

Office of Audit Services



Public Agency Review

Local Government Services Authority

**CalPERS ID: 7214598140
Job Number: P12-013**

April 2017



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April 28, 2017

CalPERS ID: 7214598140
Job Number: P12-013

Richard Averett, Executive Director
Local Government Services Authority
316 Midvalley #194
Carmel Valley, CA 93923

Dear Mr. Averett:

Enclosed is our final report on the results of the public agency review completed for the Local Government Services Authority (LGS). As you know, we have delayed issuing the final report while the Attorney General's Office conducted its investigation on the common-law-employment status of the individuals LGS reports to CalPERS as its own employees—the subject of Finding 1. The Attorney General has completed its investigation and issued a confidential report to CalPERS, which confirms Finding 1.

Your written response to our draft report, included as an appendix to the report, indicates disagreement with Finding 1. We appreciate the additional information that you provided in your response. After consideration of this information, while we added clarifying language to Finding 1, our recommendations remain as stated in the report.

In accordance with our resolution policy, we have referred the issues identified in the report to the appropriate divisions at CalPERS. Please work with these divisions to address the recommendations specified in our report. It was our pleasure to work with you and we appreciate your time and assistance during our review.

Sincerely,

Original signed by Beliz Chappuie

BELIZ CHAPPUIE, Chief
Office of Audit Services

Enclosure

cc: Board of Directors, Local Government Services Authority
Risk and Audit Committee Members, CalPERS
Matthew G. Jacobs, General Counsel, CalPERS
Anthony Suine, Chief, BNSD, CalPERS
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LOCAL GOVERNMENT SERVICES AUTHORITY

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RESULTS IN BRIEF

The primary objective of our review was to determine whether Local Government Services Authority (LGS) complied with applicable sections of the California Government Code (Government Code), California Code of Regulations (CCR) and its contract with the California Public Employees' Retirement System (CalPERS).

The Office of Audit Services (OAS) noted one finding and an observation during the review. Details are noted in the Results section beginning on page three of this report.

LGS incorrectly enrolled individuals who were not LGS employees into membership. LGS contracted with the Transportation Authority of Marin (TAM), South Bayside Waste Management Authority (SBWMA), Marin Transit District (MTD), and Metropolitan Transportation Commission (MTC) to provide staffing services. The sampled individuals placed with these agencies were common-law employees of these agencies, not of LGS. Therefore, LGS incorrectly enrolled them into CalPERS membership.

Additionally, OAS noted an observation, where we were unable to determine definitively whether LGS and its affiliated agency, Regional Government Services (RGS) are the same entity or separate entities. The reported purpose of LGS is to provide administrative, support and staffing services to other California public agencies, identified by LGS as Client Members. RGS reportedly provides all the administrative services to manage LGS. During the course of this review, OAS found that LGS did not have a physical work location or office and did not have any common-law employees since the administrative staff that performed the day-to-day functions were employees of RGS. RGS and LGS contend that all of the administrative staff, including the Executive Director, are employees of RGS, which is not a CalPERS contracting agency for retirement benefits. However, OAS was unable to determine if RGS employees were properly excluded from CalPERS membership without determining if LGS and RGS are the same or separate entities.

OAS recommends LGS comply with applicable sections of the Government Code, CCR and its contract with CalPERS. We also recommend LGS work with the appropriate CalPERS divisions to resolve issues identified in this report.

SCOPE

LGS contracted with CalPERS effective February 11, 2002 to provide retirement benefits for local miscellaneous employees. By way of its contract with CalPERS, LGS agreed to be bound by the terms of the contract and by the Public Employees' Retirement Law (PERL). LGS also agreed to make its employees members of CalPERS subject to all provisions of the PERL.

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As part of CalPERS Board of Administration (Board) approved plan for Fiscal Year 2012-13, OAS reviewed LGS' membership eligibility and enrollment processes as these processes relate to its retirement contract with CalPERS. The review was limited to interviews with LGS staff and the examination of employee/employer relationships of sampled individuals retained by LGS to perform services for its Client Members, as well as a review of records focusing on pay periods from July 1, 2009 through June 30, 2012. The on-site fieldwork for this review was conducted during January 7-11, 2013 and subsequently on August 16, 2013.

This review did not include a formal determination as to whether LGS is a "public agency" (as that term is used in the PERL). Therefore, OAS expresses no formal opinion or finding with respect to whether LGS is a public agency or whether its employees are employed by a public agency. However, given the facts and questions raised by OAS' review, OAS recommends that further analysis be undertaken by the relevant divisions within CalPERS on this issue.

OAS determined that all four of the sampled employees reported to CalPERS by LGS were actually common-law employees of other agencies. Therefore, the employees should not have been enrolled into membership and payroll should not have been submitted to CalPERS. As a result, OAS did not review the pay schedule, compensation earnable, payrates, payroll elements, and unused sick leave since the reported employees were determined not to be LGS employees. The review objectives and methodology are listed in Appendix A.

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OFFICE OF AUDIT SERVICES REVIEW RESULTS

1: LGS incorrectly enrolled ineligible individuals into CalPERS membership.

Condition:

LGS incorrectly enrolled ineligible individuals into membership and improperly reported service credit and compensation earnable for these members. OAS reviewed one sampled individual assigned to each of the Client Members in existence during the time period covered by this review. In applying the common-law employment test to these sampled individuals, OAS noted that LGS did not control the manner and means of how the work would be performed by the sampled individuals assigned to the four Client Members. Therefore, these sampled individuals are not common-law employees of LGS. Rather, each individual is a common-law employee of his or her respective Client Member. Our determinations are limited to one sampled employee from each of the four client members. However, without agreeing to OAS's determinations, the Executive Director stated that the information provided on each sampled individual would also apply to all other individuals assigned to that Client Member. Based upon this representation, the results of our review would likely apply to approximately 13 individuals assigned to MTC, six individuals assigned to MTD, one individual assigned to SBWMA and 11 individuals assigned to TAM.

