

COURT OF APPEALS FILE NO. A11-1330

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STATE OF MINNESOTA

IN COURT OF APPEALS

In the Matter of the PERA Salary
Determinations Affecting Retired and
Active Employees of the City of Duluth,

OAH DOCKET NO. 4-3600-2089-2

RELATORS' BRIEF AND ADDENDUM

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LEGAL ISSUES

I. Is PERA's Order excluding amounts paid for "deferred compensation:" from salary an improper enforcement of an unadopted interpretive rule?

ALJ held: In the affirmative
PERA held: In the negative

II. Is PERA's Order excluding amounts paid for "insurance supplement" from salary fraudulent, arbitrary, unreasonable and unsupported by substantial evidence?

ALJ held: In the negative
PERA held: In the negative

III. Is PERA estopped from reducing benefits to retirees by promissory, equitable estoppel or reliance?

ALJ held: In the negative
PERA held: Did not rule

IV. Is PERA's Order reducing benefits to retirees barred by the statute of limitations?

ALJ held: In the negative
PERA held: Did not rule

V. Is PERA's Order reducing benefits to retirees unconstitutional as impairment of contract or taking of private property?

ALJ held: Did not rule
PERA held: Did not rule

VI. Is PERA's failure to award attorney's fees to Relators in violation of law?

ALJ held: Did not rule
PERA held: Did not rule

STATEMENT OF THE CASE

In March 2009, PERA staff notified 485 retirees that the City of Duluth had erroneously reported certain amounts paid between 1995 and 2008 as “salary” for purposes of calculating retirement plan contributions and benefits. PERA staff intended to reduce individual monthly benefits by as much as \$200 per month and require repayment of up to \$20,000 each by retirees. Those notices informed the employees that if they disagreed with PERA’s salary eligibility determinations, they could file Petitions for Review (ALJ Finding 1).

Seventy of the 485 current and retired City employees who received those letter notifications filed Petitions for Review, including Relators herein. (ALJ Finding 2).

The PERA Board referred those seventy matters to the Office of Administrative Hearings (OAH) for the initiation of contested case proceedings before ALJ Bruce Johnson in OAH Docket Numbers 4-3600-20751-5 through 4-3600-20820-5. (ALJ Finding 4).

The ALJ considered motions by PERA and the Relators for summary disposition on April 13, 2010 and allowed post hearing submissions.

Relators and PERA supplemented the record with information regarding the tax treatment of amounts that the City paid on the Relators’ behalf. On July 21, 2010, the ALJ concluded that a genuine issue of disputed fact existed regarding the City’s tax treatment of the payments in dispute. Accordingly, the ALJ denied all of the pending motions for summary disposition. (ALJ Finding 17).

The ALJ heard testimony on September 30 and October 14, 2010.

The ALJ issued his Findings of Fact, Conclusions and Recommendation on January 18, 2011.

PERA staff and Relators filed exceptions to the ALJ's recommendation and responses to those exceptions. The PERA Board heard oral arguments on April 14, 2011 and conducted its deliberations on May 12, 2011. The PERA Board issued its Order on June 24, 2011, and served it upon Relators by mail on June 29, 2011.

Relators obtained a Writ of Certiorari filed July 25, 2011.

STATEMENT OF THE FACTS¹

Relators are retired employees of the City of Duluth Fire Department, and are members of Local 101 of the International Association of Firefighters (hereinafter "Local 101"). (ALJ Finding 29)

Since prior to 1983, Local 101 has had a collective bargaining agreement ("CBA") with the City of Duluth that establishes the terms and conditions of employment within the Fire Department. That CBA has included since 1997 a term relating to deferred compensation and insurance supplement payable by the City of Duluth to PERA on behalf of each Relator. (ALJ Finding 78)

PERA manages and administers pension plans for public employees, including the PERA Police and Fire Plan (P & F Plan). During the period from 1995 through 2008, Relators as members of the IAFF participated in the P & F Plan. (ALJ Finding 28).

Each Relator had given notice of retirement to PERA, received from PERA numerous pre-retirement estimates, and in reliance on those estimates, retired and received monthly benefits. After retirement, their accounts were audited (Transcript, p. 178). Following audit, PERA sent a Benefit Letter stating: "This is the actual monthly amount that will be paid for duration of your retirement." (178) PERA staff testified that when retirees make elections, retirees are held to those decisions irrevocably (179). Retirees are never allowed to change those choices, or to un-retire (179). Every one of the Relators was required by PERA to make irrevocable decisions based upon the information they received from PERA (179).

¹ Relators agree with and incorporate by reference all Findings of Fact of the ALJ in his January 18, 2011 decision.

In March 2009 each Relator was notified that his or her monthly retirement annuity would be reduced by as much as \$250 per month. They were also notified they would be required to pay back benefits previously received, in amounts up to \$20,000. (ALJ Finding 122).

James Charbonneau had based his decision to retire on whether he would receive a certain amount of money as his goal. When he received an estimate that met his goal, he decided to retire. (191) The PERA written estimates of benefit were the “only thing you can rely on, in making the decision to retire.” (194) Charbonneau would not have made the same decision to retire had he known of the reduction in his monthly benefit (195). He could have worked longer to build up the pension to make up the difference. “You have a number set, that the amount you need to retire, you can work longer to get to that number, but once you are gone, you are gone.” After retirement, in 2009, he received a notice of a \$166.02 monthly reduction in his monthly benefit. Charbonneau intended to work a year or two at the fire department credit union after retirement, but he is still working that job for almost four years now and has no plans to quit (196).

Terry Purcell retired December 1, 2006. He went to a PERA pre-retirement seminar and obtained an estimate of his retirement benefits after taxes (199). He had planned on a certain amount. When he received the estimate, it was better than he expected, and it gave him the flexibility and option so he decided to retire about a year and a half earlier than he had planned (200). In March of 2009, Purcell was notified that his monthly annuity would be reduced more than \$177. Because of the reduction, he has returned to work as a substitute teacher. His wife was unable to retire, and she is planning to work a year or two longer now. It has been a hardship for them (202).

Pamela Wutz retired July 31, 2007. She had been watching her PERA estimates over the previous five years, looking at a minimum of \$3200 per month income for retirement. She took a penalty for early retirement, but met her final number. In March of 2009, Wutz was notified that her pension would be reduced \$158 per month, a huge difference to her (206). It was so significant that Wutz approached the City and requested her job back. She talked to PERA to determine if she could still continue putting contributions into PERA. (207) The City declined her request for her job back (207). She applied again and was required to take the test (207). As recently as a week before the hearing, Wutz again requested her job back and was denied (207). Wutz absolutely would not have made the same retirement decision if she knew her benefit would be reduced (208).

Douglas Michog retired on December 31, 2007. He had made two trips to PERA and utilized the calculator on the PERA website to determine his retirement number. (209-210). He had the option to purchase four years of military time toward PERA, but was only able to afford two years from his Deferred Compensation Account (210). During the time he considered retiring, and until his actual retirement date, no one ever told him that there might be a problem with the retirement calculations (211). Michog's pension was reduced by \$220 per month. He would not have made the same retirement decision if he had known his benefit would be \$220.00 less (211). Michog is trying to help his children in school, and has a father in law he is helping in a nursing home. (211) After he received the reduction he got a job servicing fire extinguishers in private businesses.

Paul Ostman retired May 31, 2006. He had attended PERA seminars and paid attention to the calculation of maximum benefit (218). He was entitled to a pension from the TRA spoke

with both agencies over a period of five years to maximize his benefits (219). The information he received was invaluable, and he depended on them (220). When Ostman was notified in March 2009 that his PERA pension would be reduced by \$249 per month (221), he asked for his file from PERA. After he requested and received the file, PERA sent an unsolicited letter advising him that the reduction would only be \$220 per month (222). Ostman would not have retired if he knew that the amount he received would be reduced. He would have worked another year and a half to maximize his benefits. (223).

David Salvesson retired in July of 2006. He used funds from Deferred Compensation to purchase military buy back. The PERA estimates were the key to making his decision, along with the military buy-back (226). He had a specific retirement goal, since he had mortgage payments and other expenses. In March 2009, Salvesson received notice that his pension would be reduced by \$140 per month. He would not have retired if he knew the amount would be reduced since it was not a sufficient amount to pay his set costs (227). He has returned to work to make up the reduction (227).

In 1994, John Hall was President of and chief negotiator for the City of Duluth Supervisors Association (hereinafter "CDSA") and negotiated the CDSA contract effective 1995-1996. In that round of contract negotiations the City was represented by former Chief Administrative Officer Karl Nollenberger. Hall recalls the City would not offer a greater salary increase, but wanted to offer some additional compensation. The City could provide a greater amount but did not want to place it in a percentage of salary because of the effect on subsequent negotiations. Hall recalls Nollenberger suggested a payment toward "deferred compensation." Nollenberger was a CPA and familiar with financial, budget and accounting matters. Hall

repeatedly requested verification that such payments would be includable as PERA salary and Nollenberger always assured him they would be. (Hall Affid. Exhibit 131) (ALJ Finding 83).

