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July 3, 2017

**VIA FEDEX ONLY, SIGNATURE REQUIRED**

Renee Ostrander  
Chief, Employer Management Account Division  
P.O. Box 94229  
Sacramento, CA 94229-2709

Dear Ms. Ostrander:

This letter constitutes the appeal by Local Government Services (“LGS”), a duly formed joint powers agency, of CalPERS adverse determination dated June 19, 2017, rejecting the accrued service credit of LGS employees since inception of the LGS-CalPERS contract in 2002. Pursuant to the due process clauses of the United States Constitution, set forth in the Fourteenth Amendment, and Article 1, section 7 of the California Constitution, and California Code of Regulations, title 2, section 555.1, the instant appeal is filed on behalf of LGS and all individuals who have been employed by LGS since its inception whom are impacted by CalPERS adverse determination.<sup>1</sup>

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<sup>1</sup> This appeal is not intended to, nor should be viewed by CalPERS, as an impediment to the timely transfer of service credit from LGS to its client partners as contemplated by CalPERS determination. However, we would be remiss to allow the various misrepresentations and inaccuracies set forth in the June 19 letter to LGS and its employees to go unanswered. As a review of your correspondence file will reflect, LGS administrators and its attorneys have repeatedly attempted to meet with CalPERS program and legal staff to resolve this service credit dispute. Indeed, since the 2015 draft audit was released, over the last two years CalPERS has consistently refused any and all meetings to discuss the employment status of former and current LGS employees. By this appeal LGS further demands that CalPERS correct, in writing, its blatant misrepresentations. Finally, we note that despite written and verbal communication that LGS was requesting a meeting to discuss implementation of the final audit conclusions, which CalPERS had set an August 14 deadline to complete, your agency failed to respond to our meeting request while it secretly prepared the multitude of letters to LGS and its employees.

BAR ADMISSIONS:

UNITED STATES SUPREME COURT

UNITED STATES COURT OF APPEALS: DISTRICT OF COLUMBIA, NINTH AND TENTH CIRCUITS • ALL CALIFORNIA FEDERAL AND STATE COURTS

LGS has reviewed the final audit report and strongly disagrees with the Office of Audit Services' (OAS) analysis and conclusions that LGS incorrectly enrolled individuals who were not LGS employees into membership in that, according to CalPERS, LGS employees were common law employees of its partner agencies. This conclusion is based on a flawed interpretation of common law factors for determining employer/employee relationship. LGS also strongly objects to CalPERS's decision to ignore their own advice of 2006, to LGS wherein CalPERS expressed no reservations about the LGS business model of assigning employees to clients. To impose a highly damaging retroactive solution to a situation allowed by CalPERS to continue for fifteen and a half years, when no harm was intended or caused to anyone, constitutes an imprudent misuse of public resources.

LGS recognizes that CalPERS has a fiduciary duty to only enroll eligible employees into its pension system. However, here CalPERS has conducted a flawed analysis of common law control factors in rejecting the LGS employees, and has disregarded other laws which may also form the basis for eligible pension eligibility. The common law control test is dependent upon several factors; the refusal of CalPERS' program staff to meet with LGS to discuss these factors and their relative weight in the LGS service delivery model has prevented a mutually satisfactory resolution of this ongoing dispute. It is undisputable that analysis of common law employment implicates analysis infused with a certain degree of discretion by the decision-makers. Here CalPERS has the authority, and has indeed acted, to exercise its discretion to protect accrued service credit of public employees by considering transferring employees to other agencies. If these reallocation agreements are finalized, CalPERS should make a good faith effort to preserve the service credit of all remaining LGS employees.

### ***Background***

LGS was created and duly organized as a public joint powers agency in March, 2001. Consistent with the Legislature's intent in enacting the joint exercise of powers statute, Government Code section 6500 et seq., LGS was created to provide cost effective and efficient services to other public agencies in need of administrative support, employer of record services, and a convenient method of staffing programs that did not have permanent or on-going funding.

Shortly after formation, LGS decided to pursue CalPERS membership to provide a defined benefit program for future LGS employees. LGS informed CalPERS as to the purpose and business model of the JPA. LGS sought further CalPERS assistance after formation when LGS was setting up groups based on client locations for Employer Paid Member Contributions (EPMC). In fact, CalPERS continued over ensuing years to provide assistance on how to designate different groups for EPMC benefits. Again, no objections were made by CalPERS as to the LGS service delivery model.