Government Code Section 20460 provides that any public agency may participate in and make all or part of its employees members of this system by contract entered into between its governing body and the Board. Government Code Section 20022 defines a contracting agency as any public agency that has elected to have all or any part of its employees become members of this system and that has contracted with the Board for that purpose. Government Code Section 20028 (b) defines an employee as any person in the employ of a contracting agency. However, a contracting agency cannot report service credit and compensation earnable for services performed by individuals that are the common-law employees of another entity.

Management and control of CalPERS is vested in the Board as provided in Government Code Section 20120. Each member and each person retired is subject to the Government Code and the rules adopted by the Board pursuant to Government Code Section 20122. Government Code Section 20125 provides that the Board shall determine who are employees and is the sole judge of the conditions under which persons may be admitted to and continue to receive benefits under this system. For the purposes of the PERL and for programs administered by the Board, the standard used for determining whether an individual is the employee

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of another entity is the California common-law employment test as set forth in the California Supreme Court case titled *Tieberg v. Unemployment Ins. App. Bd.*, (1970) 2 Cal. 3d 943, which was cited with approval in *Metropolitan Water Dist. v. Superior Court (Cargill)*, (2004) 32 Cal. 4th 491 and adopted by the Board in two precedential decisions, *In the Matter of Lee Neidengard*, Precedential Decision No. 05-01, effective April 22, 2005, and *In the Matter of Galt Services Authority*, Precedential Decision No. 08-01, effective October 22, 2008.

Applying the California common-law employment test, the most important factor in determining whether an individual performs services for another employer is the right of the principal to control the manner and means of job performance and the desired result, and whether or not this right is exercised. Where there is independent evidence that the principal has the right to control the manner and means of performing the service in question, CalPERS will determine that an employer-employee relationship exists between the employee and the principal.

Other factors to be taken into consideration under the common-law employment test are as follows:

- 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 a principal or by a specialist without supervision.
- The skill required in the particular occupation.
- Whether the principal or the individual performing the services 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.

OAS reviewed the information obtained from the employment relationship questionnaires, employment contracts, and other information related to one sampled individual at each of the four Client Members. OAS determined that all the sampled individuals were common-law employees of the Client Members, rather than LGS. In all four instances, the Client Member, rather than LGS, controlled the manner and means of performing the work. As a result, for purposes of the PERL, the individuals LGS placed with the Client Members are not employees of LGS but rather common-law employees of the Client Members. As such, OAS determined that LGS incorrectly enrolled ineligible individuals into membership and improperly reported service credit and earnings for these individuals.

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The individuals selected for review worked in positions for the Client Members as follows: Executive Director (TAM), Recycling Programs Manager (SBWMA), Finance and Grants Manager (MTD), and Regional Transportation Funding Coordinator (MTC). Pertinent information identified for each sampled individual reviewed is as follows:

Transportation Authority of Marin

According to its website, TAM is a Joint Powers Agency established between the County of Marin and cities in Marin County to address Marin's transportation issues. TAM has approximately 11 individuals placed by LGS and does not contract with CalPERS for retirement benefits.

OAS reviewed the employment contract, personnel action forms, employment relationship questionnaire and other relevant information for the sampled individual to determine if the individual served in an employee/employer relationship with TAM. The facts outlined below support a finding of common-law employment with TAM:

- The individual provided full-time services for TAM as the Executive Director during August 24, 2005 through June 30, 2012.
- The TAM Board of Commissioners provides oversight over the individual as it relates to completing the day-to-day activities.
- The individual is responsible for TAM's transportation and congestion planning, strategic planning, fiscal management, administration, and all TAM activities.
- The individual assists the TAM Board of Commissioners in the development and implementation of TAM's strategic plan, policies, and objectives.
- The individual is responsible for carrying out TAM Board of Commissioners adopted policies and directives.
- The individual is required for taking steps to implement TAM's programs and services.
- The individual advises the TAM Board of Commissioners on issues of current concerns to TAM.
- The individual represents TAM with regional, State, local officials, other government agencies, and related public interest groups.
- The individual is responsible for developing and managing TAM's budget.
- The individual is responsible for handling human resources and labor relations for TAM.
- The TAM Board of Commissioners provides LGS with information to complete the performance appraisal and makes compensation recommendations for this individual.

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- The TAM Board of Commissioners established performance goals for this individual.
- The individual performed services at the TAM office in San Rafael.
- The individual is provided with an e-mail account and business cards that refer to the individual as the Executive Director of TAM.
- The individual is provided with an office, office equipment, stationery, and an automobile from TAM.
- The individual has authority to sign documents as the Executive Director of TAM.
- The services performed by the individual are part of the TAM's normal business operations.
- The individual is paid by LGS; however, LGS bills TAM for the work performed by invoice using an hourly rate that includes the individual's salary and all benefits.

OAS determined that the questionnaire responses, along with the statements found in the employment contracts and other documents reviewed, demonstrate that the individual is a common-law employee of TAM based on evaluation of the factors noted above. OAS also determined that LGS did not control the manner and means of the work performed by the individual and evaluation of the secondary factors also suggests that LGS was not the common-law employer of this individual. Therefore, LGS should not have enrolled or reported the individual's service credit and earnings to CalPERS.