The CDSA and the City entered into a tentative agreement providing for additional compensation of \$25 per month in 1995 and \$50 per month in 1996 to be paid on behalf of each member as part of total compensation. The specific language in the 1995 agreement is as follows:

“ARTICLE 12 - DEFERRED COMPENSATION

12.1. The employer shall allow an employee to participate in any deferred compensation plan of the employee's choice which meets the following criteria:

- a. It has been approved by the deferred compensation commission.
- b. It qualifies under the laws and regulations of the United States, State of Minnesota, Internal Revenue Service.
- c. The employer can accomplish any record keeping, data processing, accounting, or administration of the plan by making a reasonable effort.

The employer shall not do any act to change, alter, amend, or terminate any employee's deferred compensation plan without first giving at least sixty (60) days' written notice of its intention, and completing the processing of any grievance brought concerning the proposed action, unless law, ruling or order of the Internal Revenue Service requires it.

Beginning January 1, 1995, the employer shall contribute \$25 each month to any employee's deferred compensation plan which exists pursuant to this article. Beginning January 1, 1996, the amount of the employer's contribution shall be increased to a sum of \$50 each month.” (ALJ Finding 75)

The 1997-1999 CBA contained essentially the same language except that it increased the monthly contribution to \$75 per month in 1997, \$100 per month in 1998 and \$125 per month in 1999. It also provided covered employees with the option of using that sum either as a “contribution to a qualifying and approved deferred compensation plan, or for contribution to family-dependent hospital-medical premium, whichever is designated by the employee during the open window for insurance selection, or at the time of a life event.” (ALJ Finding 76).

The 2000-2002 CBA, increased the benefit to \$224 per month (plus an additional \$5 per month for employees enrolled in “plan 3 hospital-medical insurance”) for either deferred compensation or toward family-dependent hospital-medical premiums. These amounts remained the same through 2006 and increased to a flat \$229 per month in 2007-2009. (ALJ Finding 77). From 1997 through 2008, the same provisions were included in the IAFF CBA. (ALJ Finding 78).

During the labor negotiations that occurred between 1995 and 2008, the City advised members of its bargaining units that payments to them for either deferred compensation or family medical coverage would be considered salary for purposes of PERA. (ALJ Finding 85).

Jackie Morris was the City Manager of Payroll/Personnel Systems at the time the deferred compensation provision was added to the CDSA contract. She and her supervisor, Les Bass, the City Auditor, contacted PERA to determine how to handle this new form of compensation. They were advised by PERA to include the deferred compensation as salary. (Morris Affidavit Exhibit 111; Bass Affidavit Exhibit 108; Stark Affidavit 112) (ALJ Finding 84) Morris recalls at that time PERA included “most everything in salary,” and there were large fines for omitting items from salary (Morris Affidavit Exhibit 111)

The deferred compensation payments could be withdrawn by employees, subject to a penalty and taxes. The employees could also draw on those amounts as loans. (ALJ Finding 71). The deferred compensation funds were also available for employees to “buy back” years of military service toward their pension. (Michog Affidavit Exhibit 115, Belanger Affidavit Exhibit 113, Salverson Affidavit Exhibit 122, Ostman Affidavit Exhibit 114) The deferred compensation program never required or mandated any “match” either by employer or employee. The

deduction for deferred compensation on employee paystubs was one number, including all amounts contributed from any source. (Bass Affidavit Exhibit 18; Morris Affidavit Exhibit 111; Stark Affidavit Exhibit 112)

Retired City Finance Director Genie Stark recalls that in 2001, during the state audit she and City Auditor Bass argued the City's payments were not covered under the statute governing the \$2,000 match, since that statute required an employee match and the City's union contracts did not. Since all amounts were treated as salary, and no match was required, the State Auditors were satisfied and the issue was "resolved." (Stark Affidavit Exhibit 112)

The City does not provide "health insurance" for single employees, or family "insurance" for the families of employees. In the early 1980's, the City negotiated an agreement to institute a self-insured "pay-as-you-go" medical reimbursement plan. (Stark Affidavit Exhibit 112; Brown Affidavit Exhibit 130) The City promises to reimburse claims presented to it, and hires a claims administrator to collect, approve and pay claims of employees and families. (ALJ Finding 72)

The City reimburses medical claims for its single employees. The City has never offered to pay for any family "coverage" to employees, but offers in its CBAs a certain dollar amount of payment which employees could apply against the cost of family medical claims. Any remaining cost is paid by the employee, typically through payroll deduction. (Brown Affidavit Exhibit 130; Hall Affidavit Exhibit 131)

There is no reserve fund dedicated only for medical claims and the administrator is not an insurer. There have been times when the City fund for payment of claims was below zero. (Morris Affidavit Exhibit 111; Stark Affidavit Exhibit 112; Bass Affidavit Exhibit 108; Brown Affidavit Exhibit 130)

In 1997, the City of Duluth adopted a new software program for payroll. Paystubs of employees show "DEF COMP" on the income side of the paystub along with salary and other items of compensation, and also show a deduction for deferred compensation on the deduction side. (Hall Affidavit Exhibit 131; Isabell Affidavit Exhibit 109; Johnson Affidavit Exhibit 103; Keenan Affidavit Exhibits 104, 105).

For those few employees who did direct the deferred compensation amount toward the cost of the family medical reimbursement plan, the amount also showed as income on their paystubs as "INS SUPPL." (Keenan Affidavit Exhibits 104, 105) It may well have been subject to tax. (Keenan Affidavit Exhibits 104, 105)

The State Auditor performs annual audits of the City's finances, which include separate payroll audits. A portion of the audit of the City's payroll practices involves randomly selecting at least twenty-five payroll checks to compare with W-4 forms, time cards, employee authorizations for deductions, and other documentation. (ALJ Finding 67).

The Office of State Auditor audited the City's deferred compensation plan from 1997 through 2007. There was a special audit of that new payroll system after the first year which included deferred compensation and was satisfactory. (Hall Affid. Exhibit 131; Stark Affid. Exhibit 112; Morris Affid. Exhibit 111)

The notes of the audit by the Office of State Auditor for year-end 1997 and 1998 noted the deferred compensation plan. (Storaasli Affid. Exhibit 129)

The audit for year-end 2000 included the "salaries payable" and "PERA disclosures." The Auditor signed off on the audit conclusion on February 21, 2001. (Storaasli Affid. Exhibit 129)

The audit for the year ending December 31, 2001, noted that the deferred compensation provisions in the CBA might violate Minn. Stat. § 356.24. The note stated: “[i]t appears that the contributions made by the City are not in compliance with this statute.” However, the City’s copy of that audit note includes the hand-written note, “Resolved.” (ALJ Finding 68).

Wayne Parson, current auditor from the City of Duluth was a member of the team of the Office of State Auditor during this 2001 audit when the issue was resolved. (Storaasli Affid. Exhibit B, Exhibit 129).

The City payroll department was advised in 2005 that not all records could be retained due to insufficient memory capacity. Accordingly, the Payroll Department determined to keep only past payroll totals and not the payroll detail. Jackie Morris, testified that pre-2005 payroll records have totals but no stored detail. (Morris Affid. Exhibit 111) (ALJ Finding 114) The City did not retain paper copies of employee paystubs or paychecks. As a result, it is now impossible for the City to accurately reconstruct individual employee paystubs and other payroll records prior to 2005. (ALJ Finding 114).

On July 31, 2007, Parson directed an e-mail to Chris Arcand at PERA inquiring whether certain “employer paid benefits” of CBAs are “salary not subject to PERA withholding.” (ALJ Finding 87)

Subsequently, Parson followed up by sending the following e-mail message to Arcand:

Please see attachments. My interpretation of the information under “Salary not Subject to PERA Withholding in the PERA Employer Manual is that these employer paid benefits are not PERA salary and accordingly employee and employer PERA contributions should not be withheld/paid.

Parson sent the e-mail on Tuesday, July 31, 2007, at 3:50 p.m. The e-mail included five pages of contract excerpts addressing the issue. Arcand replied within 45 minutes, with a two

sentence answer indicating that he “agreed” that the deferred compensation payments were not salary. (ALJ Finding 89)

No follow-up or further action was taken by PERA to this notice. Although Arcand had received copies of actual CBA documents, there is no record of Arcand or anyone at PERA pursuing the issue. The Legislative Auditor made a finding that PERA never followed up the 2007 contact, and PERA concedes it did not. (Storaasli Affid. Exhibit 129)

Cheryl Keating of PERA testified there was no due diligence on the part of PERA to determine whether persons were still being allowed to retire, or if funds were still being taken incorrectly from beneficiaries. (146). PERA continued to allow people to retire and gave them retirement projections. (147). Keating agreed that this change in characterization of Deferred Compensation and Insurance Supplement “certainly could affect someone’s decision” to retire (147). Keating agreed that a difference in monthly annuity of \$200 to \$250 per month is significant (148). (ALJ Finding 95)

In August 2007, Parson told Morris that the City was incorrectly reporting its deferred compensation payments to PERA. (ALJ Finding 91).

Morris believed that Parson’s opinion was incorrect, and she phoned PERA to obtain clarification. The individual whom she consulted at PERA agreed that deferred compensation payments should be treated as PERA salary. (ALJ Finding 92).

