

**ATTACHMENT A**  
**STAFF'S ARGUMENT**

## **STAFF'S ARGUMENT TO ADOPT THE PROPOSED DECISION**

At its February 18, 2016, meeting, the CalPERS Board of Administration (Board) declined to adopt the Proposed Decision in this matter and granted a full Board Hearing in connection with the appeal of Respondents Santa Clara County Health Authority (Authority) and Kathleen King (Respondent King).

CalPERS staff requests that the Board deny Respondents' appeal of the staff determination that Respondent King was not an employee of the Authority and is not eligible for CalPERS membership.

### **I. SUMMARY OF CASE**

Respondent King was hired in 2008 by the Santa Clara County Family Health Foundation (Foundation), a non-profit 501(c)(3) organization. The purpose of the Foundation was to raise funds to support Healthy Kids, a subsidized health coverage plan administered by the Authority. The Foundation is not a CalPERS contracting agency.<sup>1</sup>

In 2013, the CalPERS Office of Audit Services performed a Public Agency Review of the Authority. CalPERS determined that Respondent King was an employee of the Foundation and had been improperly reported by the Authority as an employee of the Authority. Since the Foundation is not a CalPERS contracting agency, CalPERS determined that Respondent King was not eligible for CalPERS membership. Respondent King and the Authority timely filed appeals.

On August 20, 2015, CalPERS issued a First Amended Statement of Issues (SOI). (CalPERS Exhibit 1) The sole issue presented by the SOI was whether CalPERS correctly determined that Respondent King was an employee of the Foundation and that the Authority incorrectly reported her as an employee for purposes of CalPERS membership.

The hearing in this matter included testimony of Respondent King, Emily Hennessey – a subordinate of Respondent King, and CalPERS staff that were involved in the audit and subsequent determination.

A Proposed Decision was issued on December 3, 2015, denying the appeal and finding that the evidence presented by Respondents did not establish that Respondent King was a common law employee of the Authority. (Attachment D)

At the Board meeting held on February 18, 2016, CalPERS staff argued for adoption of the Proposed Decision. Instead, the Board set this matter for a full Board Hearing.

---

<sup>1</sup> The Foundation is not eligible to become a contracting agency with CalPERS pursuant to Government Code section 20056 and Internal Revenue Code section 414(d).

## **II. ISSUE PRESENTED**

Whether CalPERS correctly determined that Respondent King was an employee of the Foundation and that the Authority incorrectly reported her as its employee for purposes of CalPERS membership.

## **III. FACTUAL BACKGROUND**

The Authority is a public entity that contracts with CalPERS for retirement benefits for its eligible employees. The Authority was established in 1995 by an ordinance enacted by the Santa Clara County Board of Supervisors to develop the expansion of Medi-Cal Managed Care.

Respondent King was hired in 2008 by the Foundation, a non-profit 501(c)(3) organization. The purpose of the Foundation was to raise funds to support Healthy Kids, a subsidized health coverage plan administered by the Authority. The Foundation is not a CalPERS contracting agency.

In 2013, the CalPERS Office of Audit Services performed a Public Agency Review of the Authority. CalPERS discovered that despite Respondent King having the title of Foundation CEO, the Authority had been reporting her to CalPERS as an employee of the Authority. CalPERS ultimately determined that Respondent King was an employee of the Foundation and had been improperly reported by the Authority as an employee of the Authority. Since the Foundation is not a CalPERS contracting agency, CalPERS determined that Respondent King was not eligible for CalPERS membership.

The CalPERS audit finding that the Foundation is an affiliated entity of the Authority and that Foundation employees are not employees of the authority was based on a number of facts. The Foundation bylaws permit the Foundation Board to delegate the management of the day-to-day operation of the business of the corporation. The Foundation and Authority entered into an Administrative Services Agreement (Agreement) in 2002 based on that delegation of power. Pursuant to the Agreement, the Authority would provide all of the administrative services for the Foundation, including human resources and payroll. The Agreement also expressly states that the Authority and the Foundation are "separate and independent entities" and further states "neither [the Authority] nor the Foundation, nor the employees, servants, agents or representatives of either, shall be considered the employee, servant, agent or representative of the other."

In a response letter to the audit by CalPERS, the Chief Financial Officer for the Authority informed CalPERS that from 2009 onward Respondent King was a direct report of the Foundation Board and that Foundation employees "were not reporting [to], supervised, directed or evaluated by the Health Authority CEO." Similarly, the Vice-President of Human Resources for Authority wrote in an email to CalPERS that Respondent King and two other Foundation employees "were hired to provide support exclusively for the Foundation."

At the hearing, Respondents submitted documentary evidence and the testimony of Respondent King and Emily Hennessey, the Finance Director for the Foundation.