South Bayside Waste Management Authority

According to its website, SBWMA is a Joint Powers Authority that was formed in 1982 and has 12 members (10 Cities, the County of San Mateo and the West Bay Sanitary District). SBWMA provides cost effective waste reduction, recycling, and solid waste programs to member agencies through franchised services and other recyclers to meet and sustain a minimum of 50 percent diversion of waste from landfill as mandated by California State Law, AB 939. SBWMA has one individual placed by LGS and does not contract with CalPERS for retirement benefits.

OAS reviewed the employment contract, personnel action forms, employment relationship questionnaire, and other relevant information for the sampled individual to determine if the individual worked in an employee/employer relationship with SBWMA. The facts outlined below support a finding of common-law employment with SBWMA:

- The individual provided full-time services for SBWMA as the Recycling Program Manager during January 2, 2007 through June 30, 2012.

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- The Recycling Program Manager function was previously performed by a County employee that was on loan to the SBWMA.
- The SBWMA Executive Director directs, supervises, and/or reviews the work of the individual. The Executive Director of the SBWMA then provides LGS with recommendations as it relates to discipline, performance reviews, and raises.
- The individual is required to perform other duties consistent with the position of SBWMA Recycling Program Manager as directed by the SBWMA Executive Director as provided in the employment agreement.
- The individual is required to meet regularly and as often as necessary with the SBWMA Executive Director and other SBWMA officials as provided in the employment agreement.
- The individual is required to meet with other SBWMA staff and attend SBWMA meetings as provided in the employment agreement.
- The Executive Director and Finance Manager of SBWMA direct LGS on salary increases for this individual. Specifically, SBWMA determines the amount and effective dates of any increases.
- The individual provides services at the SBWMA office in San Carlos.
- The individual is provided with an e-mail account and business cards that refer to the individual as the Recycling Program Manager of SBWMA.
- The individual is provided with an office and office equipment by SBWMA.
- The individual has authority to sign documents on behalf of SBWMA as the Recycling Program Manager.
- The services performed by the individual are part of the SBWMA's normal business operations.
- The individual is paid by LGS; however, LGS bills SBWMA for the work performed by invoice using an hourly rate that includes the individual's salary and all benefits.

OAS determined that the questionnaire responses, along with the statements found in the employment contracts and other documents reviewed, demonstrate that the individual is a common-law employee of SBWMA based on the factors noted above. OAS also determined that LGS did not control the manner and means of the work performed by the individual, and evaluation of the secondary factors also suggests that LGS was not the common-law employer of this individual. Therefore, LGS should not have enrolled or reported the individual's service credit and earnings to CalPERS.

Marin Transit District

According to its website, MTD is a special district created by the authority of the Marin County Transit District Act of 1964. MTD's purpose is to develop, finance, organize, and provide local Marin County transit service. MTD has approximately

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six individuals placed by LGS and does not contract with CalPERS for retirement benefits.

OAS reviewed the employment contract, personnel action forms, employment relationship questionnaire and other relevant information to determine if the sampled individual was serving in an employee/employer relationship with MTD. The facts outlined below support a finding of common-law employment with MTD:

- The individual provided full-time services for MTD in an established position of Finance and Grants Manager during May 1, 2010 through June 30, 2012.
- The individual is identified on MTD's website as the Director of Finance and Capital Programs.
- The individual prepares and administers the MTD budget and grant program as provided in the employment agreement.
- The General Manager of the County of Marin provides LGS with the information to complete the individual's performance appraisal.
- The individual also assists in the preparation of technical analyses, including memos to the General Manager, Director of Operations and MTD Board of Directors, and serves on task forces, commissions, and committees as MTD's representative as provided in the employment agreement. (The contract did not specify if it was referring to the General Manager for the County of Marin or MTD).
- The individual compiles, analyzes, and reports financial data of MTD's monthly financial reports as provided in the employment agreement.
- The individual manages complex statistical and data analysis projects, oversees the maintenance of records systems and databases for operations, capital planning and grant administration systems, and administers assigned projects for MTD as provided in the employment agreement.
- The individual evaluates the feasibility of obtaining funding for proposed projects, writes grant applications, and ensures MTD's compliance with federal, state, and local regulations and funding source requirements as provided in the employment agreement.
- The individual develops and presents written and oral reports, financial forecasts and trend analysis on a variety of complex issues in local and regional transportation funding, including financial, legislative, and other related issues, on behalf of MTD as provided in the employment agreement.
- The individual advocates for and represents MTD at various stages in the transportation financial planning process including development of interagency agreements and Memoranda of Understanding (MOUs) pertaining to the acquisition of funding as provided in the employment agreement.
- The individual consults and renegotiates with funding agencies and project managers to revise scopes of work, budgets, and timelines to maximize use

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of grant resources on behalf of MTD as provided in the employment agreement.

- The individual acts as a liaison and technical expert for MTD regarding Generally Accepted Accounting Principles (GAAP) and Basic Principles of Accounting as applied to Governmental Accounting Standards (GASB) as provided in the employment agreement.
- The individual provides services at the MTD office in San Rafael.
- The individual is provided with an e-mail account and business cards that refer to the individual as the Director of Finance of MTD.
- MTD provides the individual with an office and office equipment.
- The individual has authority to sign documents on behalf of MTD as the Director of Finance.
- The individual performs services as part of the MTD's normal business operations.
- MTD sets the hours of work for this individual.
- The individual was hired to perform services exclusively for MTD.
- The individual is paid by LGS; however, LGS bills MTD for the work performed by invoice using an hourly rate that includes the individual's salary and benefits.
- The work performed by this individual is considered to be the work of MTD.