Nevertheless, on August 1, 2007, Parson directed Morris to stop reporting the deferred compensation/family medical payments to PERA as salary. Parson communicated that decision to Finance Director Genie Stark. That decision was not communicated to PERA, any other City official, or employees or retirees. (ALJ Finding 93, 120)

During the in-person training sessions that PERA conducted for members between August 1, 2007, and March 9, 2009, PERA did not expressly advise attendees of its new interpretation. (ALJ Finding 121).

Between August 1, 2007, and September 15, 2008, neither Parson, City or PERA staff investigated further. (ALJ Finding 94)

It was not until September 2008 that the issue of the City's apparent non-compliance with PERA's policies on reporting of salary resurfaced. In September 2008, Parson had a meeting with Lisa Potswald, who had recently become the City's Chief Administrative Officer. (ALJ Finding 96).

On September 15, 2008, Potswald, with Parson's assistance, sent a letter to Mary Most Vanek, PERA's Executive Director, informing Vanek "about an error made by the City in the treatment of certain employer-paid benefits as salary subject to PERA taxes." In her letter, Potswald referred to the payments only as "insurance supplement payments"; she did not refer to any of the payments as being for deferred compensation. The letter stated incorrectly that "[o]ur annual financial statement audit conducted by the Office of the State Auditor did not detect this error." Potswald directed Vanek to Parson for answers to any follow-up questions. (ALJ Finding 97).

In response to Potswald's letter, Chris Arcand from PERA, directed an e-mail on September 18, 2008, to Morris, requesting only those records the City has in possession which are reliable, and suggests that three years would be a reasonable time limitation. (ALJ Finding 98) He stated:

"We ask only that you provide information that would be reasonable for the City to compile. For instance, if your records are archived or inaccessible beyond three

years, we ask that you only go back three years through the date that you stopped taking the inadvertent contributions.”

Morris proceeded to gather three years of records. Morris believes the City records back to 2005 are reliable, trustworthy, and correct, but the City had destroyed all payroll detail for payroll records prior to 2005. The detail records for any prior years were not in existence at the time of Arcand’s request. (Morris Affid. Exhibit 111) The next morning, on September 19, 2008, Arcand received an e-mail directly from Parson including the following language:

“Also, please direct any inquiries regarding this issue directly to me and not to our payroll office.” (ALJ Finding 99)

When the City reported the payments from 2005 through September 2008, it did not advise PERA that some of those payments were included in employees’ taxable income at the time those payments were made. (ALJ Finding 102).

On October 8, 2008, Parson reported to PERA that for the years 2005, 2006 and 2007 he believed \$5,857,244.87 was erroneously reported as salary, and the PERA taxes overpaid during that time were \$761,907.46. He indicated that the City continues to “investigate payroll records prior to 2005. (Storaasli Affid. Exhibit 129)

Morris prepared the 2005 through 2008 records as requested by Arcand, but when she was ready to send them, she was escorted out of her office. The City then assigned Skip LeClair to create new software for the purpose of recreating the payroll detail prior to 2005. LeClair was unable to complete it without contacting Morris repeatedly for assistance. Neither LeClair nor any other person in the Payroll Department had ever worked with the prior payroll software systems. Jackie Morris believes the recreated records for the time periods prior to 2005 are not trustworthy or reliable both because LeClair contacted her so much and because no person in the

department had any knowledge of the previous software and payroll systems. (Morris Affid. Exhibit 111) The City, rather than providing the trustworthy three years of records which were requested by PERA, spent numerous hours and days creating new software in order to recreate records from 1997 through 2005 to send to PERA.

The payroll information that PERA used to recalculate the retirement benefits to City employees and the overpayments for those employees for 1995 through 2007 was likely inaccurate, and PERA knew or should have known this. (ALJ Finding 119, 127).

PERA implemented the reduced annuities for retirees effective July 1, 2009. Many retirees experienced monthly reductions in excess of \$200 per month. Paul Ostman's annuity was reduced by \$250. (Ostman Affid. Exhibit 114) For many, including Paul Ostman, \$200 had been the difference between electing a 100% survivor annuity, or 75%, or 50%. It is a significant difference for many people. (Exhibit 114) This reduction by PERA was presumably for the life of the retiree, which could be 25 or more years.

According to PERA the total "erroneous" withheld employee contributions from City of Duluth retirees are \$1.137 million, total employer erroneous contributions are \$1.414 million, and net overpayment of excess PERA benefits are \$1.268 million. PERA's action affects 485 retired employees. (ALJ Finding 123).

Patricia Kappelhoff of PERA testified it is atypical to have retroactive adjustments as long as 15 years. Most typically the average retroactivity is two years (177). Retroactivity back to 1997 is very unusual. PERA has never had a situation with 442 retirees. Even three year retroactivity is a "long time" and Kappelhoff does not recall any others that went that far with groups of beneficiaries (177). Both Kappelhoff and Cheryl Keating of PERA testified there is

nothing in past PERA experience and knowledge close to this magnitude (177, 151). They both testified the retirees are entirely blameless (177, 151). (ALJ Finding 125)

Jim Charbonneau had all his old paystubs. He made a spreadsheet and compared the City and PERA numbers to his own. There are numerous mistakes, and the numbers are inconsistent with the CBA. (Charbonneau Affid. Exhibit 101, 102) Yet even when these charts on their face show errors, PERA proceeded to use City of Duluth numbers as a basis to reduce his pension.

Doug Michog used his deferred compensation to buy back military credits. The City calculated the cost, and he was very surprised to later receive an overpayment notice from PERA along with a check for \$529.17. The City's calculation was in error and PERA apparently found that mistake. (Michog Affid. Exhibit 115)

After receiving notice in March of 2009 of the amount of reduction in his annuity, Paul Ostman requested a copy of his PERA file. Within days of making the request, Ostman received an unsolicited letter from PERA identifying errors made by PERA in the calculation of his reduced monthly annuity. (Ostman Affid. Exhibit 116) His monthly annuity was increased from the reduced amount by approximately \$30. He was also advised that the lump sum which PERA had advised him he would owe was reduced from \$7,418.69 to \$1,294.80. (Ostman Affid. ¶ 16, Ex. 116)

The ALJ received expert testimony from CPA Larry Kroll related to retiree Art Zylka's paystubs and W-2s.

Based on his analysis, it is Mr. Kroll's opinion that during tax years 2001, 2002, and 2003, the City's contributions to Mr. Zylka's deferred compensation plan were treated by the City's payroll system as current taxable wages for federal and state income tax purposes like

longevity, and were not accounted for as employer contributions to Mr. Zylka's deferred compensation plan. Moreover, there was nothing in the payroll stubs and W-2 statements that Mr. Kroll examined to document that the City ever directed its deferred compensation payments to Mr. Zylka's Section 457 deferred compensation plan. (ALJ Finding 107).

It was Mr. Kroll's opinion that the City's payments to Mr. Zylka for insurance supplement, which were made during the same period, were also treated by the City's payroll system as current taxable wages for federal and state income tax purposes and were not accounted for as pre-tax benefits. (ALJ Finding 108). Based on the City's income tax treatment of these payments, it is Mr. Kroll's opinion that the amounts that the City reported to PERA as current salary during the during tax years 2001, 2002, and 2003 were correct. (ALJ Finding 109).

From Mr. Kroll's examination of some of the other Relators' paystubs it appeared that the City had prepared those paystubs and tax documents in the same way it had prepared Mr. Zylka's paystubs and tax documents. (ALJ Finding 110).

Because of payroll entry errors made in several pay periods from 1995 through December 31, 2004, some or all of the total deferred compensation contributions for some City employees, were taxed as current wages when the contributions were made and those contributions were therefore not tax-deferred. (ALJ Finding 112).

Additionally, because of payroll entry errors made in some pay periods from 1995 through December 31, 2004, some or all of the City's insurance supplement payments to some City employees, were taxed as current wages when the payments were made and those payment were therefore not reported as pre-tax benefits. (ALJ Finding 113).

Wayne Parson testified that between 1995 and December 31, 2004, the persons processing the City's biweekly payroll frequently made errors in preparing the payroll documents for City employees, and that those errors resulted in deferred compensation contributions and insurance supplement payments being taxed as current income in pay periods. Because of apparently random patterns of errors and the absence of detailed pay records for that period, it is not possible for the City to reconstruct how much of those nontaxable benefits were improperly subject to federal and state income taxes. (ALJ Finding 116).

Between 1995 and August 1, 2007, because of the random nature of payroll entry errors, the City's payroll system sometimes included the City's deferred compensation and insurance supplement payments in employees' taxable income at the time the payments were made and at other times excluded them from employees' taxable income. (ALJ Finding 117).