In 2006 CalPERS conducted a payroll audit of LGS. There were no identified issues or challenges by CalPERS to the operational model of LGS. During this 2006 review, CalPERS examined every LGS employee's employment agreement. Every agreement contained the employee's assignment to support a named client agency. Furthermore, almost every employee agreement stated that the employee was full-time assigned to one client. LGS made no attempt to hide its business model. Yet, CalPERS' review made no mention of CalPERS' objection to the model or concern that LGS was not the common law employer. LGS continued to employ staff and assign to client agencies, continued to make contributions per CalPERS direction, and now eleven years later – fifteen years after taking on its first client – CalPERS reverses their position retroactive to day one, with no explanation of why it put LGS and its employees in jeopardy or allowed them to continue in jeopardy, building up additional years of service and contributions to be stripped away because CalPERS changed its mind.

LGS has paid all contributions required for over fifteen and a half years of operations. LGS employees have received member statements from CalPERS, and LGS has been in regular contact with CalPERS.

In December 2012 CalPERS initiated another audit. Not until May 8, 2015 did CalPERS issue its draft audit. This draft audit concluded that the four sampled LGS employees were improperly reported to CalPERS as their assigned employer was in CalPERS' view the common law employer, rather than LGS. By response dated July 7, 2015 LGS objected to the draft audit's conclusions.

Despite the gravity of its conclusions in potentially denying accrued service credit to approximately 140 public employees, CalPERS then failed to act diligently in completing the audit. The final audit was not released until April 28, 2017. At some point during that period CalPERS solicited an investigation and report from the California Attorney General into whether LGS was the common law employer of the affected individual employees. Despite acting as the agent for CalPERS for its audit of LGS, the Attorney General has asserted that its investigation is confidential, thus requiring LGS to seek future administrative and judicial intervention to obtain the investigation materials. The lack of diligence, secrecy, arbitrary and capricious conduct and utter disregard for the potential impact on the lives of public employees if they were to lose their accrued pensions flies in the face of the rule of law and principles of governmental obligations and fairness which are the hallmark of American democracy.

In response to CalPERS' final audit legal analysis, LGS responds that it is flawed with respect to (1) limiting employment to the common-law control test; (2) ignoring the well-established legal concept of co-employment; (3) ignoring CalPERS own recognition of statutory employment as an alternative basis to common-law employment; and (4) CalPERS mischaracterizes the Supreme Court's opinion and holding in *Metropolitan Water District v. Cargill* (2004) 32 Cal.4<sup>th</sup> 491.

The question of employment status is not answered by the Public Employees' Retirement Law, Government Code section 20000 et seq. ("PERL") or its regulations, but by analysis of common law and statutory principles outside the PERL.

CalPERS' audit states that an employee for purposes of CalPERS membership is defined solely by the traditional common law test. It relies upon *Cargill*, in which the California Supreme Court found that the term "employee" as used in the PERL is defined by use of the traditional common law test. In *Cargill*, the Metropolitan Water District of Southern California ("MWD") contracted with CalPERS to provide retirement benefits to MWD employees. The single issue of law presented in that case was whether, under the PERL, and MWD's contract with CalPERS, MWD was required to enroll in CalPERS all workers who would be considered MWD's employees under California common law. *Cargill, supra*, 32 Cal.4<sup>th</sup> at 496.

MWD had entered into contracts with several private labor suppliers to provide it with workers, and had not enrolled these workers in CalPERS retirement plans. Instead, MWD characterized them as "consultants" or "agency temporary employees." *Cargill, supra*, 32 Cal.4<sup>th</sup> at 497. The Supreme Court determined that under the provisions of the PERL, MWD was obliged to enroll in CalPERS all its employees other than safety employees and those excluded by the PERL.

In *Cargill*, the Court took care to explain that it was confining itself to the single issue of whether MWD was required to enroll workers considered employees as defined by the common law test. *Cargill, supra*, 32 Cal.4<sup>th</sup> at 496. It explored the details of the working relationship between MWD and its labor suppliers and used the common law test to require enrollment of common law employees not otherwise excluded by the PERL. *Cargill* did not hold that the common law test is the exclusive means for determining the employer/employee relationship. Nor did the Court have before it any asserted legislative intent to define as "employee" separate and apart from the common law control test.