OAS determined that the questionnaire responses, along with the statements found in the employment contracts and other documents reviewed, demonstrate that the individual is a common-law employee of MTD based on the evaluation of the factors noted above. OAS also determined that LGS did not control the manner and means of the work performed by the individual and evaluation of the secondary factors also suggests that LGS was not the common-law employer of this individual. Therefore, LGS should not have enrolled or reported the individual's service credit and earnings to CalPERS.

Metropolitan Transportation Commission (MTC)

According to its website, MTC was created by the state Legislature in 1970 and is the transportation planning, coordinating, and financing agency for the nine-county San Francisco Bay Area. MTC has had approximately 13 individuals placed by LGS and has a contract with CalPERS for retirement benefits as of March 1, 1972.

OAS reviewed the employment contract, personnel action forms, employment relationship questionnaire, and other relevant documentation to determine if the sampled individual was serving in an employee/employer relationship with MTC. The facts outlined below support a finding of common-law employment with MTC:

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- The individual provided full-time services for MTC as the Regional Transportation Funding Coordinator during October 1, 2008 through June 30, 2012.
- The individual provides services at the MTC facility in Oakland.
- The individual's work hours are determined by MTC.
- The individual operates under the title of Regional Transportation Funding Coordinator of MTC.
- The individual was hired to perform services exclusively for MTC.
- The individual's day-to-day activities are supervised by a MTC supervisor.
- The individual is provided with an e-mail account and business cards that refer to the individual as the Regional Transportation Funding Coordinator for MTC.
- The individual is provided with an office and office equipment by MTC.
- The individual is paid by LGS; however, LGS bills MTC for the work performed by invoice using an hourly rate that includes the individual's salary and all benefits. It also appears that MTC agreed to pay LGS a flat fee over and above the cost of this individual's salary and benefits. In a document entitled "Agreement for Management and Administrative Services" (Agreement) dated June 29, 2007, in Exhibit A, it states that the amounts stated, ". . . includes overhead charges and insurance costs at a flat rate of \$17,402 per position . . ."
- The LGS Executive Director responded in the questionnaire that the Regional Transportation Funding Coordinator administers the non-transit elements of the Regional Measure 2 Project, which is not part of MTC's normal operations. Neither is it part of LGS' normal operations.
- The MTC General Manager provides LGS with the information to complete the individual's performance appraisal. RGS employees also perform on-site visits to evaluate the individuals.
- The services performed by this individual are considered to be the work of MTC.

OAS determined that the questionnaire responses, along with the statements found in the employment contracts and other documents reviewed, demonstrate that the individual is a common-law employee of MTC based on evaluation of the factors noted above. OAS also determined that LGS did not control the manner and means of the work performed by the individual, and evaluation of the secondary factors also suggests that LGS was not the common-law employer of this individual. Therefore, LGS should not have enrolled or reported the individual's service credit and earnings to CalPERS.

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Additional Facts

OAS identified additional facts during the course of its review that support its conclusions that sampled individuals are common-law employees of the Client Members rather than employees of LGS. In one example, approximately twelve individuals were reported to CalPERS by LGS for various periods of time before January 1, 2012; all of whom provided services to Transbay Joint Powers Authority (TJPA). Thereafter, effective January 1, 2012, TJPA contracted with CalPERS for retirement benefits, and the twelve individuals were then reported to CalPERS by TJPA for the services previously reported by LGS and for all future services.

In another instance, five of the six individuals performing work for MTD were all reported to CalPERS as employees of LGS while each was providing services to MTD. Later, LGS stopped reporting all five individuals (holding the positions of Director of Finance and Capital Programs, Mobility Analyst, Planning Manager, Senior Transit Planner, and Accounting and Grants Analyst) to CalPERS on exactly the same date, October 16, 2013, despite the fact that MTD's website still showed the individuals as being on staff. OAS notes that during a meeting on August 16, 2013, the Executive Director (of LGS and RGS), stated that LGS was going to end its relationship with MTD in the next few weeks.

In addition, LGS internal communication suggests that individuals assigned to Client Members may believe that they are creating the employer/employee relationship with the Client Members. This is supported by LGS's need to issue a Human Resources Brief (Brief) in February 2013 that instructed individuals assigned to Client Members about how to respond to CalPERS auditors when asked questions related to their employers. The Brief instructed the individuals to answer that LGS pays and provides benefits, and LGS along with the on-site lead evaluates and assigns work based on contractually agreed upon duties.

Recommendation:

LGS should immediately stop enrolling and reporting service credit and compensation earnable for individuals who are the common-law employees of another entity. LGS should ensure that only the common-law employees of LGS are enrolled and reported to CalPERS. It should also determine whether LGS has any common-law employees.

LGS should work with CalPERS Employer Account Management Division (EAMD) to assess the impact of the membership enrollment issue and make the necessary adjustments to all active and retired member accounts pursuant to Government Code Section 20160. EAMD should also work with LGS to determine whether the other individuals being reported by LGS are the common-law employees of LGS or

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whether all such individuals are actually the common-law employees of another entity or independent contractors. Finally, should it be determined that LGS has no common-law employees, LGS should work with EAMD to determine what additional steps need be taken to address this issue.

Criteria:

Government Codes: § 20022, § 20028 (b), § 20056, § 20057, § 20120, § 20122, § 20125, § 20160 (a), §20221, § 20222.5, § 20460, § 20502

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Observation: OAS was unable to determine whether LGS and RGS are the same or separate agencies.

OAS was unable to determine whether LGS and RGS are the same or separate entities. RGS and LGS purport to be separate legal entities. However, in practice, they operate like one entity. They share the same Board of Directors, the same JPA members, the same Executive Director, the same organization chart, and the same administrative staff. Both entities have reported the Executive Director's home address to CalPERS as the address for the entities and neither has a public location or office. Both RGS and LGS appear to be one hundred percent fee-based, and both appear to operate as employment and/or temporary placement agencies.

