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**SUPREME COURT OF THE STATE OF WASHINGTON**

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KEVIN DOLAN and a class of similarly situated individuals,

Respondents,

v.

KING COUNTY, a political subdivision of the State of Washington

Appellant.

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**AMICUS CURIAE BRIEF OF THE STATE OF WASHINGTON**

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## I. IDENTITY AND INTEREST OF AMICUS CURIAE

Amicus curiae is the state of Washington (State). The Public Employees' Retirement System (PERS) is operated by the State through the State Department of Retirement Systems (DRS), and provides pension benefits for various categories of public employees in the State of Washington. As a PERS employer, the State has a strong interest in assuring that there is at all times a clear distinction between employees of the State who are eligible to participate in PERS and others who may perform services through state contracts but do not meet the definitions for PERS membership. The State also has a strong interest in assuring that PERS membership is defined in such a way as to maintain favorable tax status for PERS as a qualified governmental pension plan under federal law. The State offers this brief in support of King County.

## II. ISSUES

1. When a nonprofit corporation contracts with a state or local government agency to provide continuing services to the agency, and the agency pays for the services provided and exercises general control over the expenditure of public funds but does not direct the day-to-work of the corporation's employees, are the corporation's employees thereby entitled to membership in PERS?
2. Is a nonprofit corporation that performs contract services for one or more governmental agencies eligible for treatment as an "employer" for purposes of PERS?

### III. ARGUMENT

**A. Membership in the PERS system is limited to employers and employees who meet the definitions set forth in state statutes and rules.**

In this case, a group of employees of nonprofit corporations seek to establish eligibility for PERS membership, notwithstanding that they are hired, supervised, and compensated by the nonprofit corporations. Their argument is that the corporations perform contract services (providing public defender services) for King County and that the County, apparently through exercising prudent controls over the funding provided to the corporations through contracts, has thereby become the “common law” or “de facto” employer of the employees in question.

The State supports King County on the merits of this case, and commends the Court to King County’s briefing; especially King County’s opening Brief of Appellant at pp. 34-58 and King County’s Reply Brief at pp. 14-45. The nonprofit public defender corporations do not meet the definition of a PERS “employer” contained in RCW 41.40.010(4). The employees of the corporations do not meet the definition of “employee” in RCW 41.40.010(22) because they do not provide “services for compensation to an employer.” They provide services for compensation to the corporations, but the corporations are not “employers” as defined in the PERS statute.

These points are further clarified in DRS rules defining eligibility status. They provide, first, that “an independent contractor is not eligible for active membership in any state-administered retirement system.” WAC 415-02-110(1). In evaluating whether a worker is an employee of a retirement system employer, DRS evaluates whether the retirement system employer (here the County) “has the right to control and direct the work of the worker, not only as to the result to be accomplished, but also as to the means or methods by which the result is accomplished.” WAC 415-02-110(2)(a). In this case, the employees of the nonprofit corporations have not shown that the County has the right to control the means and methods by which they accomplish their work.

Because the State is itself a PERS employer, the State has a strong interest in assuring that a bright line is drawn between employees who are eligible for PERS participation and those who perform contract services and are not PERS-eligible. State agencies and institutions have thousands of employees, almost all of whom meet the requirements for membership in PERS or another state-administered retirement system. The State makes employer contributions for those employees, collects and remits employee contributions and, through DRS, administers the retirement systems in such a way as to assure that they are properly funded and meet their obligations to active and retired public employees.

The State also enters into thousands of contracts each year. Through these contracts, the State purchases goods and services for a great variety of governmental purposes. Contractors and their employees build roads and bridges for the State, maintain and repair public buildings, and provide the State with a host of professional services—medical, architectural, legal, scientific, data management, investigative, and food preparation services are only a few examples.<sup>1</sup> Like the counties, the State contracts with private entities to provide publicly-funded legal representation to indigent defendants in criminal cases and for indigent parties in certain civil matters through the Office of Public Defense, an agency in the judicial branch of state government. RCW 2.70.005, .020. Because of the State's varying needs for contract services, the contracts vary greatly in the period of performance, the nature of the services performed, and the extent to which the State audits or monitors the work of the contractors and their employees.

The State draws a careful distinction between hiring employees to perform services and entering into contracts with independent entities for services. State employees are hired through established statutory processes, usually involving the state civil service law, RCW 41.06.

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<sup>1</sup> The State regulates state agency personal service contracts by requiring them generally to be filed with the Office of Financial Management and by setting limits on their use. *See generally*, RCW 39.29.

Contracts are governed by different procedures and do not implicate the civil service laws. The State may contract with an individual or with an employer entity for services but does not directly assume supervisory control over the persons performing the service. As a general matter, the State enters into personal service contracts to “resolve a particular agency problem or issue or to expedite a specific project that is temporary in nature.” RCW 39.29.008. In a few cases, including the provision of indigent defense services, the State uses contracts rather than hiring public employees for broader policy reasons, especially the need for professional independence in performing the particular services involved. Whatever the reason, however, the State needs to know who its employees are and what its legal obligations are with respect to those employees. This is especially true of the retirement systems, which must engage in long-range planning to meet their ongoing financial obligations.

