CalPERS' Employee Grab: The View From the Trenches

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CalPERS' Employee Grab?

A View from the Trenches

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I. Introduction

Under Public Employees Retirement Law ("PERL"), participating employers are required to enroll in CalPERS "any person in the employ" of the employer. Fifteen years ago, in the landmark case *Metropolitan Water District v. Superior Court ("Cargill")*, 32 Cal. 4th 491 (2004), the Supreme Court held that the employer was required to enroll in CalPERS "common law employees," even though these workers were supplied by private companies. Since that time, employers continue to grapple with the issue of whether and how they may engage independent contractors without having to enroll them in CalPERS. This article explores case law and decisions following *Cargill*, and describes the audit process and current test employed by CalPERS to determine common law employment status.

II. The *Cargill* Case

PERL requires that participating employers enroll "any person in the employ" of the employer. *See* Gov't Code § 20028(b). Neither PERL nor CalPERS regulations define what constitutes a "person in the employ" of the employer. *Cargill* essentially held that, in the absence of a statutory definition, the common law employment test applies.

Importantly, *Cargill* did not actually decide *whether* the workers at issue were common law employees. Rather, the case presented "only the question of whether the PERL requires enrollment of all common law employees." 32 Cal. 4th at 497. The Supreme Court answered this question in the affirmative – CalPERS' compulsory enrollment requirement for its employees also includes common law employees.

Practitioners often invoke the phrase that "bad facts make bad law," and *Cargill* arguably illustrates this outcome. The allegations in the case – which the Supreme Court did not resolve but accepted as true for purposes of making its purely legal determination – were not helpful to the Metropolitan Water District ("MWD"). The workers were provided by third party "labor suppliers." They alleged:

- They worked at MWD for indefinite periods, and in some cases several years.

- MWD interviewed and selected them for the work.

- They were integrated into the MWD workforce and performed the work at MWD worksites.

- They performed work that was part of MWD's regular business.

- MWD supervisors directly oversaw and evaluated their work, determined their pay rate, determined their raises, determined their work schedules and approved their time sheets.

- MWD had full authority to discipline and terminate them.

- MWD had the full right to control the manner and means by which they worked.

32 Cal. 4th at 498-99.

Utilizing a test for common law employment recognized by the Supreme Court in *Tieberg v. Unemployment Ins. App. Bd*., 2 Cal. 3d 943 (1970), the *Cargill* court held that these allegations, if proven, could support a showing of common law employment, and that common law employees must be enrolled in CalPERS by a participating employer.

III. The *Tieberg* Test for Common Law Employment

In *Cargill*, the California Supreme Court discussed and endorsed the test for common law employment discussed in *Tieberg v. Unemployment Insurance Appeals Board*, 2 Cal. 3d 943 (1970). *Tieberg* involved the issue whether television writers were employees of the producer and, if so, whether the producer was liable for past unemployment insurance contributions.

Tieberg sets forth the test that is currently used by CalPERS. The primary and most important factor is *whether the employer retains the right to control the manner and means of accomplishing the work*. *Tieberg*, 2 Cal. 3d 943 at 950. Secondary factors to consider include:

- Whether or not the one performing services is engaged in a distinct occupation or business.

- 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

- The skill required in the particular occupation.

- Whether the principal or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work.

- The length of time for which the services are to be performed.

- The method of payment, whether by the time or by the job.

- Whether or not the work is a part of the regular business of the principal.

- Whether or not the parties believe they are creating the relationship of employer-employee.

Tieberg also appears to endorse two additional factors that are included in the *Restatement of Agency* law: (1) the extent of control which, by the agreement, the employer may exercise over the details of the work; and (2) whether the principal is or is not in business for him or herself. *Tieberg*, 2 Cal. 3d at 949-50.

Utilizing these factors, the *Tieberg* court concluded that the writers were subject to the control and direction of the producers; that the other factors collectively did not tip the scale in favor of the producers; and the writers were appropriately considered common law employees.[1]

IV. The *Holmgren* Case and CERL

Unlike PERL, the County Employees Retirement Law ("CERL") defines "employee" as "any officer or other person employed by a county *whose compensation is fixed by the board of supervisors or by statute and whose compensation is paid by the county*, and any officer or other person employed by any district within the county." *Holmgren v. County of Los Angeles,* 159 Cal. App. 4th 593, 603 (2008) (emphasis added). In *Holmgren*, the issue concerned contractors who were hired to perform certain telecommunications work for the county. The contractors, in turn hired engineers for particular work orders. The core issue was whether the County misclassified engineers hired as independent contractors, or whether they were common law employees who must be enrolled in CERL.