OAS found that one individual performed services as the Executive Director of both RGS and LGS. This individual confirmed that LGS did not have a physical work location or office and did not have any employees, including administrative staff and the Executive Director, who would perform the day-to-day functions of LGS. LGS reportedly contracts with RGS to provide all of the administrative functions for LGS although RGS is under the control of the same Board of Directors and Executive Director as LGS. The majority of the Executive Director's time was spent working for RGS. Specifically, the Executive Director stated that approximately 15 percent of the time was spent performing Executive Director services for LGS, 70 percent of the time as the Executive Director of RGS and the remaining time (15 percent) is spent performing services for a third entity that provides insurance services. The Executive Director also stated that the administrative staff are employees of RGS, which is not a CalPERS contracting agency for retirement benefits and not employees of LGS. RGS claims to have an executive staff of 15 employees that provide administration functions for RGS and LGS.

During the review of LGS, OAS found that LGS only reported some of those individuals providing services to Client Members to CalPERS for retirement benefits. LGS did not enroll or report any individuals who performed the core functions of LGS/RGS for retirement benefits. Nor did LGS report individuals providing services to Client Members through RGS. In at least one instance, individuals performing services at the same Client Member (SBWMA) were reported to CalPERS differently. The Executive Director and Finance Manager were reported to CalPERS as RGS employees and eligible for health benefits with CalPERS under PEMHCA. However, the Recycling Programs Manager was reported as an LGS employee and enrolled for CalPERS retirement benefits.

The only real appreciable difference identified between LGS and RGS appears to be the management of employment benefits. Entities seeking CalPERS retirement benefits are contracted through LGS. CalPERS retirees and others not seeking

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CalPERS retirement benefits, or those seeking only health benefits are contracted through RGS. If this is in fact the basis upon which individuals are placed with LGS or RGS, additional PERL compliance issues will need to be addressed.

LGS contracted with CalPERS to provide retirement benefits to its employees effective February 11, 2002. Between January 1, 2002 and January 1, 2014, RGS provided health benefits to its employees through CalPERS under the Public Employees' Medical and Hospital Care Act (PEMHCA). LGS and RGS both terminated their health benefits participation in CalPERS effective January 1, 2014.

Questions persist relative to whether RGS and LGS are two entities. This review does not include a formal determination as to whether LGS is RGS or its alter ego, or whether LGS and RGS are two separate entities. OAS could not determine if the individuals providing administrative services on behalf of RGS and who also performed the administrative functions for LGS are common-law employees of RGS, LGS, both, neither, or instead independent contractors. OAS recommends that LGS provide all information necessary for CalPERS staff to resolve these questions.

Without additional information, CalPERS cannot make a final determination on this issue. As a result, OAS could not determine if the individuals claimed to be RGS employees who reportedly provide administrative and executive functions for LGS are the common-law employees of RGS, LGS, both, neither, or instead independent contractors. Nor could OAS make a final determination whether LGS continues to be eligible to participate in CalPERS as a public agency given the questions surrounding whether it is a separate entity, whether it meets the requirements of public agency, and whether it has any common-law employees.

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CONCLUSION

OAS limited this review to the areas specified in the scope section of this report and in the objectives outlined in Appendix A. The procedures performed provide reasonable, but not absolute, assurance that the LGS complied with the specific provisions of the PERL and CalPERS contract except as noted.

The findings and conclusions outlined in this report are based on information made available or otherwise obtained at the time this report was prepared. This report does not constitute a final determination in regard to the findings noted within the report. The appropriate CalPERS divisions will notify LGS of the final determinations on the report findings and provide appeal rights, if applicable, at that time. All appeals must be made to the appropriate CalPERS division by filing a written appeal with CalPERS, in Sacramento, within 30 days of the date of the mailing of the determination letter, in accordance with Government Code Section 20134 and Sections 555-555.4, Title 2, of California Code of Regulations.

Respectfully submitted,

Original signed by Beliz Chappuie

BELIZ CHAPPUIE, CPA, MBA
Chief, Office of Audit Services

Staff: Alan Feblowitz , CFE, Assistant Division Chief
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APPENDIX A

OBJECTIVES

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OBJECTIVES

The objectives of this review were limited to determine whether LGS complied with:

- Applicable sections of the California Government Code (Sections 20000 et seq.) and Title 2 of the CCR.
- Reporting and enrollment procedures prescribed in the LGS' retirement contract with CalPERS.

OAS determined that all of the employees reported to CalPERS by LGS were actually common-law employees of other agencies. Therefore, the employees should not have been enrolled into membership and payroll should not have been submitted to CalPERS. As a result, OAS did not review the pay schedule, compensation earnable, payrates, payroll elements, and unused sick leave since the reported employees were determined not to be LGS employees.

This review did not include an assessment as to whether LGS is a "public agency," and expresses no opinion or finding with respect to whether the LGS is a public agency or whether its employees are employed by a public agency.

METHODOLOGY

To accomplish the review objectives, OAS interviewed key staff members to obtain an understanding of LGS' operations and hiring practices, reviewed documents, and performed the following procedures.

- ✓ Reviewed:
 - Provisions of the contract and contract amendments between the LGS and CalPERS
 - Correspondence files maintained at CalPERS
 - LGS Board minutes and resolutions
 - LGS written labor policies and agreements
 - LGS hiring documents
 - LGS personnel records
 - Various other relevant documents
- ✓ Reviewed LGS' enrollment practices for temporary and part-time employees to determine whether individuals met CalPERS membership requirements.
- ✓ Reviewed LGS' employment practices for retired annuitants to determine if retirees were lawfully employed and reinstated when unlawful employment occurs.