The respondent class in this case would invite the courts to develop a “common law” of public employment which would permit various categories of contractors and their employees to try to prove that they have achieved public employment status over time through some “course of conduct” analysis of their contractual relationship with a public agency. They ask the courts to examine not the issue of direct supervision by the public agency over the individual employees (which clearly is lacking

here) but simply the extent of public budget control over the contractor. Allowing private employees to “drift” into public employment status in this manner would seriously destabilize state and local budget planning as well as inviting additional litigation as additional people look for creative ways to maneuver themselves into retirement system eligibility.

**B. Permitting employees of nonprofit corporations to enroll in PERS would jeopardize the federal tax status of PERS.**

Because PERS membership is limited to government employees, PERS qualifies as a governmental pension plan under 26 U.S.C. § 414(d) of the Internal Revenue Code. This language defines a governmental plan as one which is “established and maintained for its employees by the Government of the United States, or by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.” As a governmental plan, PERS and the other state retirement systems are exempt from many onerous federal requirements imposed on private plans, and qualify for more favorable treatment under federal tax laws, including the right for both employers and employees to contribute to the governmental pension plan on a tax-free basis. 26 U.S.C. § 414(h). On the other hand, nonprofit corporations are governed by separate federal tax laws, generally found in 26 U.S.C. § 501. The federal provisions governing governmental plans and nonprofit

organizations are mutually exclusive. For example, an entity may qualify for tax status under 26 U.S.C. § 414(d), (h) as a governmental plan, or it may qualify under 26 U.S.C. § 501 as a nonprofit plan, but it cannot qualify under both.

The Internal Revenue Service does not view nonprofit corporations as state or a local government instrumentalities and does not accord them the special tax benefits accorded to state and local government pension plans. Therefore, nonprofit organizations may not participate in a “governmental plan” unless they are instrumentalities of a public agency based on five factors: (1) degree of control of government over the organization’s everyday operations; (2) whether the organization was created by special legislation; (3) the organization’s source of funding; (4) the manner in which the organization’s governing board is selected; and (5) whether a governmental agency considers the organization’s employees to be the agency’s employees. Rev. Rul. 89-49, 1989-1, C.B. 117.

The record in this case suggests that the nonprofit corporations supplying public defender services to King County and other entities are not public agencies or instrumentalities of public agencies. The County does not control their everyday operations, the corporations were not created by special legislation, the corporations are governed by boards not

chosen by government, and the County does not treat the corporations' employees as county employees.

If the courts were to find that the employees were nonetheless eligible to participate in PERS, the apparent result would be that DRS would be expected to start accepting employer and employee contributions from the nonprofit corporations who hire and compensate the respondent class. This would give rise to questions whether, by allowing participation by nonprofit corporations in PERS, the State risks losing "governmental plan" status for PERS.<sup>2</sup> There is a very real probability that if a nonprofit corporation is admitted into PERS, the IRS would revoke PERS' governmental plan tax qualified status, and define PERS as a private plan (as the default to losing its governmental status). The negative consequences of such an action towards PERS, its members, and its employers, cannot be overstated.

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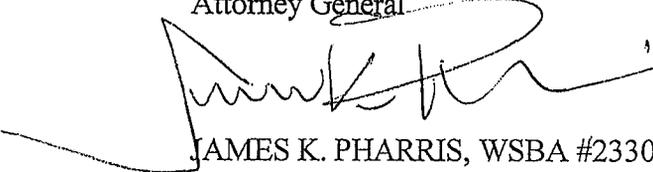
<sup>2</sup> If the respondent class is deemed eligible for PERS membership, either their current employers would have to be treated as PERS employers (giving rise to the problems discussed above), or the employees would have to be declared county employees, receiving their paychecks directly from the County. The class does not appear to have proposed the latter solution, but somehow hopes to combine the perceived advantages of private employment with the advantages of public employee retirement system membership.

#### IV. CONCLUSION

For the reasons stated above, the State supports King County on the merits of the issues raised in this litigation.

RESPECTFULLY SUBMITTED this 28th day of September, 2010.

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**CERTIFICATE OF SERVICE**

I certify, under penalty of perjury under the laws of the state of Washington, that on this date I have caused a true and correct copy of Motion to File Amicus Curiae Brief of the State of Washington and Amicus Curiae Brief of the State of Washington to be served on the following via e-mail or First Class United States Mail, postage prepaid:

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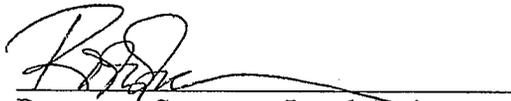
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