The Office of the Legislative Auditor, Financial Audit Division, released an audit report February 13, 2009, of PERA. The report concluded that, "PERA had some weaknesses in internal control over financial reporting as noted below." The audit included a specific finding that "PERA did not have adequate controls to assure that employers reported and remitted the correct amount of wages and retirement contributions." The audit also found that "PERA did not regularly scrutinize employer contribution amounts to determine reporting accuracy, although it would on occasion follow up on specific questions. PERA did not more closely examine the City of Duluth's contributions after the City contacted PERA in 2007 to ask about what could be included in employee salary amounts." (Storaasli Affid. Exhibit 129) (Emphasis added)

None of PERA's actual newsletters or the Reporting Manuals, when addressing the definition of salary, ever include the words "deferred compensation." Deferred compensation is

not specifically mentioned in the Employer Manual—under the section titled “Salary Not Subject to PERA Withholding. (ALJ Finding 59)

None of the documents published by PERA have specifically identified employer deferred compensation payments as a form of compensation not includable in salary for PERA purposes. PERA has also never issued guidance to its participating employers or members that payments made by a public employer to be directed to employee deferred compensation plans do not constitute salary for purposes of calculating PERA benefits. (ALJ Finding 62)

Unlike the TRA, PERA has never issued written guidance to all of its participating employers explicitly advising them of PERA’s interpretation that Minn. Stat. § 353.01, subd. 10, excludes employer-paid deferred compensation from treatment as PERA salary. (ALJ Finding 63)

PERA has authority to adopt rules containing its interpretations of the provisions of Minn. Stat. § 353.01, subd. 10(b) but has never exercised that authority. (ALJ Finding 64)

The ALJ cited two informal contacts by the City of St. Paul, one in 1992 and one in 2004, relative to deferred compensation. The 1992 informal contact included no documentation. (ALJ Findings 54, 55, 56, 57).

ARGUMENT

I. PERA'S ORDER EXCLUDING AMOUNTS PAID FOR "DEFERRED COMPENSATION" FROM SALARY IS IMPROPER ENFORCEMENT OF AN UNADOPTED INTERPRETIVE RULE.

The ALJ concluded that PERA's interpretation of Minn. Stat. §353.01, subd. 10(b)(2), retroactively excluding from salary thirteen years of employer contributions to deferred compensation, was an improper unadopted interpretive rule,. The ALJ held that PERA must recalculate Relators' benefits to include deferred compensation from 1995 to the present (ALJ Recommendation1). PERA in its Findings and Conclusions rejected the ALJ's Findings, Conclusions, and Recommendation on the issue and affirmed PERA staff's decision to exclude the deferred compensation payments. (PERA Order, p. 7)

A. STANDARD OF REVIEW

The PERA Order rejecting the ALJ's Recommendation relies upon its interpretation of the terms of a statute, Minn. Stat. §353.01. The Court, in a question of law, is not bound by PERA's interpretation.

"When a decision turns on the meaning of words in a statute or regulation, a legal question is presented. Northern Natural Gas Co. v. Omalley, 277 Fed.2d 128, 137 (8th Circuit 1960) (citing Trust of Bingham v. Commissioner, 325 U.S. 365, 371, 65 S.Ct. 1232, 1235, 89 Lawyer's Edition 1670 (1945)). In considering such questions of law, review in courts are not bound by the decision of the agency and need not defer to agency expertise. State by McClure v. Sports & Health Club, 370 N.W.2d 844, 854, N. 17 (Minn. 1985); No Power Line, Inc. v. Minnesota Env'tl. Quality Counsel, 262 N.W.2d 312, 320 (Minn. 1977)." St. Otto's Home v. Minnesota Dept. of Human Services, 437 N.W.2d 35 (Minn. 1989).

Because the decision in the present case depends upon the interpretation of statute, no deference is given to PERA in making this determination.

B. ANALYSIS

PERA claims it is enforcing a longstanding policy to exclude deferred compensation contributions from salary.

The Minnesota Supreme Court has held that “an agency determination that “make[s] specific the law enforced or administered by the agency” is an interpretive rule that is valid only if promulgated in accordance with the Act.” Mapleton Community Home, Inc. v. Minnesota Department of Human Services, 391 N.W.2d 798, 801 (Minn. 1996).

Mapleton held that if the statute is clear, and if the agency interpretation corresponds with the plain meaning of that statute, the agency is not deemed to have promulgated a new rule. Further, if the agency interpretation is a longstanding one, the agency is not deemed to have promulgated a new rule. Mapleton, supra.

The ALJ concluded that Minn. Stat. §353.01, subd. 10(b)(2) was ambiguous as to whether employer contributions to deferred compensation plans are excluded from salary for purposes of PERA. There has not been any version of MS §353.01, subd. 10(b)(2) which contained an explicit exclusion of employer deferred compensation contributions from salary. There is no definition of “fringe benefits” as mentioned in the 1994 amendment to the statute, which would unambiguously include the employer contributions at issue here. The ALJ noted the employer contributions are not “voluntary,” but set in the CBA.

The ALJ determined that PERA’s interpretation of Minn. Stat. §353.01 Subd. 10(b)(2) is not a “longstanding interpretation.” The only evidence of any interpretation is a letter from PERA in response to one email from the City of St. Paul in 2004. The PERA staff member who

received the email was unsure regarding whether employer deferred compensation payments were to be reported as PERA salary, and asked another staff member “You have an opinion?”

There is no evidence that this 2004 communication from PERA to St. Paul was distributed even within PERA staff in written form. PERA did not notify the City of Duluth other employers or participants of any claim that the current PERA interpretation was longstanding. In fact, Jackie Morris, the City’s payroll manager, had consulted with PERA early in 1995 and again in 2007 and both times was advised to include deferred compensation as salary.

The ALJ further found there was no rule- making undertaken at any point to resolve any statutory ambiguity. PERA never issued written guidance to its participating members, as the Teachers Retirement Board did.

The Minnesota Supreme Court held in Cable Communications that an agency interpretation of its governing legislation was not a longstanding interpretation. PERA’s present history of applying its present interpretation only once in an individual letter to one employer in 2004 falls even far short of the insufficient agency actions in Cable Communications. Cable Communications Board v. Nor-West Cable Communications Partnership, 356 N.W.2d 658, 667 (Minn. 1984).

Th ALJ noted that agencies are not permitted to authoritatively determine questions of widespread application through case-by-case adjudication. Dullard v. Minn. Dep’t of Human Servs., 529 N.W.2d 438, 445 (Minn. App. 1995). Before policies are adopted affecting persons, those persons have the right to fair notice of that possible adoption and the right to submit input in the rule making process. In the Matter of Application of Crown CoCo, 458 N.W.2d 132, 138

(Minn. App. 1990); Hibbing Taconite Co., 431 N.W.2d 885 (Minn. App. 1988). The ALJ noted that one letter, email or occasional telephone conversations are not acceptable alternatives to notice and comment rule making, and do not constitute longstanding interpretations that place interested parties on notice of the expected interpretation to be applied by the agency. The ALJ noted:

“The purpose of the Administrative Procedure Act is to ensure that we have a government of law and not of men. Under that act, administrative officials are not permitted to act on mere whim, nor their own impulse, however well intentioned they might be, but must follow due process in their official acts and in the promulgation of rules defining their operations.” Monk & Excelsior, Inc. v. Minn. State Board of Health, 225 N.W.2d 821, 825 (Minn. 1975).

Minn. Stat. §14.381 was enacted in 2001. This statute created a remedy to prevent agency attempts to “enforce a policy, guideline, bulletin, criteria, and manual standard, or similar pronouncement as though it were a duly adopted rule.” The statute provides that the agency cannot enforce the unadopted rule. PERA’s claim that one e-mail in 2004 creates a “rule” falls far short of even a “bulletin,” “manual standard” or “guideline” which was prohibited by this statutory remedy.

In the case of In Re: Rate Appeal of Benedictine Health Center, 728 N.W.2d 497 (Minn. 2007) the Minnesota Supreme Court held that a Department of Human Services rule, even though stated in a printed memorandum in 1992, was an unpromulgated rule which was not properly adopted pursuant to the Administrative Procedure Act and therefore not entitled to deference. Care Providers of Minnesota, Inc. v. Gomez, 545 N.W.2d 45 (Minn. App. 1996) It involved DHS recouping federal overpayments of benefits from providers promptly. The

Minnesota Court of Appeals held that DHS's collection of overpayments was the interpretation of clear federal law and not in an invalid, unpromulgated rule. The Court stated:

“Moreover, the providers have not shown that they have been prejudiced by DHS's failure to promulgate a rule. The providers do not claim that they would have acted differently with notice of pending adoption of a new rule.” 545 N.W.2d at 48. (Emphasis added)

Here, the retirees have shown prejudice since they relied for many years on the established policy and practice of PERA to accept the employer contributions of deferred compensation as salary, and calculating retirement benefits based on those contributions. If PERA had attempted to promulgate a rule changing that interpretation, the parties would have had an opportunity to participate in those rule making procedures. If PERA had actually adopted the rule, the parties then would have had an opportunity to renegotiate their collective bargaining agreements. PERA's unpromulgated interpretation effectively deprives the retirees of over a million dollars over 15 years in contractually negotiated employer contributions. The importance of rule making, rather than arbitrary case-by-case decisions which apply retroactively to 1995, is highlighted by the circumstances of the present case.

As the ALJ concluded, PERA's Order and interpretation of Minn. Stat. §353.01(10) is an improper enforcement of an unadopted interpretive rule. It has not been promulgated in accordance with Minn. Stat. §14.381. PERA's Order retroactively excluding deferred compensation payments from salary of Relators from 1995 to 2008 must be reversed as contrary to law.