Respondents argued that despite what the Foundation bylaws and the Agreement state, Respondent King was a common law employee of the Authority, or of both the Authority and the Foundation, and that CalPERS should recognize this co-employment situation to allow Respondent King membership in the CalPERS system.

In support of their co-employment theory, Respondents provided examples of how the organizations operated. For instance, W-2 forms and paychecks identified Authority as the employer; employee evaluations, including self-reviews, were organized by the Authority's HR department; office space and supplies were provided by the Authority and the Foundation used the Authority's servers and email addresses. Respondent King also testified that it was really the Authority's CEO that directed her employment, including how much her salary would be, who she was able to hire and fire, and approval for time off.

However, in 2012, the Foundation and Authority terminated the Agreement. As soon as the Agreement was terminated, so did the examples Respondents cite to as evidence of control by the Authority. The Foundation moved offices and contracted with other providers for payroll, administrative services and human resource functions.

The Administrative Law Judge (ALJ) looked to *Metropolitan Water District v. Superior Court* (2004) 21 Cal.4<sup>th</sup> 491 (*Cargill*) and *Tieberg v. Unemployment Ins. App. Bd.* (1970) 2 Cal.3d 943, to apply the common law employment test and determine whether Respondent King was a common law employee of the Authority. Under that test, the most important factor is the right to control the manner and means of accomplishing the result desired.

The ALJ found that Respondents did not prove that Respondent King's employment situation meets the "control or right to control the manner and means" requirement. First, the relevant documents clearly established that the Foundation is a separate entity from the Authority. Respondent King estimated that under her leadership, the Foundation raised about \$132 million for the Authority; however, it was not established that the Authority directed those efforts so as to have controlled "the manner and means" to accomplish those results. The ALJ further found that the Agreement would not have been necessary if the Authority had the right to control the Foundation, and that when the Agreement terminated, so did the examples Respondents cited to as evidence of control by the Authority.

The ALJ found that Respondent King was an employee of the Foundation, not of the Authority, and that she was not employed by both. The ALJ concluded that Respondents' appeal should be denied.

## IV. ARGUMENT

### A. The Correct Test was Used to Determine Whether Respondent King was an Employee of the Authority.

The PERL does not define "employee," and case law holds that the common law employment test should be applied by CalPERS to determine whether an individual is an employee for PERL purposes.<sup>2</sup> In 2008, the Board designated *Galt Services Authority*<sup>3</sup> as a Precedential Decision. The *Galt* decision provides as follows:

In *Cargill*, the [California Supreme Court] held that the PERL requires contracting public agencies to enroll in CalPERS all common law employees. CalPERS argues that the common law employment test, which the *Cargill* court used to ensure that [a contracting agency's] employees would obtain pension benefits, should be applied in this matter to deny enrollment in CalPERS to [a contracting agency's] claimed employees. CalPERS' argument is persuasive. Although the court in *Cargill* used the common law employment test to provide CalPERS pension benefits to [a contracting agency's] common law employees, CalPERS may use that same test to deny pension benefits to any persons who are not common law employees....

(Emphasis added.)

Based on the California Supreme Court case of *Cargill* and the Precedential Decision in *Galt*, the ALJ correctly applied the common law employment test to determine whether Respondent King was an employee of the Authority.

### B. The Common Law Employment Test was Correctly Applied to Determine that Respondent King was Not an Employee of the Authority.

The common law employment test was first described by the California Supreme Court in *Empire Star Mines Co.*<sup>4</sup>:

In determining whether one who performs services for another is an employee or an independent contractor, *the most important factor is the right to control the manner and means of accomplishing the result desired.* If the employer has the authority to exercise complete control, whether or not that right is exercised with respect to all details, an employer-employee relationship exists. Strong evidence in support of an employment relationship is the right to discharge at will, without cause. Other factors to be taken into consideration are (a) whether or not the one performing services is engaged in a distinct occupation or business; (b)

---

<sup>2</sup> *Metropolitan Water District v. Superior Court* (2004) 21 Cal.4th 491 (*Cargill*).

<sup>3</sup> *Galt Services Authority*, Prec. Dec. No. 08-01, effective October 22, 2008.

<sup>4</sup> *Empire Star Mines Co. v. Cal. Emp. Com.* (1946) 28 Cal.2d 33, 43-44

the kind of occupation, with reference to whether in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; (c) the skill required in the particular occupation; (d) whether the principal or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work; (e) the length of time for which the services are to be performed; (f) the method of payment, whether by the time or by the job; (g) whether or not the work is a part of the regular business of the principal; and (h) whether or not the parties believe they are creating the relationship of employer-employee. (Emphasis added.)