The court of appeal rejected the claim that the engineers were common law employees. Interestingly, the plaintiffs asserted facts similar to those at issue in *Cargill*, including:

- They were screened, interviewed and effectively hired by the County.

- They were subject to the direction supervision and control by the County.

- They worked side by side with County employees.

159 Cal. App. 4th at 598.

Despite these facts, the court of appeal agreed that county employment is not governed by the common law definition of employment; that the County's civil service system determines

[1] Another case that is often cited is *Borello vs. Department of Industrial Relations*, 48 Cal. 3d 341 (1989). *Borello* involved agricultural workers who challenged their independent contractor status. Citing *Tieberg* with approval, *Borello* held that the workers were not independent contractors, even though the employer presented significant evidence that it did not control the day-to-day details of the work at issue.

who is an employee, and how one becomes an employee; and that because the engineers did not meet the definition of an employee – either under the County's civil service rules or CERL – they were properly classified as independent contractors.

> ***RPLG Practice Pointer***: The *Holmgren* case raises the question whether local cities can defend against common law employment claims by defining employment more specifically, and thus assert similar defenses that were successful in a CERL context. Although similar issues were raised in *Cargill*, the Metropolitan Water District does not have the same constitutional right to control employment as do local agencies – particularly charter cities. At least with respect to charter cities, there appears to be no harm in using local codes to define employment in a way that would exclude or minimize common law employment claims.

V. *Dynamex* – The Emerging "ABC" Test

Last year, the California Supreme Court gave employers across the state a case of serious heartburn when it issued its ruling in *Dynamex Operations West, Inc. v. Superior Court*, 4 Cal. 5th 903 (2018). The decision amounts to a seismic change in the law that makes it very difficult for employers in certain industries and occupations to demonstrate that their workers are independent contractors rather than employees. But while the decision carries wide-ranging implications for private entities, its application in the public sector is uncertain.

In *Dynamex*, a group of drivers brought a class action against their employers asserting it deprived them of certain entitlements under California law by misclassifying them as independent contractors rather than employees. The California Supreme Court adopted a brand-new three-part test that "presumptively considers all workers to be employees, and permits workers to be classified as independent contractors only if the hiring business demonstrates that the worker in question satisfies *each* of three conditions":

> *(A) The hiring business has no control and direction over the performance of the work, both under the contract and in fact;*
>
> *(B) The work is outside the usual course of the hiring entity's business; and*
>
> *(C) The worker customarily engages in an independent business of the same nature as the work performed for the hiring process.*

Although Part A of the test largely resembles the preexisting common-law standard for employee classification, Parts B and C constitute a major shift in the law that is sure to wreak havoc on many private-sector companies, especially those in the gig economy.

The ABC test announced in *Dynamex* will carry fewer consequences for public-sector employers than for private-sector employers. By its own terms, the decision is limited to "workers who fall within the reach of the wage orders" — that is, legally binding orders that govern "obligations relating to the minimum wages, maximum hours, and a limited number of very basic working conditions (such as minimally required meal and rest breaks) of California employees" in certain industries and occupations. At least one Court of Appeals case has confirmed that *Dynamex* only applies to claims arising under wage orders. *See Garcia v. Border Trans. Grp., LLC* (2018) Cal. App. 5th 558, 571.

Fourteen of California's 17 Wage Orders specifically exempt "employees directly employed by the State or any political subdivisions thereof, including any city, county, or special district," and courts have interpreted another Wage Order governing miscellaneous employees to exempt public employees. Moreover, charter cities, charter counties, and general law counties may rely on the "home rule doctrine" — which gives certain local entities control over employment matters despite conflicting state law — although some courts have found otherwise on this issue depending on whether the duties of the workers at issue implicate a statewide interest.

The impact of *Dynamex* remains to be seen, but it is certainly possible that the ABC criteria could be adopted in contexts outside of Industrial Wage Orders.

VI. Assembly Bill 5 – Lorena Gonzalez (D-San Diego)

This bill would purport to codify *Dynamex*. AB 5 has been one of the most contentious measures of the 2019 legislative session. While the stated intent of the measure was to target the "gig economy" – particularly rideshare companies such as Uber and Lyft – the effects will ultimately resonate with all California employers.