II. PERA’S ORDER EXCLUDING AMOUNTS PAID FOR “INSURANCE SUPPLEMENT” FROM SALARY IS IMPROPER ENFORCEMENT OF AN UNADOPTED INTERPRETIVE RULE, FRAUDULENT ARBITRARY, UNREASONABLE AND UNSUPPORTED BY SUBSTANTIAL EVIDENCE

The PERA Order retroactively adjusted retiree benefits to exclude from salary all amounts paid pursuant to the CBA for “insurance supplement” between 1995 and 2008. The ALJ found that the City did not provide an insurance plan, but provided only cash reimbursement of medical expenses. The ALJ found that the insurance supplement payments were included in income, similar to longevity pay and the employees were taxed upon it at time of receipt. The ALJ found that the treatment of insurance supplement payments was inconsistent and variable and the recreated documentation provided by the City of Duluth to PERA for the years 1995 to 2005 was entirely unreliable.

A. STANDARD OF REVIEW

To the extent PERA’s Order excludes amounts paid for “insurance supplement” from salary pursuant to PERA’s practice, the standard of review as set forth in Section IA herein applies. To the extent PERA recalculates retirees’ benefits, excluding insurance supplement payments upon which employees were already taxed as additional salary, and utilizing known incorrect and “recreated” numbers from the City of Duluth, PERA’s actions are fraudulent, arbitrary, unreasonable and unsupported by substantial evidence in violation of Minn. Stat. §14.69. The Court may reverse or modify PERA’s decision if it is “fraudulent, arbitrary, unreasonable, unsupported by substantial evidence, not within its jurisdiction, or based on an error of law.” Axelson v. Mpls Teachers’ Ret. Fund Ass’n, 544 N.W.2d 297, 299 (Minn. 1996)

PERA is seeking to discontinue retirement benefits that have been audited, granted and paid. The burden of proof is on PERA to show that the benefits, which have been paid, should be discontinued. PERA must satisfy its burden of proof by showing by a preponderance of the evidence that the benefits should be discontinued. In The Matter of Fact/Finding Conference Regarding the Application for Continuation of Disability Benefits of Michael Stockstead 17550 Berrington Court, Glen Lake, Minnesota 1998 W.L. 879201, OAH Docket NO. 4-3600-11646-5 (July 1998).

B. ANALYSIS

Beginning in 1995, the CBAs of the City of Duluth allowed the City to pay deferred compensation to PERA. Soon thereafter the CBAs allowed an option for employees who were eligible and participating in family medical to direct some of that additional compensation toward reimbursement of family medical expenses. There was no “insurance” plan, and the City plan was always a “pay-as-you-go” medical reimbursement plan. The ALJ found that the funds paid by the City for medical reimbursement were always included in the salary of employees and denominated “INS SUPP.”

The undisputed testimony of both experts Larry Kroll and Wayne Parson was that the Insurance Supplement was always included in gross income on the income side of the paystub (69, 377). The employee would be entitled to a deduction for the cost of any health premium actually paid. If the Insurance Supplement exceeded the amount of the deduction, which happened in some years, the employee paid tax on it. There were numerous specific examples of payment of tax on the Insurance Supplement specifically including John Keenan. (Exhibits 104, 105). James Charbonneau was taxed on Insurance Supplement which exceeded the cost of the

health plan. (Exhibits 101, 102). Wayne Parson agreed that employees never received both a full deduction for premiums paid and a deduction for the Insurance Supplement. Since they always pay the premium, whether they select the Insurance Supplement or not, essentially they never receive a deduction for the Insurance Supplement and it is always additional income to them (383).

In the years 2004-2006 the Insurance Supplement provided in the Collective Bargaining Agreement exceeded the amount of premium paid for Family Plan 3, and in those circumstances, as well as others, the employees paid tax on the Insurance Supplement as though it were additional income, such as longevity pay. (Exhibit 120)

Jackie Morris believes the City's payroll detail is reliable only from 2005 forward, and the recreated detail from prior to 2005 is unreliable.

When PERA requested payroll records from the City on September 18, 2008 only three years were requested. Even though the City had deleted records prior to 2005 the City created a special software program to attempt to recreate the records that had been deleted. The individual designing the software contacted Jackie Morris numerous times after she was placed on leave for help in order to create the software. Jackie Morris states that even after the software was created, it required interpretation in working with the old software programs. No one then working at the City had experience with any of the older software programs. Jackie Morris does not believe that any of the recreated numbers prior to the year 2005 are trustworthy or reliable.

Jim Charbonneau had all his old paystubs and made a spreadsheet. He notes numerous errors and mistakes in the PERA's numbers compared to his own. (Charbonneau Affid. Exhibit

101, 102) Doug Michog also determined the City's calculations for his military buy-back were wrong. (Michog Affid. Exhibit 115)

Another example of the unreliability of the City's numbers is the comparison of the charts produced for each retiree. Paul Ostman's chart is attached as Exhibit 14 to his Affidavit. (Exhibit 114) Other retirees also attached these charts to their Affidavits. The chart purports to be the total of deferred compensation, payment towards family medical, etc., available for each year from 1997 through 2007. Since all the firefighters were under the same CBA, the numbers listed in their charts should be identical. The numbers are not identical between the retirees, and the numbers listed do not even match the total of the benefits that were written in the contract. These charts are proof that the City's recreated numbers are incorrect and unreliable. PERA's reliance on these numbers, knowing them to be incorrect, is arbitrary and capricious. As a fiduciary, PERA has an obligation to the employees and retirees to conduct its activities in accordance with the law and plan documents. Minn. Stat. §356A.05. PERA has a duty to diligently police salaries reported by governmental subdivisions in order to determine that the amounts reported are consistent with the PERA plan documents. See Application of Allers, 533 N.W.2d 646 (Minn.Ct.App. 1995), rev. den. August 30, 1995. See also Legislative Audit Report. (Storaasli Affid. Exhibit 129)

Minn. Stat. 356A.02 addresses "Fiduciary Status and Activities." Under Subd. 1, fiduciaries include any member of a governing board of a covered pension plan, chief administrative officer of a pension plan and other persons. Subd. 2 defines fiduciary activity as including, but not limited to, (Subd. 2) the determination of benefits, (Subd. 3) the determination of eligibility for membership or benefits, (Subd. 4) the determination of the amount or duration

of benefits and (Subd. 5) the determination of funding requirements. Minn. Stat. 356A.04 details the general standard of fiduciary conduct. Subd. 1 states that the fiduciary duty is owed to active, deferred and retired members of the plan, who are its beneficiaries. Minn. Stat. §356A.04 Subd. 1 (Emphasis added)

PERA's fiduciary duty includes the duty to "police" salary contributions made to the plan. Application of Allers, 533 N.W.2d 646 (Minn. App. 1995) PERA concedes it has not done so, and that the Legislative Auditor found that PERA did not "regularly scrutinize employer contribution amounts to determine reporting accuracy." Mary Most Vanek responded that "we do not have an effective way to ensure that employers interpret State statute correctly in regards to what should or should not be included in eligible salary." She conceded "Due to limited resources we have not conducted field audits . . ." (Storaasli Affid. Exhibit 129)

PERA notified each retiree at time of retirement that his or her account would be "audited" and that "is the actual monthly amount that will be paid for duration of your retirement." (See Ostman Affid. Exhibit 114) PERA admits that audit did not include a determination of whether the pension was based on eligible salary. PERA holds retirees to their irrevocable decision to draw the PERA retirement, but its duty to continue to pay the audited amount after 13 years is not equally irrevocable.

Any mistakes made in the present case were made by PERA and not by the 485 retirees, who had no knowledge or control and were entirely blameless.

Fiduciary duty is the highest standard of duty implied by law. Henry Campbell Black, et al, Black's Law Dictionary, 626 (6 Ed. 1990). Minn. Stat. 356A.04 Subd. 2 provides that PERA, as a fiduciary, shall exercise the same care that they should exercise in the management of their

own affairs. PERA knowingly accepted the employee and employer contributions from about 1200 employees for a period of 13 years and twice advised the City to include them in salary. PERA sent summaries of the contributions and the retirement benefits expected over the same years. PERA provided retirement benefit estimates, processed retirement applications, and provided “audited” retirement annuities to 485 retirees. For PERA to claim now that it did not have a duty to determine whether the contributions were proper, and that it could retroactively rescind those contributions after 13 years, is a violation of its fiduciary duty, and arbitrary and capricious.

In conclusion, PERA’s retroactive adjustment of retiree benefits to exclude “insurance supplement amounts” from salary is fraudulent, arbitrary, unreasonable and unsupported by substantial evidence since it is based on admittedly incorrect and unreliable numbers, the amounts were appropriately included in salary and the Relators were taxed on them, and PERA admits it never audited the employers’ contributions, in violation of its statutory and fiduciary duties.