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- ✓ Reviewed LGS' independent contractors to determine whether the individuals were either eligible or correctly excluded from CalPERS membership.
- ✓ Reviewed LGS' affiliated entity organizational structure to determine whether employees of the affiliated entity qualified for CalPERS membership and were enrolled as required.

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APPENDIX B

AGENCY'S WRITTEN RESPONSE



July 7, 2015

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Via Email: Young.Hamilton@calpers.ca.gov

RE: CalPERS Draft Report Response

Dear Ms. Hamilton:

The Local Government Services Authority (LGS) is in receipt of the draft compliance review report (CalPERS ID 7214598140, Job Number P12-013) dated May 8, 2015. You have directed that our response address whether LGS agrees with the recommendations in the report. LGS has reviewed the draft report and strongly disagrees with the Office of Audit Services' (OAS) analysis, conclusion, and recommendations, as explained below.

The report has one "finding": that LGS incorrectly enrolled individuals who were not LGS employees into membership, because CalPERS has concluded that LGS employees were common law employees of other agencies. This conclusion is based on an interpretation of common law factors for determining employer/employee relationship.

RESPONSES TO VARIOUS STATEMENTS IN THE REPORT

The report "noted an observation" that "we were unable to determine definitively whether LGS and its affiliated agency, Regional Government Services are the same entity or separate entities." Based on this statement and others in the report, and a later referral of the question to other CalPERS staff, our view is that the OAS' purpose is to cast suspicion and doubt about the legitimacy of these joint powers authorities (JPAs) and JPAs in general, despite their authorization under California law and a significant body of case law recognizing their independent legal existence, as discussed below. Otherwise, it is unclear why the auditor would not have further checked on this question before issuing such a statement in the report.

The report includes the following statement under Review Results, Condition 1: *LGS incorrectly enrolled ineligible individuals into CalPERS membership.* By way of background: LGS was municipally incorporated March 1, 2001. One of its goals was to provide a CalPERS defined benefit program for future LGS employees. LGS sought CalPERS feedback and advice prior to formation and further assistance after formation when LGS was setting up groups for Employer Paid Member Contributions (EPMC). In fact, CalPERS continued over ensuing years to provide assistance on how to designate groups for EPMC benefits.

LGS has paid all contributions required for over thirteen years of operations. LGS employees have received member statements from CalPERS, and LGS has been in contact with PERS during the entire time, dealing with routine and non-routine issues as they arise.

The changes in CalPERS regulations, procedures and retirement law over the past fourteen years have been challenging for all public agencies; only further making the point that one agency (such as LGS) could more efficiently serve the needs of small agencies, than each agency acting as their own employer, benefits provider, HR support, payroll server, etc. With all the financial pressure on public agencies because of their participation in CalPERS medical and retirement plans, one would think that the LGS organization and business model would be a welcomed innovation.

The report attempts to apply the common law employment test to four sample LGS employees, not acknowledging other criteria and standards that are used under California law to determine the employee/employer relationship. The report claims the LGS Executive Director “stated that the information provided on each sampled individual would also apply to all other individuals assigned to that Client Member.” The Executive Director does not recall ever making such a statement. The auditor might have misunderstood a comment by the Executive Director that the four LGS employees’ basic benefit plans were representative of that group.

The report further claimed that the LGS Executive Director “also stated that the determination OAS makes about the common law relationship between the individuals reviewed and Client Members [sic]¹ will apply to all individuals placed by LGS with the same Client Member.” The Executive Director did not agree in advance that whatever the auditor’s determination was regarding the relationship for one person, that the same determination would be applicable for all LGS employees assigned to a client of LGS. The way this statement is presented is that an LGS representative is pre-concurring with OAS’s opinion irrespective of whether LGS disagrees with OAS findings or conclusions.

The auditor, with his supervisor on the phone, said that while LGS might have been compliant when it was formed, case law had changed in subsequent years making LGS non-compliant. Mr. Wall cited cases from the 1970’s for how LGS was no longer in compliance. LGS was formed three decades after the cases cited. If CalPERS’ position is that LGS did not have qualifying employees under case law dating from the 1970’s, should not CalPERS staff have advised LGS at that time that the nature of this business would not be compliant instead of continuing to advise and assist LGS in complying with PERL and CalPERS requirements? LGS can no more rely on the OAS auditor’s mistake to prove the correctness of our position than OAS can use a mischaracterization of what the LGS Executive said to prove the CalPERS position.

The report claims that it identifies “facts . . . supporting a finding of common law employment with [the LGS clients].” Some of the claimed facts are incorrect statements. The facts cited do not include those supporting LGS as the employer; and those facts cited, LGS argues, do not constitute a clear determination of employment by LGS clients. This one-sided bias is also demonstrated in the report’s selected out-of-context references to an internal benefits newsletter which gives our employees awareness of the CalPERS auditor review. The mentioning of the audit in the newsletter seems evidence enough for the CalPERS auditor to deduce that LGS or its employees must be questioning the employer/employee relationship with the client. LGS would have been remiss if it

¹ “Client Member” is incorrect and misleading terminology.

had not notified employees of an audit. Further, the newsletter was a monthly vehicle to inform employees about a variety of issues. That same newsletter also contained information about recent changes to LGS benefits, a new payroll system, and other information applicable to employees. The auditor stated his objectives well before the preliminary report was issued that he was focused solely on the twenty factor test and appeared determined to prove his previously stated opinion that LGS was not the employer. LGS felt it appropriate to inform employees of the audit and this preliminary report confirms that decision. Somehow this information is used by CalPERS to prove the opposite of what it is: one piece of evidence that LGS is exercising normal employer communication with its employees.