The lobbying efforts surrounding AB 5 were fast and furious. Numerous industry advocates proposed carve outs, with varying degrees of success. On September 11, after various unsuccessful attempts to insert employer friendly amendments, AB 5 passed out of the Senate on a party line, 29 to 11 vote. AB 5 is now in the process of being enrolled, and predictions are that it will almost certainly be signed by the Governor.

Notably the League and other public sector advocacy groups were largely silent and took no position on the measure. CalPERS itself took no position, even though it appears CalPERS would oppose its application to its member agencies. This is because it appears that AB 5 will *not* apply to local government. Litigation on this issue is likely, however.[2]

VII. CalPERS' Application of the Common Law Employee Test Since *Cargill*

The evidence suggests that CalPERS is taking an increasingly aggressive stance when evaluating independent contractor relationships. In connection with recent litigation, our office

[2] The author looks forward to further discussion on AB 5 at the Annual League Conference in Long Beach.

made a request under the Public Records Act for Office of Administrative Hearing ("OAH")[3] decisions involving employee/independent contractor status determinations. The decisions produced by CalPERS prompt two insights: [4]

First, even if no independent contractors have raised concerns about their status and they appear to be content with the independent contractor relationship, there is still a significant risk of an adverse audit determination. CalPERS regularly conduct audits of individual worker status and is unafraid of challenging independent contractor status. In fact, of the OAH cases reviewed, 42% of the cases began as an audit determination by CalPERS— and **not** a request for service credit from the worker. And, in our sample, CalPERS determined that a given worker was a common law employee in 67% of the cases.

Second, if a public agency appeals a CalPERS decision, the public agency has the burden of proof. Most OAH decisions hold it is the party challenging CalPERS' initial determination which must prove, by a preponderance of the evidence, that CalPERS was in error. In most cases, this means that the public agency must prove that the alleged employee is, in fact, an independent contractor. Due to the highly subjective multi-factor test under *Tieberg* and related case law, the OAH, and the CalPERS Board itself, have wide discretion in weighing various factors when determining whether to affirm or reject CalPERS' initial determination. And, in our sample, the OAH sided with CalPERS' initial determination 83% of the time.

California Government Code section 20125 provides that the CalPERS Board shall determine who are employees and is the sole judge under which persons may be admitted to and continue to receive benefits under this system.

A. CalPERS Has Not Issued Regulations to Define Independent Contractor Status

It is noteworthy that although CalPERS may propose and issue regulations on a wide variety of issues related to the Public Employees Retirement Law ("PERL"), it has not issued any regulations in an effort to define independent contractor status. Employers, and public agencies in particular, seek bright line tests for determining whether a worker may be appropriately classified as an independent contractor. It appears that CalPERS prefers no bright line, with determinations made on a case by case basis.

B. CalPERS "Precedential" Decisions

The CalPERS Board designates certain decisions as "precedential," meaning that they provide the essential blueprint for the applicable analysis. There are two precedential decisions concerning independent contractors, and whether certain workers meet the common law employees test.

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[3] The Office of Administrative Hearings is the State agency empowered to hold evidentiary hearings and make initial rulings regarding CalPERS reporting and eligibility rules. *See infra*

[4] Eleven cases were disclosed. With the *Fuller* decision (discussed *infra*), we our data sample included twelve cases.

In 2005, CalPERS designated as precedential the decision entitled *In the Matter of Lee Neidengard*, Precedential Decision No. 05-01, Case No. 6099, OAH No. L-2003100580 (effective Apr. 22, 2005(("*Neidengard*"). *Neidengard* involved Tri-Counties Regional Center ("Tri-Counties"), a non-profit that received state funding to provide services to developmentally disabled individuals. Tri-Counties contracted with CalPERS to provide retirement services for its employees. Respondent Neidengard was hired by Tri-Counties as a staff physician in the 1970's. Tri-Counties eventually faced a budget shortfall and attempted to make staff reductions by offering many of the staff "contract" positions that did not receive CalPERS benefits, but continued to perform largely the same work. Neidengard used the Tri-Counties medical facilities, and his patient files were housed at the Tri-Counties office and Tri-Counties exercised "considerable if not complete control over the manner and means by which Respondent performed his work." While Neidenbard signed several professional services agreement with Tri-Counties as an alleged independent contractor, the OAH -- applying *Cargill* and *Tieberg* -- found that he continued to be a common law employee of Tri-Counties, and thus should have been enrolled.