III. PERA IS ESTOPPED FROM REDUCING BENEFITS TO RETIREES BY PROMISSORY AND EQUITABLE ESTOPPEL AND RELIANCE.

PERA reduced the benefits of 485 retirees including Relators claiming employer-paid deferred compensation and insurance supplements should not be included in salary, though those amounts had been accepted by PERA and included in PERA salary and benefit calculations and pensions since 1995, pursuant to the specific instruction of PERA in 1995 and 2007. As of July 31, 2007, PERA received notice that the City had included those amounts in salary, yet took no

steps to notify employees, retirees or potential retirees of the dramatic reduction to their benefits until March 2009.

Retirees typically received numerous estimates from PERA as part of their retirement planning, and made life decisions based upon those PERA estimates. Immediately following notice of retirement, PERA “audited” retiree accounts and paid those monthly benefits until notices were sent in March 2009.

Some retirees took early retirement at a reduced benefit based upon the PERA estimate, then learned their benefit was further reduced. Some have returned to work and spouses have been unable to retire as planned. Pam Wutz retired July 31, 2007 when PERA had received actual notice from the City of Duluth, but she was never advised her pension would be reduced by \$158 per month. She was denied re-employment. Doug Michog relied on PERA estimates prior to his retirement in December 2007. He has had to obtain other employment due to the \$220 reduction in his pension.

A. STANDARD OF REVIEW.

PERA’s Order should be set aside if it is an abuse of discretion. City of North Oaks v. Sarpal, 797 N.W.2d 18 (Minn. 2011).

B. ANALYSIS

The elements of a promissory estoppel claim against a governmental unit are well established. Christensen v. Minneapolis Mun. Employees Retirement Bd., 331 N.W.2d 740 (Minn. 1983). Christensen specifically held that promissory estoppel was sufficient to establish a protectable right of a public employee to an offered pension. The Court noted, that “the state reasonably expects its promise of a retirement program to induce persons to accept and remain in

public employment, and the persons are so induced, and injustice can be avoided only by enforcement of that promise. Promissory estoppel, like equitable estoppel, may be applied against the State to the extent that justice requires.” Christensen at 749.

A claim for promissory estoppel against a governmental unit has three elements “(1) Was there a clear and definite promise? (2) Did the promisor intend to reduce reliance and did such reliance occur? (3) Must the promise be enforced to prevent injustice?” It also is the case that the promise may be one which might reasonably induce the promisee’s action or inaction. Faimon v. Winona State Univ., 540 N.W.2d 879, 882 (Minn. App. 1995), rev. denied, (Minn. Feb. 9, 1996). Further, “[p]romissory estoppel unlike equitable estoppel may be applied against the state to the extent that justice requires.” Christensen v. Minneapolis Mun. Employees Retirement Board, 331 N.W.2d 740, 749, (Minn. 1983).

Estoppel against a governmental unit was also discussed in AAA Striping Services Co., v. Minnesota Dept. of Transp., 681 N.W.2d 706 (Minn. App. 2004). That case held that a letter from the Minnesota Department of Transportation was the basis for promissory estoppel if “it was materially false, if the State knew or should have known it was false, if the State intended that AAA relied on the representation, and if knowing the error in representation or in not knowing the error in representation, AAA justifiably relied on that representation to its detriment.” 681 N.W.2d 721. The Court held that there was a material fact issue as to whether the representation was false and whether AAA justifiably relied upon the letter, but held the letter was affirmative misconduct. It did not require the claimant to show that the State was acting with malice.

In the present case, PERA's conduct of creating audited benefit estimates and statements over 13 years, requiring retirees to make irrevocable decisions based upon them, and PERA's knowledge of the issue on July 31, 2007, yet continued processing of retirements with no notice to retirees, is far stronger "affirmative misconduct" than the letter in the AAA Striping Services case.

In Housing and Redevelopment Authority of Chisholm v. Norman, 696 N.W.2d 329 (Minn. 2005), the Court noted that "Promissory Estoppel may remain proper for analyzing non-contractual promises or retirement benefits of public employees . . ." 696 N.W.2d at 337.

As to the elements of promissory estoppel in this matter:

1. There was a clear and definite promise. PERA represented to Relators orally and in writing, multiple times, that these mandatory contributions were included in the calculation of their benefits, and they were promised in writing in the benefit estimates and audited statements what their annuities would be based upon those contributions; PERA advised the City in 1995 and again in 2007 to include these items in salary.

2. PERA intended and induced reliance. PERA certainly intended to induce reliance by sending out frequent statements and by failing to notify employers or take any due diligence to monitor employer contributions, even after notice in 2007. This action and failure to act goes far beyond a simple mistake or clerical error in one individual account.

3. The promise must be enforced to prevent injustice. The injustice lies not only in reducing the Relators' monthly benefits, but also by disgorging and sending back to the City of Duluth the mandated employer contributions which PERA held as fiduciary for the retirees alone pursuant to the CBA.

See also, Law Enforcement Labor Svcs., Inc. v. County of Mower, 483 N.W.2d 696 (Minn. 1992). In that case a county, which had advised retirees in writing that it would pay their health insurance premiums, was estopped from depriving retirees of those promised benefits.

There is a relevant decision from the Office of Administrative Hearings by Judge George Beck in In the Matter of the Retirement Benefits of William G. Allegrizza, Sr., 1995 WL 937283, Case 1-3600-9270-5 (March 1, 1995). It held that PERA was estopped from reducing the benefit amount it was presently paying to the retiree.

In that case the employee retired and began receiving his retirement annuity. PERA later stated to him in a letter that they had made an error and that they were incorrectly overpaying him. The employee testified that, if he had been advised about the correct retirement amount prior to retiring, he would have waited two or three years to retire. The decision cited the Christenson case, and the restatement of Contracts, stating: "A promise which the promissor should reasonably expect to induce action or forbearance on the part of the promisee . . . and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." This is also noted in Christensen v. Minneapolis Municipal Retirees Retirement Board, 331 N.W.2d 740, 749 (Minn. 1983).

Allegrizza relied upon PERA's estimates and sustained a reduced benefit of about \$3,200 per year. The judge noted the prejudice sustained by the retiree, who cannot regain the employment that he gave up, based upon the estimates from PERA.

As in Allegrizza, the retirees in the present case relied upon statements from PERA regarding their retirement benefits. They relied upon those estimates in deciding when to retire. The affidavits of the retirees demonstrated that they would have continued to work if they had

known that their benefits would have been reduced so substantially. They also would have negotiated to receive other compensation from the City if they were not entitled to use the City's contributions towards their benefits. The retirees are entirely blameless and the PERA's promises must be enforced to prevent injustice. Moreover, the promised benefits are fully funded by the past contributions and there is no harm to PERA or the Plan by reversing the PERA decision.

Equitable estoppel also applies in the present case, to prevent PERA from reducing benefits and recovering past benefits paid. "Equitable estoppel prevents the assertion of otherwise valid rights where one has acted in such a way as to induce another party to detrimentally rely on those actions." Pollard v. Southdale Gardens of Edina Condo. Ass'n, 698 N.W.2d 449, 454 (Minn. App. 2005) The doctrine "is based on the principle that wherever one of two innocent persons must suffer by the acts of a third, he who by his conduct, act, or omission has enabled such third person to occasion the loss must sustain it." Pesina v. Juarez, 288 Minn. 379, 385, 181 N.W.2d 109, 113 (1970).

PERA by its failure to audit and by its direction in 1995 and 2007 enabled the City of Duluth to report and pay to PERA salary and benefits and contributions of the Relators which PERA now claims were incorrect. PERA continued to process retirements even after it had notice of the issue in July 2007. PERA continued to give statements to the Relators over many years regarding their contributions and projected benefits. If PERA should claim that it was really the City of Duluth that was at fault, then PERA is the one who enabled the City of Duluth. PERA's actions go far beyond individual clerical errors or simple mistakes. City of North Oaks v. Sarpal, 797 N.W. 2nd 18 (Minn. 2011) It is the innocent Relators who sustain the loss. Under

the rule of equitable estoppel, PERA is estopped from making these changes to the Relators' benefits.

Pollard v. Southdale Gardens of Edina Condo. Ass'n, 698 N.W.2d 449, 454 (Minn. App. 2005) holds that estoppel can consist of a negative omission to act and can consist of silence, rather than affirmative acts or words. It is not necessary that the facts be actually known to the party estopped, or that the conduct be done with any fraudulent intention. It is enough that the conduct was done such that it would be expected that the other party would act upon that information.

The Court stated in Pollard:

“The authorities are ... substantially all agreed upon the following general propositions. First. *To create an estoppel, the conduct of the party need not consist of affirmative acts or words. It may consist of silence or a negative omission to act when it was his duty to speak or act.* Second. It is not necessary that the facts must be actually known to a party estopped. It is enough if the circumstances are such that a knowledge of the truth is necessarily imputed to him. Third. It is not necessary that the conduct be done with a fraudulent intention to deceive, or with an actual intention that such conduct will be acted upon by the other party. It is enough that the conduct was done under such circumstances that he should have known that it was both natural and probable that it would be so acted upon. Dimond v. Manheim, 61 Minn. 178, 182, 63 N.W. 495, 497 (1895) (emphasis added).” Pollard at 698 N.W.2d 454

There are no relevant factual disputes regarding PERA's acts. PERA notified the City in 1995 and 2007 to include the salary amounts, and admits that its benefit estimates and audited statements to the Relators included salary amounts it now claims were not allowed. Repeated oral and written representations were made by PERA as a fiduciary with the intent that the Relators would rely on them. Relators did rely on them and made irrevocable decisions to their serious detriment. PERA's actions in keeping secret the alleged errors between July 2007 and

March 2009 go far beyond a simple clerical error. The Relators did not know that PERA's statements and audits were "wrong." The Relators changed their position for the worse by not having the opportunity to negotiate for other benefits in their CBAs and by basing retirement decisions on PERA's statements. The undisputed evidence establishes that PERA is equitably estopped from reducing retirement benefits.