The report recommends that, “LGS should immediately stop enrolling and reporting service credit and compensation earnable . . . It should also determine whether LGS has any common law employees.” The report is saying LGS should immediately stop providing a retirement benefit for its existing employees, with no regard for the disruption that would entail. LGS has, in good faith and transparency, provided services to client agencies for over thirteen years. LGS was established to help agencies meet their support needs in a cost-effective manner, and everything CalPERS has requested of the agency has been done. LGS has communicated to CalPERS over the years and sought their help in complying with payroll reporting, enrollment, and the correct resolution format for adding EPMC benefits for selected geographic groups.

The report states that “OAS was unable to determine whether LGS and RGS are the same or separate agencies.” The first paragraph of page 13 changes the focus to Regional Government Services Authority (RGS), by implying that the LGS audit caused RGS to terminate its health care benefits participation in CalPERS during the LGS audit. The reason for the change (which the report failed to mention), was the legacy cost of CalPERS’ required retiree medical benefit without vesting requirements. Both RGS and LGS have been talking to their respective employees and benefits broker for years about moving to medical benefits program that did not require this retiree defined benefit. The number of eligible employees to join another medical coverage pool was finally achieved, enabling the two agencies to change pools and establish HRA accounts for employees that allowed the Authorities to fund this benefit on a pay-as-you-go basis.

The report’s characterization of LGS as RGS’ “alter-ego” is unsubstantiated and should have been investigated by CalPERS prior to issuing this report, since it appears to be a significant concern. Yet the report is silent about what relevance the issue has to the subject matter of the audit, what jurisdiction CalPERS has over the issue, what expertise it has to make that determination (particularly regarding two local government agencies), and what the consequence would be if CalPERS concluded that LGS and RGS are alter-egos. Without that information, it appears that CalPERS is on a fishing expedition with defamatory consequences for both LGS and RGS. Early in the report the OAS says another CalPERS group should investigate whether LGS and RGS are separate, but on page 13 the OAS says without further information it could not determine if RGS employees providing services to LGS were really RGS employees or maybe no one’s employees. The report further heightens its vitriol by questioning whether LGS is even a public agency. A piece of ‘evidence’ causing the auditor to question the legitimacy of LGS is the use of the Executive Director’s home address as the address for CalPERS. There was a short time after terminating a contract with a city to provide payroll and financial services, when the Executive Director’s home address was used as the physical address. The mailing address for LGS was, in fact, a PO Box, and the physical address was updated years ago. Despite notifying a number of PERS divisions many, many times, OAS claims to have never received the updated address. RGS administrative staff—who provide

administrative support for LGS pursuant to an agreement between the two agencies—are ‘virtual’ in order to keep costs low, reduce environmental impact and to accommodate a geographically and situationally diverse workforce. Many agencies try to accommodate remote employees, at least to some degree or under extenuating circumstances (such as long commutes and partial disability) or simply to help improve morale. The fact that LGS has been successful in extending this arrangement does not make the Authority any less of a public agency than CalPERS itself or any other agency.

Page 13 of the report also states, “The only real appreciable difference identified between LGS and RGS appears to be the management of employment benefits. . . [with those seeking] health benefits are contracted through RGS.” In fact, both LGS and RGS contracted with CalPERS for medical benefits for ten years. This misstatement in the report demonstrates that the auditor did not even check with CalPERS Medical to see that LGS was a participating agency. This mistake leads the author to call for another investigation of “additional PERL compliance issues. . .”

Page 14 of the report states that “. . . LGS did not enroll or report any individuals who performed the core functions of LGS/RGS for retirement benefits.” That is correct: RGS administrative staff support several agencies in addition to RGS employees. The report nevertheless makes unsubstantiated assumptions based on an isolated fact without any reference to applicable law or explanation of the relevance. The report restates that OAS could not determine the “alter ego” status of LGS. The report instructs LGS to provide all information necessary for CalPERS staff to resolve these questions. LGS has responded in a timely manner to all requests for information about LGS, LGS employees, and LGS clients, providing OAS staff with responsive documents electronically. The report’s language concerning “alter ego” status is inflammatory and LGS requests it be stricken from the final report. It serves no business purpose other than to attempt to discredit by innuendo.

LEGAL ANALYSIS RESPONSE

In response to CalPERS draft 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.4th 491.

This is not a typical case where the common law employment test is being applied to determine whether individuals are employees, as opposed to independent contractors. The individuals are all employees, and LGS paid employer contributions to CalPERS on behalf of its employees. No independent contractors are involved and no attempt was made, as in *Cargill* and other cases, to prevent employees from being enrolled in CalPERS. Rather, the dispositive question is whether LGS, or the JPA client agencies holding CalPERS contracts, or both are employers.

STATUTORY EMPLOYMENT

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 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.

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. (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).)

Government Code section 6506 provides:

The agency or entity provided by the agreement to administer or execute the agreement may be one or more of the parties to the agreement or a commission or board constituted pursuant to the agreement, or a person, firm or corporation, including a nonprofit corporation, designated in the agreement. One or more of the parties may agree to provide all or a portion of the services to the other parties in the manner provided in the agreement. The parties may provide for the mutual exchange of services without payment of any consideration other than such services.

In defining the term “employee,” the *Cargill* Court held that unless given reason to conclude that the Legislature intended the term to have a different meaning, “we also can only adhere to the common law test.” *Cargill, supra*, 32 Cal.4th at 501.