In 2008, CalPERS designated as precedential the decision entitled *In the Matter of Galt Services Authority*, Precedential Decision 08-01, Case No. 8287, OAH No. N-2007080553 (effective Oct. 22, 2008) ("*Galt Services*"). *Galt Services* involved the City of Galt, which was *not* a contracting agency with CalPERS. The City attempted to create a new joint powers authority, the Galt Services Authority ("GSA"), and transfer many of the City employees to the new GSA entity. The GSA entity would then contract with CalPERS so that the employees could receive CalPERS benefits. CalPERS refused to contract with the new GSA entity, arguing that the newly-transferred employees were, in fact, still employees of the City. The OAH agreed. The City approved all of the GSA's actions, reimbursed the GSA for the employees' salaries, set up bank accounts and auditing for the GSA, prepared payroll checks for GSA employees, and was the GSA's only client. Applying *Cargill* and *Tieberg*, the OAH found that the employees remained under the City's control, and thus were not common law employees of the GSA.

C. The Decision in *Tracy C. Fuller / Cambria Community Services District*

This case involves Regional Government Services ("RGS"), a Joint Powers Authority ("JPA") formed to provide worker and interim support to various public agencies. In this case, RGS contracted with the Cambria Community Services District ("CCSD") to provide an Interim Finance Manager, Tracy Fuller ("Fuller"). The contract specifically provided that Fuller was an independent contractor, and that all persons working for RGS are RGS employees, and not employees of CCSD.

RGS entered into a contractual relationship with Fuller. Fuller was assigned an RGS business card, office, a phone extension and an email address. Fuller was assigned to CCSD where she performed Interim Finance Manager tasks. Fuller was provided a CCSD office, telephone, an email address and access to certain CCSD computer systems. She received assignments from CCSD, and there were other indicia of employment with CCSD.

The Administrative Law Judge concluded, among other things:

- CCSD should have known that the enrollment requirement would apply to Fuller because the position at issue was a position that is filled by a regular employee. In fact, Fuller's predecessor and successor were regular CCSD employees.

- Fuller was, in fact, acting as a finance manager, and the work she was doing was clearly an integral part of the regular business of CCSD.

- CCSD had the right to control the manner and means of the work performed by CCSD.

The CalPERS Board adopted the *Fuller* decision in October 2018. Subsequently, CalPERS agendized whether to adopt *Fuller* as a precedential decision. *Fuller* was subsequently removed from the agenda, and it is currently uncertain whether CalPERS will move forward to designate it as precedential.

Fuller is particularly troublesome for public agencies because it interferes with a model that has been in play for some time – a model beneficial to both the public agency and the worker.

VIII. The Process to Appeal a CalPERS Determination

The process to appeal and adjudicate an adverse CalPERS determination is governed by statute and regulations, with strict timelines. Local agencies should be careful to observe the statutory timelines, and to create a complete record.

A. The Audit and Appeal

CalPERS has the right to audit payroll and personnel information to ensure compliance with PERL. In the context of evaluating independent contractor status, CalPERS will issue an "initial determination" whether CalPERS views the relationship as a bona fide independent contractor relationship. The local agency will then be given an opportunity to respond. At some point thereafter, CalPERS will issue a "final determination."

The final determination triggers a thirty day timeline. This timeline may be extended by CalPERS for thirty (30) days. Local agencies should be very mindful of this deadline, as it will be strictly enforced.

RPLG Practice Pointer: When communicating with CalPERS, always confirm receipt of the applicable communication. Consider sending confirmations in different ways – i.e., by email, regular mail and/or certified mail. Document all contact with CalPERS.

B. The Statement of Issues

After filing an appeal, CalPERS will issue a Statement of Issues. As provided by California Government Code section 11504:

The statement of issues shall be a written statement specifying the statutes and rules with which the respondent must show compliance by producing proof at the hearing and, in addition, any particular matters that have come to the attention of the initiating party and that would authorize a denial of the agency action sought.

C. Statement of Defenses:

The Statement of Issues triggers a fifteen (15) day timeline to file a Notice of Defense. (Cal. Gov. Code § 11506(a).) Failure to file a Notice of Defense constitutes a waiver of the right to a hearing. (*Id.* § 11506(c).)