In conclusion, PERA should be estopped by both promissory and equitable estoppel from reducing the benefits of retirees who reasonably relied on PERA as fiduciary.

IV. PERA'S ORDER REDUCING BENEFITS TO RETIREES IS BARRED BY THE STATUTE OF LIMITATIONS.

The contributions at issue were first made to PERA by the City of Duluth in 1995 and continued through July 2007. PERA's Order results in adjustment of salary and benefits for Relators retroactive from 2007 to 1995, or 12 years. PERA claims there is no statute of limitations limiting retroactive adjustments.

A. STANDARD OF REVIEW.

See IA relating to questions of law.

B. ANALYSIS

Although PERA originally requested only three years of records from the City, the City recreated its destroyed records back to 1995 and recalculated all benefits for the entire period.

Prior to 1990, Minn. Stat. §353.27 contained a three year statute of limitations. PERA argues that the statute was amended in 1990 to allow erroneously taken deductions to be refunded "at any time." Minn. Laws 1990, Ch. 570, Art. 11, Sec. 5.

The language “at any time” was deleted in 2006. After the 2006 amendment, §353.27, Subd. 7(c) read, “Employer contributions and retiree deductions taken in error from amounts which are not salary under section 353.01, subdivision 10, are invalid upon discovery by the association and must be refunded as specified in paragraph (d).” Paragraph (d) speaks of discovery of the receipt of erroneous deductions and contributions under paragraph (a), clause (2). However, that paragraph specifically addresses a contribution made for a person “who otherwise does not qualify for membership under this chapter” See Minn. Laws 2006, Ch. 271, Sec. 16. Clearly the present retirees did qualify for membership and therefore are not covered by paragraph (d). The retirees submit the contributions were not erroneous since Minn. Stat. §353.01, Subdivision 10, permits the payment of the contributions. The statute does not mandate refunds under these circumstances.

The law was amended again in 2009 to provide a three year limitation on the correction of erroneous contributions and deductions. There was an additional statute allowing the City of Duluth to elect a three year statute of limitations. See Minn. Laws 2009, Ch. 169, Sec. 50 and Sec. 49. PERA concludes the City effectively did not accept the 2009 three year statute of limitations. If so, the statute of limitations defaults to the prior 2006 version of the statute where the language “at any time” was removed. If PERA is correct that the language “at any time” was intended to abolish any statute of limitations, then the removal of that language obviously would restore the applicable statute of limitations. The statute of limitations before the language inserting “at any time” was three years. The previous three year statute should apply.

Moreover, there are numerous other statutes of limitation which may apply. Minn. Stat. §547.07(2) provides a two year statute of limitations under a statute for a penalty or forfeiture.

Minn. Stat. §541.07 also provides for a two year statute of limitations for recovery of wages or damages or fees or payroll errors or penalties in Minn. Stat. §541.07(5). That statute provides for a three year statute if the violation is willful. Minn. Stat. §541.07(5) defines wages as all remuneration for services or employment.

Minn. Stat. §541.05(2) provides for a six year statute of limitations for liabilities under statute. M.S. 541.05(1) provides for a six year statute of limitations for contract claims. Minn. Stat. §541.05(4) provides for a six year statute of limitations for recovery of personal property or damages to personal property.

The retirees claim that the two year statute of limitations applies. PERA is not entitled recalculate Relators' benefits back to 1995.

V. PERA'S ORDER REDUCING BENEFITS TO RETIREES IS UNCONSTITUTIONAL AS IMPAIRMENT OF CONTRACT AND TAKING OF PRIVATE PROPERTY.

PERA's Order includes return to the City of Duluth of a portion of the City's payment towards the retirees' retirement benefits. Those contributions by the City were made to PERA pursuant to CBAs as fiduciary for the private benefit of the retirees. Those payments for the benefit of the retirees should not be returned by PERA to the City of Duluth.

The constitutionality of an amending statute, impairing the rights of a retiree, was considered in Christensen v. Minneapolis Municipal Retirees Retirement Board, 331 N.W.2d 740 (Minn. 1983). The Court held that a statute seeking to change the benefits to be received by a retired officer would be an unconstitutional impairment of contractual obligations.

In Christensen the Supreme Court directly considered the issues of promissory estoppel and unconstitutional impairment of contractual obligations. The Court specifically held that promissory estoppel did apply to the State, prohibiting the reduction of a pension owed to a public retiree who was already retired and receiving his pension. The Court specifically held that the amending statute which changed the eligibility requirements for a public pension was invalid as it was an unconstitutional impairment of contractual obligations.

The Plaintiff had worked for the City of Minneapolis for at least ten years before he retired in 1974. He was a contributing member of the Minneapolis municipal retirees' retirement fund. He became entitled to the pension benefits upon his retirement in 1974, having served the requisite ten years.

In 1980, the Minnesota legislature imposed a new minimum age requirement for entitlement to benefits. Under the new law, Christensen was not eligible to receive pension benefits. His pension benefits were discontinued. The Plaintiff apparently had considered the fact that he could get a pension after working for ten years, as both an inducement to work, and when to retire.

The Supreme Court in Christensen rejected the validity of any statement in PERA statutes, or other terms, which purport to limit a contractual right. Christensen held that public retirees have a right to the offered pension, that this right is protectable, and that this right cannot be abrogated by statements that there is no contract right.

The Court rejected its prior "gratuity" analysis and stated quite specifically that promissory estoppel does apply, even if there were no contract rights. It held that promissory

estoppel applies where a promise is illusory, and the retiree had a right to the benefits, where he began employment and then later retired in reliance on the promise of the pension.

The Christensen case also held that the deprivation of the retirees' pension rights was an unconstitutional impairment of contract. See U.S. Constitution, Article I, Section 10, Clause 1. See also Minnesota Constitution, Article I, Section 11. The Court specifically held that the prohibition in the Minnesota Constitution against the impairment of contract applied to implied-in-law obligations created by promissory estoppel. 331 N.W.2d 750.

The Christensen Court applied the three part test of Energy Reserves Group v. Kansas Power & Light, 459 U.S. 400, 103 S.Ct. 697, 74 L.Ed. 2d 569 (1983). The Court held that the three part test was applied with more scrutiny where the State seeks to impair a public contract, than it is with private contracts.

The Christensen Court held that the retirees' need to be secure in their retirement benefits overrode the State's concern in correcting any inequities in the pension plan. The Court held that the need for a minimum age requirement was not so compelling, or such a reasonable condition to the public purpose, as to justify impairment of the State's obligation. There was no claim that the pension fund was in jeopardy. The interests of the State in correcting previous errors could be served by less drastic alternatives. The Court held that the statute failed on the third prong of the three part test.

As applied to the present case, the same results should be reached. This certainly is a severe impairment of the contractual obligation. The public retirees' pension rights are being very substantially reduced. It should be noted that in Christensen, the retiree had only paid \$7,051.51 in to the retirement fund, but had received benefits of \$27,380.86. The actual value of

the retirement allowance as of the date that the payments were terminated was \$73,872.61. Therefore, the Court explicitly rejected the claim that the retiree was receiving too much of a bargain, given the value of his contributions. In the present case, the retirees are receiving substantial reductions in their present and future retirement benefits. Some monthly payments are reduced by \$250 and retirees will be required to pay back \$15,000. For the 485 employees the total involved in the present case exceeds \$1,000,000. Some retirees have had to continue second jobs and spouses have been unable to retire. One tried to return to work numerous times and was refused.

With the second test, the State must demonstrate a significant and legitimate public purpose. There is little public purpose in not allowing the retirees to receive their pensions. Those pensions were already fully funded by the retiree and City contributions. Whether or not those contributions are allowed is a matter of bookkeeping. The retirees' pensions are fully funded by the past employee and employer contributions. Allowing them as salary does not impair the PERA system. The IRS has no objection to the retirees receiving their full pension benefits since the definition of salary is purely an issue of state law, and the plan may be amended retroactively. The retirees submit that the public purpose in not allowing the employer contributions and the pension benefits is quite modest.

The third test is "whether the adjustment of the rights and responsibilities of the contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption." 103 S. Ct. At 705-06 (brackets in original). Christensen, supra, at 331 N.W.2d 751. PERA's Order fails the third test. Especially objectionable is the return of the employer's contributions credit to the City. If there were a

proper significant purpose in requiring a refund of the retiree and employer's contributions, the employer's contributions should not be refunded to the City. The employer's contributions towards the retiree's pension value were part of the total compensation package for the retirees in the CBA. The City has already paid those sums. The retirees were to receive pension benefits based upon those sums. Sending those sums, together with interest, back to the City is not a reasonable condition appropriate to the public purpose. As with Christensen, if errors were made, and if action were required properly to correct errors, correcting those errors could be served sufficiently by less drastic alternatives, as required by Christensen, supra. As stated in Christensen, "The State's concern in correcting inequities in the City's pension plan must yield to the retiree's need to be secure in his expected retirement benefits." Christensen, supra at 331 N.W.2d 751. The retirees should be entitled to keep the retirement fund value of both the employee and employer contributions. Anything less is an unconstitutional impairment of contract.