Neither the PERL nor CalPERS regulations define common law employment. The Supreme Court, however, recognized in *Cargill*:

[T]he PERL incorporates common law principles into its definition of a contracting agency employee and the PERL requires contracting public agencies to enroll in CalPERS all common law employees except those excluded under a specific statutory or contractual provision. *Cargill, supra*, 32 Cal.4<sup>th</sup> at 496.

The Supreme Court also concluded that there was no co-employment exception to the requirement of enrolling employees into CalPERS; thus, where two employers shared responsibility and authority, if one employer provided CalPERS benefits, the employee must be enrolled.

CalPERS has never adopted regulations defining employment for pension eligibility, nor has it ever addressed through the regulatory process whether co-employment or statutory employment may serve as bases for service credit eligibility. Although in 2008-2009 it had provided notice of a scheduled public hearing (subsequently cancelled and never rescheduled) CalPERS has never promulgated a regulation defining common law employment. It issues circular letters, however, that explain CalPERS' policy in light of the PERL and establish rules and guidelines that "employers are expected to follow." Absent duly adopted regulations under the Administrative Procedure Act, or statutory definitions within the PERL, Circular Letter 200-154-04 sets forth CalPERS policy for determining workers' status under the common law standard for employment and pursuant to statutory employment criteria.

In LGS' view, CalPERS must consider all potential legal standards for determining which agency is the employer of LGS employees. It must also properly apply all aspects of the common law test, and not improperly apply precedents that dealt with different situations, in which employers were attempting to avoid enrolling employees in CalPERS by treating them as independent contractors. All LGS employees were enrolled in CalPERS.

### ***Legal Basis for Appeal***

1. Despite having been instructed by judges to the contrary, CalPERS continues to misinterpret and misapply the legal conclusions of the California Supreme Court in *Metropolitan Water District v. Cargill*.
2. Despite having been instructed by judges to the contrary, CalPERS continues to reject the well-settled legal theory of co-employment as a basis for pension eligibility. "General and special employment" and "joint employment" are concepts long recognized in California. As one court has held, "[i]t is settled that a general and special employment relationship is present if there exists in each some power, not necessarily complete, of direction and control. As indicated, the control need not be exercised. It is sufficient if the right to direct the details of the work is present." *Sehrt v Howard* (1960) 187 Cal.App.2d 739, 742. Moreover, as the court opined in *In-Home Supportive Services v. Workers' Compensation Appeals Board* (1984) 152 Cal.App.3d 720, 732, "joint employment occurs when two or more persons engage the services of an employee in an enterprise in which the employee is subject to the control of both."
3. Despite having been instructed by judges to the contrary, CalPERS continues to reject the well-established theory of statutory employment as a basis for pension eligibility. LGS is established as a joint powers authority pursuant to the Joint Exercise of Powers Act. The Joint Exercise of Powers Act (Govt. Code § 6500 et seq.) empowers public agencies to exercise by cooperative action any existing

power common to the contracting public entities and to have their own employees to perform the work of the agency. (Govt. Code §§ 6500, 6502, *Oakland v. Williams* (1940) 15 Cal.2d 542; 50 Ops.Cal.Atty.Gen. 1 (1967); 56 Ops.Cal.Atty.Gen. 411 (1973).)

The Act provides a statutory basis for pension eligibility under the PERL. Indeed, CalPERS recognizes the concept of statutory employment (CalPERS Circular Letter No. 200-154-04 and Federal-State Reference Guide, Publication 963, p. 4-11 (Rev. 11-2014):

In certain cases it is clear that the work in question was performed by employees, but it may not be clear which of two or more entities, organizations or individuals are the employer.

... When a question is raised about the identity of the employer, all facts relating to the employment must be considered. Copies of any statutory provisions relating to the relationship should be reviewed. If there is any provision in a statute or ordinance that authorizes the employment of the individual and the individual is hired under this authority, the individual is an employee of the governmental entity.

4. CalPERS has failed to exercise its statutory authority under Government Code section 20125 to adopt controlling regulations establishing its interpretation of the common law control test, including but not limited to differentials between indicia of control for professional versus non-professional employees.
5. With respect to the specific legal issues in dispute here, the CalPERS Board of Administration has failed to exercise its statutory powers, indeed obligations, pursuant to the authority granted it in the Public Employees' Retirement Law, specifically enumerated in Government Code section 20125.
6. This June 2017 adverse determination by CalPERS improperly injects the largest public pension system in the world into the realm of how public agencies conduct their operations; public policy in California allows duly constituted public agencies, and their governing bodies, the authority to tailor their services consistent with their statutory authority. CalPERS has no authority to intervene or undermine the actions of other public agencies with respect to how public services are delivered.
7. Despite being instructed by judges to the contrary, CalPERS continues to fail to harmonize, or indeed recognize, that other statutory enactments, such as the Joint Exercise of Powers Act, the Education Code, etc., must be read in conjunction with the PERL.

