, because such relationship is part of the common law, must be incorporated into the PERL's definition of "employee".

For all these reasons, CalPERS findings should be overturned, and Respondent King should be properly credited for the contributions previously made on her behalf.

Dated: November 4, 2015

WYLIE, McBRIDE, PLATTEN,
& RENNER

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PROOF OF SERVICE

I declare:

That I am now and at all times herein mentioned a citizen of the United States and a resident of Santa Clara County, California. I am over the age of eighteen years and not a party to the within action. My business address is 2125 Canoas Garden Avenue Suite 120, San Jose, CA 95125. On this date I served the following:

RESPONDENT KATHLEEN KING'S REPLY BRIEF

X ____ By Mail: by placing a true copy thereof, enclosed in a sealed envelope with postage thereon fully prepaid, in the United States Post Office mail at San Jose, Santa Clara County, California, addressed as set forth below. I am readily familiar with my firm's practice of collection and processing correspondence for mailing. It is deposited with the U.S. Postal Service on that same day in the ordinary course of business. I am aware that on motion of a party served, service is presumed invalid if postal cancellation date or postage meter date is more than 1 day after date of deposit for mailing in affidavit.

X ____ By e-mail: I personally sent to the addressee's e-mail address a true copy of the above-described document(s). I verified transmission.

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I declare under penalty of perjury that the foregoing is true and correct. Executed on November 4, 2015, at San Jose, California.

EVANGELINA M. TRUJEQUE