It is clear that the most important factor when applying the common law employment test is the right to control the manner and means of accomplishing the result desired. The ALJ sifted through all of the evidence presented at the hearing and correctly determined that "Respondents did not prove that Respondent King's employment situation meets the "control or right to control the manner and means" requirement. (Attachment D, Legal Conclusions p.4)

Respondent King estimated that under her leadership, the Foundation raised about \$132 million for the Authority. However, the ALJ specifically found that Respondents did not establish that the Authority directed this effort so as to have controlled "the manner and means" used to accomplish this result. Further, the ALJ found that the Authority and the Foundation contracted (via the Agreement) for the provision of services; and the Agreement would not have been necessary if the Authority had the right to control the Foundation. When the Agreement terminated, so did the examples Respondents cite to as evidence of control by the Authority. Furthermore, none of the services that were provided by the Authority pursuant to the Agreement are of the type of criterion that establish "control".

The ALJ could have ended the analysis after making the above finding, as the most important factor of the test was not met. However, the ALJ pressed on and the Proposed Decision provides a comprehensive analysis and leaves nothing open to question. For instance, Respondent King put on evidence that she was required to get approval from the Authority CEO before she could take time off work. The ALJ acknowledged this fact but dismissed it in the following way:

The two entities were admittedly intertwined, to the extent that the CEO of the Authority seemed at times to ignore the fact that the Foundation was separate and that Respondent King reported to the Foundation's Board. For reasons not explained, Respondent King did not assert her rights as the Foundation Executive Director to have the Foundation make decisions such as when she could take leave at a particular time. But this failure does not make her a common law employee of the Authority; the evidence did not establish that the Authority controlled her employment in significant or meaningful ways and it certainly did not have the right to do so. (Attachment D, Legal Conclusions p.4)

**C. Failure to Adopt the Proposed Decision Risks CalPERS' Status as a Tax-Qualified Plan Because CalPERS Must Operate For the "Exclusive Benefit" of the Participating Employer's Common Law Employees.**

The risks associated with permitting Respondent King's membership in CalPERS are high. CalPERS is qualified under section 401(a) of the Internal Revenue Code (IRC) and, as a result, it is tax-exempt under IRC section 501(a). For a pension plan like CalPERS to be qualified and retain its tax-exempt status it must be operated for the "exclusive benefit" of the employers' employees and their beneficiaries.<sup>5</sup> Accordingly, CalPERS must ensure that its contracting agencies provide retirement benefits *only* to their employees. Failure to do so jeopardizes the tax-exempt status of the CalPERS plan. As such, CalPERS cannot permit individuals like Respondent King who are not employees of a contracting agency under the *Cargill* and *Galt* common law employment test, to reap CalPERS benefits.

**V. CONCLUSION**

This case is not an academic exercise. There are very real negative consequences for not adopting the Proposed Decision and permitting ineligible persons into CalPERS membership. The standards for determining who is entitled to CalPERS membership must be clear and consistently applied. Without such standards, persons employed by private entities – which have different goals and compensation arrangements than public entities – would creep into membership status, in a way that neither the Legislature nor this Board ever contemplated or approved. That is why this Board has clearly stated in a precedential decision (*Galt*, cited above) that the common law employment test applies to membership determination and is the only test uniformly used to determine whether to include or exclude persons from membership. Dual or joint employment between a CalPERS-contracting agency and a non-CalPERS-contracting agency is not a concept that is contained in the common law employment test nor has it been recognized by CalPERS as a way for ineligible persons to manipulate the system and become members.

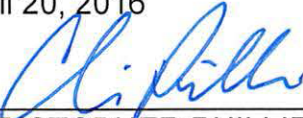
The Proposed Decision properly applies the common law employment test. It is clear that Respondent King was not an employee of the Authority. While a requirement of her position, as well as other positions of the Foundation, was to work collaboratively with the Authority to achieve common goals, more than collaboration is needed to establish an employment relationship. The glaring reality is that once the Foundation decided to terminate the Agreement with Authority, all the alleged "control" Respondents rely on disappeared. The reason it disappeared is that all of the services and functions that had been performed by the Authority were only performed pursuant to the Service Agreement. The ALJ saw through Respondents' arguments and reached the correct result.

---

<sup>5</sup> See, 26 U.S.C. § 401(a); see also 26 C.F.R. § 1.401-1(a)(3), "In order for a trust forming part of a pension... plan to constitute a qualified trust under section 401(a), ... (ii) It must be part of a pension... plan established by an employer for the exclusive benefit of his employees or their beneficiaries..."

Accordingly, staff argues that the Board should adopt the Proposed Decision that upholds CalPERS' determination that Respondent King was an employee of the Foundation and not an employee of the Authority, and the Authority should not have reported Respondent King to CalPERS for purposes of membership.

April 20, 2016



---

CHRISTOPHER PHILLIPS  
Senior Staff Attorney