Local agencies should be careful to include all affirmative defenses in this Notice, or they may face a later motion to exclude evidence or argument.

CalPERS is responsible for making arrangements with the Office of Administrative Hearings ("OAH") for a hearing date. The local agency will be asked to set convenient dates and times for a hearing.

> ***RPLG Practice Pointer***: When setting dates, make sure there is sufficient time for discovery, and for resolution of discovery disputes. As with any litigation, it is very possible that disputes will arise over whether CalPERS has sufficiently complied with its discovery obligations (*see infra*.) At the state of setting a hearing, local agencies should have considerable latitude in setting a mutually agreeable and reasonable date(s) for hearing.

D. Discovery:

1. California Public Records Act

As set forth *infra*, there is a limited right to discovery under the APA. However, practitioners may also avail themselves of the Public Records Act ("PRA") to obtain documents. The PRA is a powerful tool to obtain documents related to how the OAH and CalPERS have ruled in other cases.

2. The APA Discovery Statute

Section 11507.6 is the APA discovery statute. While the traditional discovery is not permitted (e.g. depositions and interrogatories), the statute provides for various categories of permitted discovery. Practically, the two key categories are:

a. Witnesses: Under the statute, each party may obtain "the names and addresses of witnesses to the extent known to the other party, including, but not limited to, those intended to be called to testify at the hearing" (Cal. Gov. Code § 11507.6.)

b. Documents: The statute provides for various categories of documents, including documents that will be introduced at the hearing, investigative reports, statement and others categories of documents.

RPLG Practice Pointer: Local agencies should pay careful attention to the discovery process. If an agency fails to identify a witness, or a document, it could be excluded during the hearing. In addition, if CalPERS fails to provide requested documents, agencies should consider filing a motion to compel.

E. The Hearing Process: An Administrative Law Judge will preside over the hearing. Pre-briefing is permitted, but not required. Opening statements may be made. Witnesses will be sworn and are subject to direct and cross examination. Exhibits are proffered and subject to authentication and objection. Hearsay is admissible, subject to the rule that a material finding may not be premised solely on hearsay.

At the conclusion of the hearing, the parties may request the opportunity for post hearing briefing. The parties may agree on a briefing schedule.

F. The Proposed Decision and Appeal Opportunity: The ALJ will issue a Proposed Decision, which becomes final, unless one party appeals to the CalPERS Board. If appealed to the CalPERS Board, the case will be docked for final decision.

G. Penalties

Under California Government Code section 20283, if an employer fails to enroll a member within 90 days (which will always apply in these situations), the employer may be required to pay all employer and employee contributions associated with enrolling the contractor into the system retroactively to the time of initial hire. In addition, CalPERS may impose an additional $500 administrative fee per member.

IX. Observations and Preventive Measures

There are a variety of preventive measures that an agency should consider in connection with independent contractor relationships.

Agencies should consider an internal audit, to catalog their independent contractor relationships and to gauge risk. Consider making the audit subject to the attorney client privilege, to ensure that it is not subject to later disclosure.

When being audited by CalPERS, ensure that accurate information is provided. CalPERS may send out "employment relationship questionnaires" to employees without the agency's knowledge. Consider adopting a rule requiring that employees coordinate with the city attorney before unilaterally responding to outside agency. This can help ensure that CalPERS receives balanced and accurate information.

With respect to independent contractor relationships:

- When utilizing retired CalPERS annuitants, carefully observe the requirements of California Government Code section 21221, including the 960 hour per fiscal year limitation.

- Confirm the third-party relationship, and have the worker sign and acknowledge that they are working as an independent contractor, and not as an employee.

- Ensure all identification of the worker is as a contractor. Avoid providing the same email address or other identification that would suggest the worker is an employee.

- Confirm in writing that the local agency has no right to control the manner and means of performing the work at issue.

- Avoid requiring the worker to attend meetings.

- Do not supply dedicated office space. If space is provided, consider using "hotel" office space that is not dedicated to the worker.

- Do not supply the specific "tools" needed to perform the work.

- Consider requiring the contractor to indemnify the local agency for adverse determinations by CalPERS.

- Consider obtaining an advance opinion from CalPERS as to whether the relationship qualifies a bonafide independent contractor relationship.

X. Conclusion

Local agencies should be aware of the risks associated with independent contractor relationships, and consider taking preventive measures in connection with the relationships.