In addition to violation of the constitutional guarantees preventing impairment of contract, PERA's Order also violates the constitutional prohibitions against the taking of private property for public purposes without just compensation. Guaranteed by Article 1, Section 13 of the Minnesota Constitution and by the Fifth Amendment of the United States Constitution. In the present case, PERA proposes that the employer contributions for the benefit of the retirees are to be returned to the City, not to the retirees. The action proposed by PERA under the statutes is a violation of these constitutional rights. The retirees are entitled to the contractual promises set forth in the CBA for their benefit. Taking those sums out of the pensions, and reducing the pension benefits is also a violation of those rights.

“Just compensation” means cash fair market value of the property taken. Almota Farmers Elevator & Warehouse Co. v. United States, 409 U.S. 470, 472, 93 S.Ct. 791, 792, 35 L.Ed.2d 1 (1973). These principles were affirmed in City of Rochester v. Northwestern Bell Telephone Co., 431 N.W.2d 874. Here, the City’s payments were made to PERA as fiduciary pursuant to the CBA for the sole benefit of the retirees. The retirees had an absolute right to those benefits pursuant to the CBA. Paying any portion of those dedicated funds back to the City constitutes an unconstitutional taking for public use without just compensation to the retirees.

VI. PERA’S FAILURE TO AWARD ATTORNEYS’ FEES IS IN VIOLATION OF LAW

Neither the ALJ nor the PERA Order addressed the issue of attorneys’ fees, though Relators made specific written request.

Relators have incurred significant expense to provide legal representation on behalf of all similarly situated retirees. PERA has made clear that whatever decision is made will apply across the class of all 485 City of Duluth retirees. Accordingly, the entire class is benefitting from the significant time and expense incurred by the Relators in providing legal representation. Both the ALJ and PERA were in a unique position to evaluate the quality and thorough nature of the legal representation, which will benefit all similarly situated retirees. There are several legal bases for such a recommendation.

A. Minn. Stat. §15.472

Neither the PERA Order nor the ALJ addressed the claim for attorneys fees. Under Minn. Stat. §15.472 a prevailing party shall be awarded fees and expenses by the ALJ if they show that the position of the state was not substantially justified. The ALJ recommended PERA's action to be rescinded and Relators' benefits reinstated.

Where the Department of Transportation unilaterally promulgated an addendum purporting to interpret the prevailing wage statute without engaging in formal rule making, the position of the state was not "substantially justified" and the party was entitled to an award of attorneys' fees and expenses. Donovan Contracting of St. Cloud, Inc. v. Minnesota Dept. Of Transp., 469 N.W.2d 718 (Minn. App. 1991) rev. den.

Here the ALJ found that PERA's action of enforcing its interpretation without rule making was unauthorized. Under Donovan, Relators are entitled to attorneys' fees as PERA's position is not substantially justified.

B. Minnesota Private Attorney General Statute.

Minnesota Statute §8.31(3a) provides that a person injured by violation of certain laws may bring a civil action and recover damages together with costs and disbursements, including costs of investigation and reasonable attorneys fees. The Private Attorney General Statute reads as follows:

Subd. 3A Private Remedies. In addition to the remedies otherwise provided by law, any person injured by a violation of any of the laws referred to in subd. 1 may bring a civil action and recover damages, together with costs and disbursements, including costs of investigation and reasonable attorney's fees, and receive other equitable relief as determined by the court. The court may, as appropriate, enter a consent judgment or decree without the finding

of illegality. In any action brought by the Attorney General pursuant to this section, the court may award any of the remedies allowable under this subdivision. Minn. Stat. 8.31(3a). (Emphasis added)

Subd. 1 of Minn. Stat. 8.31 provides as follows:

“Subdivision 1. Investigate offenses against provisions of certain designated section; assist in enforcement. The attorney general shall investigate violations of the law of this state respecting unfair, discriminatory, and other unlawful practices in business, commerce, or trade, and specifically, but not exclusively, the Nonprofit Corporation Act (sections 317A.001 to 317A.909), the Act Against Unfair Discrimination and Competition (sections 325D.01 to 325D.07), the Unlawful Trade Practices Act (sections 325D.09 to 325D.16), the Antitrust Act (sections 325D.49 to 325D.66), section 325F.67 and other laws against false or fraudulent advertising, the antidiscrimination acts contained in section 325D.67, the act against monopolization of food products (section 325D.68), the act regulating telephone advertising services (section 325E.39), the Prevention of Consumer Fraud Act (sections 325F.68 to 325F.70), and chapter 53A regulating currency exchanges and assist in the enforcement of those laws as in this section provided.” Minn. Stat. 8.31 Subdivision 1. (Emphasis added)

Subdivision 1 is broad and general, including acts that are unfair, discriminatory or unlawful practices in business, commerce, or trade. Compensation in the nature of a promise between employer and employee to provide retirement income and benefits falls within the category of unfair or discriminatory practices in commerce or trade. Accordingly, the Relators, since they have stepped forward and provided significant resources and assistance to all similarly situated retirees of the City of Duluth, are within the definition of the Private Attorney General statute allowing recovery of attorney’s fees were this matter in District Court. The Court should provide for recovery of attorney’s fees under the Minnesota Private Attorney General statute.

C. PERA Board Administrative Expense.

Minn. Stat. §353.03 Subdivision 3 grants to the PERA Board of Trustees certain powers. Included in those powers is the authority to pay necessary expenses for the administration of the fund and all claims. PERA has represented to the ALJ that whatever decision is reached will be applied to the entire class of retirees. Attorneys' fees which apply to the entire class of 485 retirees of the City of Duluth may be paid as an expense of administration. The statute provides:

“Subd. 3. Duties and powers. (a) The board shall: . . .

(7) provide for the payment out of the fund of the cost of administering this chapter, of all necessary expenses for the administration of the fund and of all claims for withdrawals, pensions, or benefits allowed” Minn. Stat. 353.03 Subdivision 3(a)(7)

The statute allows for necessary expenses for the administration of “all claims for withdrawals, pensions or benefits allowed.” Clearly, this claim is within the administration of the fund relating to PERA’s attempted reduction of pensions or benefits allowed. The PERA Board has authority to pay reasonable attorneys’ fees, and the Court should direct the PERA Board to pay Relators’ fees as an administrative expense.

D. The PERA Board may award attorney’s fees by analogy to ERISA (Employee Retirement Income Security Act) (29 U.S.C. § 1132(g)(1)).

The federal statute governing qualified retirement plans in the private sector specifically allows for recovery of attorneys’ fees in ERISA cases. Section 502(g)(1) of ERISA provides that in suits by participants or fiduciaries brought to enforce ERISA, the Court can award attorney’s fees to either party. In May 2010, in Hardt v. Reliance Standard Insurance Company, ___ US ___, 130 S. Ct. 2149, 176 L.Ed. 2d 998 (2010), the United States Supreme Court held that a

person does not have to be a “prevailing party” in order for attorney’s fees to be awarded under 29 U.S.C. Section 1132(g)(1) of ERISA. Attorney’s fees may be awarded to either party if the fee claimant shows that he or she has achieved “some degree of success on the merits.” The Court held that the person need not meet the higher standard of being a “prevailing party” to be eligible for the attorney’s fees award at the Court’s discretion. In the Hardt case, the apparent success was an award remanding the claim to the Plan for a second review. It was not a determination that benefits were improperly denied. Apparently, that was “some success” sufficient to support an award of attorney’s fees. Prior to the Hardt decision, numerous circuit courts of appeal had adopted a 5-factor test for an award of attorney’s fees, which the Court completely rejected, finding it had no relation to ERISA laws as written. Accordingly, by analogy to ERISA, the Relators in the above-matter achieved “some success” in the decision of the ALJ which success benefits the class of all 485 retirees of the City of Duluth.

CONCLUSION

Relators respectfully request the Court to reverse PERA's Order, and order PERA to revise its recalculations of Relators' retirement benefits to include as PERA salary all deferred compensation and insurance supplement payments. Relators further request the Court to order PERA to reinstate PERA's prior calculations, and to pay to Relators any amounts wrongfully retained by PERA during this proceeding. Relators further request the court to order PERA to award attorney's fees and expenses to Relators.

Respectfully submitted



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IN COURT OF APPEALS

In the Matter of the PERA Salary
Determinations Affecting Retired and
Active Employees of the City of Duluth,

OAH DOCKET NO. 4-3600-2089-2

CERTIFICATION OF BRIEF LENGTH

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subds. 1 and 3, for a brief produced with a proportional font. The length of this brief is 13834 words and 1200 lines. This brief was prepared using Corel WordPerfect X4 software.

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