8. CalPERS has never exercised its statutory authority under Government Code section 20125 to define “independent contractor” with respect to pension eligibility under the PERL.
9. CalPERS has never exercised its statutory authority under Government Code section 20125 to define “third party employer” with respect to pension eligibility under the PERL.
10. CalPERS failure to adopt lawful regulations defining employment status has resulted in CalPERS reaching adverse determinations based on unlawful “underground regulations,” violative of the California Administrative Procedure Act as codified in the Government Code.
11. By the conduct of its five-year audit of LGS, CalPERS has failed to comply with well-settled due process principles enshrined in the federal and California Constitutions.
12. Common law employment does not constitute the sole basis for pension eligibility under the PERL.<sup>2,3</sup>
13. CalPERS has shown complete disregard for the threatened pensions of those LGS employees who were never assigned to a CalPERS employer agency and therefore CalPERS has failed to comport with the California Constitution at article 16,

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<sup>2</sup> CalPERS conduct has undermined public agencies in California through arbitrary and unaccountable pressure to comply with unwritten policies. Further, by its historical pressure to increase public pension benefits and by certain of its adverse service credit eligibility determinations, including but not limited to LGS, CalPERS has failed to show the requisite amount of respect for the public fiscal crisis brought on in large part by its own actions.

<sup>3</sup> CalPERS, with its immense resources and budget, defends its decisions through its own legal staff, or through costly outside counsel, or through the Attorney General; it thus has unfair financial advantage against individuals or public agencies which believe CalPERS has made an erroneous decision and attempt to challenge the decision. Sound public policy argues in favor of the Legislature to “even the playing field” for challenges to CalPERS by enacting legislation which would allow a prevailing appellant to recover its attorneys’ fees. Here CalPERS has forced LGS, a public agency, to expend great time and expense in responding to CalPERS’ demands for information and documents over a five-year period, and again, for LGS to prosecute this appeal to protect the accrued pensions of its hundred-plus former and current employees. Where CalPERS is found to have erred as a matter of law, the aggrieved public agency or individual should have a right to recover the monies expended to correct CalPERS decision.

section 17: "A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty."

***Factual Basis for Appeal***

The key facts pertinent to this appeal include, but are not limited, to the following:

1. LGS is a duly organized joint powers agency under California law.
2. Despite numerous opportunities to communicate its concern regarding the employment status of LGS' employees, CalPERS failed to do so until issuance of the 2015 draft audit report.
3. LGS role as employer of the aggrieved individuals identified by CalPERS is reflected by LGS having performed functions and control typical for an employer.
4. LGS assigned the individuals to specific job positions and/or duties within its client agencies.
5. LGS ultimately supervised the individuals. LGS handled human resources and payroll responsibilities.
6. LGS partnered with its client agencies to direct the work and assignments for its employees.
7. At no time did the LGS client agencies exercise complete control over the individuals. No personnel action could be taken unless by LGS.
8. The client agencies were invoiced by LGS for the services performed by the individuals, and funds were transmitted by the client agencies to LGS for the services provided.
9. LGS was solely responsible for all statutory and discretionary insurance coverage for the individuals.
10. LGS was solely responsible for discipline of the individuals, if necessary.
11. LGS was solely responsible for investigating and resolving any personnel matters, including, but not limited to, allegations of harassment or discrimination.

The California Supreme Court has observed that the term "employee" is flexible, and that statutory provisions for pensions must be liberally construed "to the end that their beneficial purposes are broadened rather than narrowed." *Knight v. Board of Administration of State Employees' Retirement System* (1948) 32 Cal.2d 400, 402. The

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CalPERS final audit and its June 19, 2017 adverse determination disallowing all accrued service credit are incorrect as a matter of law. This Appeal attempts to (1) preserve the earned pensions of the affected individuals and (2) to adjudicate the parameters of CalPERS self-asserted authority.

  
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Richard H. Averett  
Executive Director  
Local Government Services

c: Sky Woodruff, LGS General Counsel