The Legislature has carved out a statutory exception to common law employment and, absent controlling statutes or regulations, service credit under CalPERS is allowable. As authorized by Government Code section 6506, and as recognized by *Cargill’s* statutory exception, and pursuant to a joint powers agreement, LGS serves as the administering agency for the JPA and as employer of the individuals challenged by CalPERS. The role of LGS as a joint powers agency is consistent with the public policy principles of the Joint Exercise of Powers statute which was codified to promote efficient and cost-effective services amongst California’s public agencies. It is not the role or purview of CalPERS to impose its unilateral interpretation of other legislative enactments. Moreover, it is CalPERS’ legal obligation to harmonize other statutory law when exercising its power to interpret the PERL. *Cargill* was a closely divided 4 to 3 decision. As Justice Brown explained in her concurring and dissenting opinion, the fiscal and economic burdens placed on public agencies have generated alternative strategies which cannot be summarily dismissed by CalPERS. It is instructive to reiterate a portion of Justice Brown’s opinion:

Concurring and Dissenting Opinion by BROWN, J.

This is a case of the tail wagging the dog—with a vengeance. The majority purports to decide only whether real parties in interest—workers leased by the Metropolitan Water District (MWD) from independent labor suppliers—must be enrolled as members of the California Public Employees’ Retirement System (CalPERS). In reality, the majority has uncritically

applied an arguably obsolete common law definition of “employee” to a new labor paradigm and conferred an authority on CalPERS—one never accorded by the Legislature—to unilaterally determine the legality of public employers using leased workers. Proper exercise of our role in defining the common law and according deference to the legislative and executive branches should compel the court to decline plaintiffs' invitation to remake the civil service in the image of the pension system. I respectfully dissent.

Cargill, supra, 32 Cal. 4th at 509-10.

The employees who are the subject of the audit are statutory employees of LGS under applicable law, and nothing in the audit contradicts that conclusion.

COMMON LAW EMPLOYMENT

CalPERS audit states that an employee for purposes of CalPERS membership is defined solely by the traditional common law test. See pp. 3-4. 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.4th 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.4th 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.4th 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 its 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.4th at 496.

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.

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.

CO-EMPLOYMENT

It is well-settled in the law that an employee may have more than one employer. A special employment relationship arises when an employer lends an employee to another employer and relinquishes to the borrowing employer the right to control the employees’ activities. *Marsh v. Tilley Steel Company* (1980) 26 Cal.3d 486, 492. The right to control and direct the activities of an alleged employee or the manner in which the work is performed, whether exercised or not, is the primary factor in determining whether an employment relationship, special or otherwise, exists. *Kowalski v. Shell Oil Co.* (1979) 23 Cal.3d 168, 175; *Riley v. Southwest Marine, Inc.* (1988) 203 Cal.App.3d 1242, 1250. The borrowed employee is held to have two employers, the original or general employer and the special employer.

“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.”

The California Supreme Court has also held:

Facts demonstrating the existence of a special employment relationship do not necessarily preclude a finding that a particular employee also remained under the partial control of the original employer. Where general and special employers share control of an employee’s work, a ‘dual employment’ arises, and the general employer remains concurrently and simultaneously, jointly and severally liable for the employee’s torts. *Marsh, supra*, 26 Cal.3d at 494-495; See also *Societa per Azioni de Navigazione Italia v. City of Los Angeles* (1982) 31 Cal.3d 446, 460.

The Supreme Court in *Cargill* also determined that even in co-employment situations there was no co-employment exception to the employer’s reporting duties. *Cargill, supra*, 32 Cal.4th at 506. MWD was claiming in that case that the employees were not district employees, maintaining that under a theory of co-employment the labor suppliers, and not MWD, should be deemed the employers for purposes of the PERL. The Supreme Court determined that even if the employees were co-employees of both MWD and the labor supplier, the lack of a co-employment exception to

the PERL would still require MWD to report those employees to CalPERS. *Ibid.* So long as one employer is a CalPERS employer, *Cargill* instructs that it must report those employees to CalPERS.

Although there is no co-employment exception to a CalPERS-covered employer's duty to enroll its employees in CalPERS (*Cargill, supra*, 32 Cal.4th at 506; Circular Letter, p. 1.), where both potential co-employers are CalPERS members, as long as one of the co-employers has enrolled the co-employed employees, CalPERS' requirements have been satisfied. With respect to a majority of LGS employees, both separated and active, that provided services to the Metropolitan Transportation Commission ("MTC"), MTC is a CalPERS-covered employer. Thus, the LGS employees serving MTC must be enrolled in CalPERS whether or not LGS as a joint powers authority might be considered their co-employer.² All of the LGS employees that provided services to MTC were enrolled in CalPERS, so CalPERS' requirements for those employees were satisfied, viewing LGS and MTC as co-employers.

There is no co/joint employment exception to the PERL's mandatory reporting requirement governing MTC. So if MTC qualifies as a CalPERS employer, it does not matter that LGS is also the individuals' employer, as long as the employees were enrolled. Here, all of the employees in question were enrolled. Treating MTC and LGS and co-employers of those employees, CalPERS' requirements have been satisfied.

CONCLUSION

In sum, LGS asserts that statutory employment and co-employment analyses lead to the conclusion that the individuals were or are in the employ of the LGS. 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. LGS, as the employer under statutory authority, properly employs the affected individuals, in addition to serving as a co/joint employer. As such, the CalPERS draft audit is incorrect as a matter of law.

Sincerely,



Original signed by Richard Averett

Richard Averett
Executive Director

Cc: Director of Human Resources
Special Counsel

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² The same co-employment analysis applies to those LGS-reported individuals assigned to the Transbay Joint Powers Authority prior to its January 1, 2012 contract with CalPERS. The draft audit recognizes on page 11 that prior service credit was incorporated into the contract.